

BANK LEUMI LE-ISRAEL B.M. AND CONSOLIDATED COMPANIES

**Condensed
Financial Statements
as at 30 June 2006**
(unaudited)

Bank Leumi le-Israel B.M.

Head Office: Leumi House, 34 Yehuda Halevi Street, Tel Aviv 65546, Israel

Tel: (972) 3-5148111, Fax: (972) 3-5149732

This is a translation from the Hebrew and has been prepared for convenience only. In the case of any discrepancy, the Hebrew will prevail.

30 August 2006

Bank Leumi le-Israel B.M. and its Consolidated Companies
Condensed Financial Statements as at 30 June 2006 (unaudited)

Index

	Page
1. Directors' Report	
A. General Developments in the Business of the Group	
Description of the Leumi Group's Business Activities and their General Development	2
Control of the Bank	3
Capital Resources and Transactions in the Shares of the Bank	4
Distribution of Dividends	7
Principal Data of the Leumi Group	9
B. Other Information	
Principal Developments in the Economy	10
General Environment and Effect of External Factors on Activities	16
Accounting Policy on Critical Subjects	18
Employees' Rights	18
C. Description of the Group's Business according to Segments and Spheres of Activity	
Development of Income, Expenses and Tax Provision	19
Structure and Development of Assets and Liabilities	26
Operational Segments in the Group	30
Activities of Major Subsidiaries and Affiliates	61
Capital Market and Financial Services Activities of the Bank and the Group	64
Non-Banking Activities of Companies included on the Equity Basis	67
Exposure to Risk and Methods of Risk Management	68
Linkage Status and Liquidity Status	71
Legal Proceedings	74
Description of the Taxation Position	75
D. Additional Matters	
Organizational Structure	75
Leumi for the Community	80
Internal Auditor	82
Evaluation of Disclosure Controls and Procedures	82
Changes to the Composition of the Board of Directors	83
2. Management Review	
Rates of Income and Expenses	84
3. Certification of the President and Chief Executive Officer	93
Certification of the Head of the Finance and Economics Division	94
4. Condensed Financial Statements	
Joint Auditors' Review	95
Condensed Balance Sheet – Consolidated	96
Condensed Statements of Profit and Loss – Consolidated	97
Condensed Statement of Changes in Shareholders' Equity - Consolidated	98
Notes to the Condensed Financial Statements – Consolidated	99

A. General Developments in the Business of the Group

The Directors' Report has been prepared in accordance with the directives on reporting to the public of the Supervisor of Banks. The principles used in preparing the interim reports are consistent with the principles used in preparing the Annual Report to 31 December 2005, other than as detailed in Note 2 to the Financial Statements. The interim report should be read in conjunction with the Annual Report for 2005.

Description of the Leumi Group's Business Activities and their General Development

Total assets under the management of the Group (balance sheet items, customers' securities portfolios, and provident and supplementary training funds) amounted to some NIS 579 billion at the end of June 2006, some US\$ 130 billion, as compared with NIS 568 billion at the end of 2005, an increase of some 1.9%.

Net profit of the Group in the first half of the year totaled NIS 1,490 million, as compared with NIS 1,106 million in the corresponding period of 2005, an increase of 34.7%. On eliminating special salary expenses, as detailed later, the increase was 66.2%. The increase in net profit derived mainly from the sale of non-banking holdings in consequence of the legal restrictions that apply to the Bank. For further details see pages 55 and 56 below. Net profit in the second quarter of the year totaled NIS 378 million, as compared with NIS 578 million in the corresponding period of 2005, a decline of 34.6%. On eliminating special salary expenses, there was an increase of 4.7%.

Net operating profit in the first half of the year totaled NIS 767 million, as compared with NIS 1,072 million in the corresponding period of 2005 a decrease of 28.5% and in the second quarter of the year the net operating profit totaled NIS 367 million, as compared with NIS 541 million in the corresponding period of 2005, a decrease of 32.2%. On eliminating special salary expenses, net operating profit grew by 5.2% and 9.8% respectively.

The decline in the net operating profit is explained primarily by the increase in special salary expenses in the amount of NIS 380 million, as detailed below, by the decline in the contribution of the companies included on the equity basis, a decrease in the profit of overseas subsidiaries, primarily as the result of negative exchange differentials in respect of the investments in those companies, as well as from a decrease in the profits of a number of subsidiaries in Israel.

Net profit per share in the first half of 2006 was NIS 1.053, compared with NIS 0.782 in the corresponding period in 2005.

Based on data of the banking system as at 31 March 2005, as published by the Bank of Israel, the Leumi Group's share of the overall banking system was as follows:

	31.3.2006	31.12.2005	31.12.2004	31.12.2003
	in %			
Total assets	29.8	30.3	30.1	29.8
Credit to the public	30.3	30.3	29.9	30.0
Deposits of the public	29.9	30.5	30.3	30.2
Operating profit before tax	29.2	30.3	34.7	32.0
Operating profit after tax	28.5	30.6	33.9	31.7

Control of the Bank

On 30 June 2006 the State of Israel held 11.94% of the issued share capital of the Bank (fully diluted – 11.26%) and 19.78% of the voting rights in the Bank (fully diluted – 18.66%)

Sale of Shares in the Bank by the State

On 15 November 2005, the Bank was informed by M.I. Holdings Ltd. ("MIH") that further to the procedure for the sale of up to 20% of the shares of the State in the Bank which was published by the Accountant-General of the Ministry of Finance and MIH on 14 September 2005, Barnea Investments B.V. ("Barnea") had been chosen as the preferred bidder. Barnea was incorporated in the Netherlands, and is a wholly owned subsidiary of Barnea S.a.r.l., incorporated in Luxembourg, which is held jointly and indirectly by Stephen Feinberg and J. Ezra Merkin, through the Cerberus and Gabriel private investment fund groups which are controlled by Mr. Feinberg and Mr. Merkin respectively.

The sale was completed on 24 November 2005 (the "Closing Date"), when Barnea paid some NIS 2.474 billion for 9.99% of the share capital of the Bank (NIS 17.51 per share), together with interest, a total of some NIS 2.475 billion.

Of the shares purchased, shares representing 4.99% of the Bank's share capital are held in trust and Barnea and the trustee have executed a power of attorney empowering the committee appointed pursuant to Section 12 of the Bank Shares (Arrangement Shares) (Temporary Provision) Law, 1993 (the "Committee"), including whoever succeeds it in this capacity, as provided under said Law, or any other person whom the Minister of Finance shall empower, to (1) participate and vote such shares at all meetings of the Bank and (2) to exercise the right to appoint directors in the Bank with respect to all shares of the Bank held by Barnea.

The State also granted to Barnea an option to purchase a further 10.01% of the capital of the Bank, pursuant to the conditions of the option agreement signed between the government, MIH and Barnea on 23 November 2005 (the "Option Agreement"), and conditional, *inter alia*, on their having obtained all necessary permits from the Bank of Israel and the other relevant supervisory bodies in Israel and overseas for the purchase of the shares and control of the Bank. The option, which took effect from the Closing Date, was exercisable 180 days after the Closing Date, subject to extension for up to an additional 12 months under certain conditions. On 24 May 2006, MIH advised the Bank that on that day an application had been received from Barnea requesting the extension of the exercise period of the said option for an additional 12 months, until 24 May 2007, and that in said application, Barnea stated, *inter alia*, that they had filed with the Bank of Israel a request for a permit to control the Bank. On 6 July 2006, MIH announced that the date for the exercise of the option had been deferred to 24 May 2007.

The price per share for exercising the option was fixed at NIS 14.70, bearing annual interest at 2%, the price and interest being linked to the CPI. The option will expire, *inter alia*, in the event that the percentage of the shares that are held by Barnea falls below 7.5% of the Bank's issued share capital, as the result of the transfer of shares by Barnea (whether shares held directly by Barnea or whether shares held by the trustee mentioned above).

Regarding certain conditions relating to activities during the exercise period of the Option Agreement, which commenced from the Closing Date, and regarding restrictions in connection with the distribution of dividends, which apply from the time of the granting of a control permit to the purchasers by the Bank of Israel, see pages 14 and 15 of the Annual Report for 2005.

For details regarding the issue of options to employees and the sale of shares to employees see pages 5 to 7.

Capital Resources and Transactions in the Shares of the Bank

Shareholders' Equity of the Group at 30 June 2006 amounted to NIS 17,351 million, compared with NIS 16,000 million at the end of 2005, an increase of 8.4%. The increase in shareholders' equity derives mainly from the profit for the first half of the year, from changes in adjustments in respect of the presentation of securities available for sale according to fair value, and from an increase in capital account as against the recording of salary expenses in respect of the sale of shares and issue of options, which was offset from the reduction from the capital of the loans made available to the employees for the purchase of shares of the Bank.

The securities portfolio (nostro) is mainly composed of government debentures, which generally represent the use of raised sources and the available capital. The major part of the securities portfolio is classified as available for sale securities and is included in the balance sheet on the basis of fair value. The income is recorded in the statement of profit and loss on an accrual basis, and the difference between the value on an accrual basis with regard to debentures and on a cost basis with regard to shares and the fair value is directly recorded in a separate item in shareholders' equity, after the deduction of the effect of related taxes.

As a result of adjustments in respect of presentation of securities available for sale according to fair value, a net increase in value of NIS 69 million was recorded in shareholders' equity in the first half of the year, compared with stability in the corresponding period in 2005 (all of the amounts are stated net after the effect of related taxes) arising mainly due to the change of classification of the investment in Migdal Insurance and Financial Holdings Ltd.

The total net aggregate balance of adjustments of securities held in the available for sale portfolio to market value as at 30 June 2006 totaled an amount of NIS 115 million (after the effect of taxes).

According to the principles of the capital adequacy computation, the balance in respect of adjusting securities to fair value does not affect the capital computation for the purpose of the minimum capital ratio, save for losses that have not yet been realized from adjustments to fair value of shares available for sale less the effect of taxes.

Shareholders' Equity relative to Total Assets on 30 June 2006 reached 6.4%, compared with 5.9% on 31 December 2005.

Shareholders' Equity relative to Risk Assets reached 12.10% on 30 June 2006, compared with 11.55% on 31 December 2005. This ratio is higher than the minimum ratio of 9% set by the Supervisor of Banks. The ratio of Tier I capital to risk assets was 7.86% on 30 June 2006, compared with 7.46% at the end of 2005.

The improvement in the capital adequacy ratios derives primarily from the profits in the first half of the year.

Issues of Debentures and Subordinated Capital Notes

In the first half of 2006, Leumi Mortgage Bank Ltd. issued subordinated notes in the amount of NIS 713 million.

Interested Persons' Transactions in the Shares of the Bank

On 19 January 2006, Eliahu Insurance Company Ltd. acquired 194,131 shares, such that the overall holding of the Eliahu Group in the Bank amounted to 9.9969% (fully diluted – 9.4311%).

For details in respect of the sale of shares by the State see above on page 3.

The Issue of Options to Employees

On 2 February 2006, the Bank's General Meeting approved a plan for the issue of options to entitled employees, as determined in the outline published by the Bank on 24 January 2006 (the "Outline"). In accordance with this program, on 14 February 2006, 84,853,960 options, exercisable into 84,853,960 ordinary shares of the Bank, were allotted (of which 122,644 options were allotted to the Chairman of the Board of Directors and 156,659 options were allotted to the Chief Executive Officer). The said options are subject to all the terms of the Outline, including:

1. The options will be exercisable in two equal tranches, the first tranche at the end of two years from the date of the allotment of the options and the second tranche as from the end of the second year from the date of the allotment of the options and up to the end of the third year from the date of the allotment of the options.
2. The options were issued to the employees free of consideration.
3. The exercise price per share will be NIS 13.465 and will be linked to the CPI (commencing from September 2005). The price will be adjusted for the distribution of dividends (whose amounts will be linked to the CPI), bonus shares and the bonus element of rights issues, if such issues take place. This price was determined in coordination with the Ministry of Finance.

In respect of the issue of the said options, the Bank will record salary expenses in accordance with the fair value of the options with the addition of salaries tax and national insurance contributions. This expense will be recorded in the Bank's financial statements over a period of two years from the date of allotment.

The estimate of the fair value of the options, as of the date of allotment, which was prepared by an external valuer in accordance with the Black & Scholes model, was some NIS 422 million. The calculation of the value was based upon the following principal criteria:

- standard deviation of the annual yield: 25%.
- risk free linked interest rate: 3.5%.
- price per share – the closing rate of NIS 17.30 per share on 14 February 2006.
- dividend distribution policy: 50% of the net profit.
- rate at which employees leave during the vesting period of the options: 2%.

The Bank received approval from the Tax Authority for the operation of the plan as a "plan for the allotment of shares by means of a trustee" within the context of section 102 of the Income Tax Ordinance, on the capital gains taxation path. The profit benefit portion (which will be considered to be income from work in the hands of the employees) at the time of the granting of the options was some NIS 368 million. In respect of this portion, the Bank will pay salary tax and national insurance contributions in the amount of some NIS 44 million, and as against this the Bank will save companies tax and profits tax in the amount of some NIS 91 million. This saving will be recorded in the Bank's books over the period of two years from the date of the allotment, in parallel with the recording of the expense. The amount of the expense in respect of the fair value will be recorded against capital account. In the first half of the year, the Bank recorded some NIS 88 million as salary expenses in the statement of profit and loss (second quarter – NIS 48 million).

Sale of Shares to Employees

On 14 June 2006, employees of the Bank purchased 2.8478% of the capital of the Bank (40,274,560 ordinary shares, of these, 75,532 were purchased by the Chief Executive Officer), in accordance with an outline published on 9 May 2006 (and amended on 10 and 25 May 2006). On 3 July 2006, the General Meeting approved the purchase of 59,131 ordinary shares by the Chairman of the Board of Directors of the Bank, which purchase was carried out on 5 July 2006.

The purchase of the shares was carried out in accordance with an agreement of March 2006 with the Accountant-General regarding the offer of ordinary shares of the Bank by the State to the employees of the Bank, in accordance with the agreements in respect of the privatization of the Bank and decisions of the Finance Committee of the Knesset. According to the above agreement, the shares would be offered to the employees in two stages, the first of which, an offer of 2.873% of the share capital, has been carried out, as mentioned above. The second stage, in which a further 1% of the share capital of the Bank will be offered to the employees, will be carried out after completion of the privatization process. The base purchase price was set at NIS 16.10 per share (as agreed by the Ministry of Finance and matching the average price of the sale to Barnea). The shares were offered to the employees at a discount of 25% below the base price, the price being linked to the CPI for September 2005 up to the date of exercise of the offer with the addition of interest of 2% per annum from 24 November 2005 (the "Exercise Price"). The Exercise Price was adjusted for the dividend distribution on 28 February 2006 (NIS 0.78 per share).

The benefit granted to the employees and the Chairman of the Board of Directors in respect of the said purchase, which was evaluated by an external valuer, included a number of components and totaled some NIS 191 million (including salary tax and national insurance). This amount was recorded in the second quarter of the year as a salary expense, of which an amount of NIS 157 million was against the capital account.

Set out below are the parameters according to which the calculation was made:

- calculation of the fair value was made according to the price of the Bank's shares at the time of granting, which is the average price of the Bank's shares in the period during which the employees subscribed for the shares. The period was 31 May 2006 to 11 June 2006, and the average price of the shares during this period was NIS 16.71.
- the calculation of the fair value takes into account the "flaws" in the offered shares (locked-up for 4 years and regular tax payment in respect of the benefit component) as compared with regular shares.
- the shares are locked-up for 4 years. In respect of this "flaw" of lack of marketability, 15% was reduced from the value of the shares at the time of granting.
- an annual dividend payment of 50% of net profit was assumed.
- the financing of the purchase of the employees' shares was through CPI-linked, interest free loans granted by the Bank.
- the interest rate for the calculation of the value of the benefit embodied in the loans was 4% per annum linked to the CPI.
- The Bank received an approval from the Tax Authority under which the provisions of section 102 of the Income Tax Ordinance will apply to the program.

The following table sets out details of the calculation:

	NIS thousands
Fair value of the shares net of lack of marketability	102,911
Cost of financing loans	54,543
Salary tax and national insurance	33,982
Total salary expense	191,436
Tax shelter to Bank in profit and loss	(48,514)
Total net cost in profit and loss	142,922
Amount recorded in capital account	178,414

In order to finance the purchase of the shares, the employees were granted loans, which will be repayable at the end of the 4 years' lock-up period of the shares. The loans are linked to the CPI, do not bear interest and are not on non-recourse conditions. The granting of the loans was approved by the Supervisor of Banks, who noted in his approval that when determining the repayment terms, the Bank was requested to take into account the fact that approval would not be given for the extension of the repayment period of the loans beyond the end of the lock-up period. The total of the loans granted to the employees (including to the Chairman) was some NIS 466 million which amount was deducted from the Bank's capital.

Distribution of Dividends

A. Dividend Policy for 2006-2007

On 29 March 2006 the Bank's Board of Directors resolved to determine the following dividend policy:

It is the intention of the Board of Directors to recommend to the General Meeting the distribution of an annual dividend, for the years 2006 and 2007, in an amount constituting at least 50% of the net annual distributable profit of the Bank, if there is no adverse change in the profits of the Bank and/or in its business and financial condition and/or in the general economic situation and/or in the legal and fiscal environment.

All dividend distributions will comply with the provisions of the Companies Law, 1999, which provides, *inter alia*, that the Bank may make a distribution out of its profits provided that there is no reasonable concern that the distribution will prevent the Bank from meeting its present and anticipated obligations, when they become due. The Bank is also required to comply with the limits laid down by the Supervisor of Banks such as: minimum capital ratio of not less than 9%, compliance with the requirements of Section 23A of the Banking (Licensing) Law, 1981, which placed limits on the percentage of equity that a banking corporation may invest in non-banking (real) corporations, and also compliance with the limits determined by the Supervisor of Banks regarding granting credit as a percentage of equity and the limits he determined regarding dividend distributions, such as: no dividend will be distributed if the non-monetary assets exceed equity or if the dividend distribution will cause such a situation; no dividend will be distributed out of capital reserves or positive differentials arising from the translation of the financial statements of autonomous overseas units; or where one or more of the last three calendar years ended with a loss.

The abovementioned policy is also subject to the restrictions on distribution of dividends arising from the privatization process relating to the Bank, which will apply after the grant of a control permit by the Bank of Israel to the purchasers. (See "Sale of Shares of the Bank by the State" on page 15 of the Annual Report for 2005.)

The above declaration of policy does not constitute any undertaking towards any third party (including concerning the dates of payment of the dividend or the rates of dividends in the future).

Certain declarations appearing above in this section contain "forward-looking information". For the meaning of this term, see the section "Description of the Banking Corporation's Business and Forward-Looking Information in the Directors Report" on pages 16 and 17.

B. The dividend policy for the years 2003 to 2005 (inclusive) was to recommend to the General Meeting the distribution of a dividend in an amount that constituted at least 35% of the annual distributable net profit of the Bank, and this in similar language to the policy for the years 2006 and 2007 detailed above.

C. Dividend for 2005

The Special General Meeting of Shareholders convened on 2 February 2006 approved the recommendation of the Board of Directors of 4 December 2005, regarding the distribution of a cash dividend at the rate of some 65.9% of the net profit for the first nine months of 2005 (some NIS 1,103 million), at the rate of 78.0% of the paid-up capital.

The dividend was paid on 28 February 2006 to shareholders of record on 15 February 2006 (the record date). The stock traded "ex" dividend on 16 February 2006. The dividend was at the rate of NIS 0.78 for every ordinary share of NIS 1.0 par value.

Bank Leumi le-Israel B.M. and its Consolidated Companies
Principal Data of the Leumi Group

	First Half	First Half	Year
	2006	2005	2005
Income, Expenses and Profit (NIS millions):			
Net interest income before provision for doubtful debts	3,441	3,197	6,628
Provision for doubtful debts	386	939	1,426
Total operating and other income	1,955	1,793	3,718
Total operating and other expenses	3,701	2,849	6,070
Of which: Costs of Voluntary Retirement	5	6	107
Operating profit before taxes	1,309	1,202	2,850
Provision for taxes	638	405	1,193
Net operating profit	767	1,072	2,059
After-tax net profit from extraordinary items	723	34	77
Net profit for the period	1,490	1,106	2,136
Proposed dividend	-	-	1,103
Net profit per share (in NIS)	1.503	0.782	1.510
Assets and Liabilities at End of Period (NIS millions):			
Total assets	272,388	263,598	272,824
Credit to the public	177,974	169,674	177,255
Securities	47,787	46,080	47,825
Deposits of the public	219,372	216,423	221,828
Shareholders' equity	17,351	16,086	16,000
Major Financial Ratios in Annual Terms (%):			
Credit to the public / Total assets	65.3	64.4	65.0
Securities / Total assets	17.5	17.5	17.5
Deposits of the public / Total assets	80.5	82.1	81.3
Shareholders' equity (excluding minority interest) / Total assets	6.4	6.1	5.9
Shareholders' equity / Risk assets (a)	12.1	11.92	11.55
Tier I capital / Risk assets	7.86	7.81	7.46
Net profit / Shareholders' equity (excluding minority interest) (c) (d)	19.5	15.3	14.3
Net operating profit / Shareholders' equity (excluding minority interest) (c) (d)	9.8	14.8	13.7
Rate of tax provision from the profit	48.7	33.7	41.9
Provision for doubtful debts / Credit to the public (d)	0.43	1.11	0.80
Provision for doubtful debts / Total credit risk (d)	0.29	0.74	0.53
Net interest income before provision for doubtful debts / Total assets (d)	2.54	2.44	2.43
Total income / Total assets (b) (d)	4.00	3.82	3.79
Total income / Total assets managed by the group (b) (d) (e)	1.87	1.93	1.83
Total operating and other expenses / Total assets (d) (f)	2.74	2.17	2.22
Total expenses / Total assets managed by the group (d) (e) (f)	1.28	1.10	1.07
Net profit / Total average assets (d) (f)	1.10	0.87	0.82
Net operating profit / Total average assets (d) (f)	0.56	0.84	0.79
Financial margin including income and expenses from derivative financial instruments	1.86	1.60	1.60
Operating expenses (excluding costs of voluntary retirement) / Total income (b) (f)	68.5	57.0	57.6
Operating and other income / Operating and other expenses (excluding costs of voluntary retirement) (f)	52.9	63.1	62.4
Operating and other income / Total income (b)	36.2	35.9	35.9

(a) Shareholders' equity - plus minority interest and less investments in the capital of companies included on the equity basis and various adjustments.

(b) Total income - net interest income before provision for doubtful debts plus operating and other income.

(c) Shareholders' Equity - at the beginning of the period.

(d) On an annual basis.

(e) Includes off-balance sheet activities.

(f) In the first half of 2006, there were special salary expenses which significantly affected the results, see details in the report.

B. Other Information

Principal Developments in the Economy*

General

In the first half of 2006 the economic growth in the economy continued at a rapid pace. The gross domestic product expanded by a real term rate of some 5.5% as compared with the corresponding period in 2005. However, the events on the security front that took place in July and August (further details follow) may result in a slowdown in the pace of growth in the second half of the year. The growth in the economy during the reported period was based primarily on the expansion of local demand (mainly domestic consumption and investments) and less on growth in exports. As a result, the State's income grew at a considerable rate, which allowed the lowering of the VAT rate. The inflation rate was slightly higher than the price stability target and the Bank of Israel continued the process of raising interest rates.

The Implications of the Security Situation on Economic Activity in Israel

During July hostilities broke out in the north of the country and in the south, as a result of attacks by terrorist organizations from Lebanon and Gaza against those regions. The worsening of the security situation which occurred in the north of Israel during July and August is expected to have a negative effect on the economy, which will be reflected in the macro-economic data in the short-term. This is because the economic activity in the north, which constitutes some 20% of the activity in the economy, was significantly affected in the short term. Therefore, the rate of growth in the economy in 2006 may be slightly lower than the estimate made prior to the outbreak of the security-related events and the budget deficit will grow, but is expected to remain within the government's target range. According to estimates published by the Bank of Israel on 2 August 2006, the direct damage caused by the hostilities in the north to the gross domestic product (GDP) of the State of Israel was estimated at 0.7%-0.9% of the GDP, taking into account the damage to the tourism sector even after the end of the hostilities. As of the beginning of August 2006, the weekly impact on the GDP is estimated at between NIS 750 million and NIS 1.08 billion. This figure does not take into account the continuing effect on tourism after the end of hostilities.

However, and assuming that the situation will soon return to its previous status, it can be expected that except for certain sectors, most of the economic activity in Israel will not be hurt in the medium term. Although the financial markets reacted in a negative fashion on the outbreak of hostilities, by the beginning of August they had stabilized and the shares indices and the exchange rate of the shekel against the dollar returned to levels that existed previously. The credit rating companies S&P, Fitch and Moody's reaffirmed the sovereign credit rating and the forecast credit rating of the State of Israel during the months of July and August (after the outbreak of hostilities).

Further to what was mentioned above, the sector that is the most sensitive to security-related developments is the tourism sector, which had recorded an impressive recovery over the course of the past two years. The damage to incoming tourism is expected to continue for a number of months, even if the security situation improves soon. It should be emphasized that the weighting of the tourism sector in the GDP is relatively small and therefore the overall effect on the economy is not great.

Another sector that is expected to be directly hurt by the security situation is the agricultural sector, since a large number of farms are located in the northern region. The immediate effect of the security situation on the agricultural sector was the reduction of supply, with a short-term effect on the level of prices in the economy. Various trade and services sectors in the north of the country have also been

* Sources of data: publications of the Central Bureau of Statistics, the Bank of Israel, the Ministry of Finance and the Tel Aviv Stock Exchange

adversely affected, whether as a result of the movement of residents of those areas further south or whether as a result of the marked reduction in consumption by the residents who remained in the areas that were directly affected by the unstable security situation. It would appear that economic difficulties are primarily felt by households and small to medium-sized businesses, whose activities are directed at the local market. In the medium term, in the fields of investments and construction (residential, commercial, public buildings and infrastructure) an increase in investment is expected, which will be required in order to repair the damage. However, at this stage, it is still difficult to estimate the extent of the damage or the investment that will be required.

According to information published by the Bank of Israel, the effect of the hostilities varies from sector to sector, the industrial sector having sustained partial damage, while trade almost completely ceased and tourism ceased completely. As may already be seen, and from previous experience, tourism may be hurt not only in the north, but also in the rest of the country, and recovery will be gradual. Unlike other sectors, the damage to tourism will continue for several months after the end of hostilities and will amount, according to an estimate made by the Bank of Israel, to some NIS 1 billion.

In the wake of the direct and indirect damage caused to the residents and to businesses in the north, the Knesset and the government have acted to provide compensation and various forms of relief to households and owners of businesses.

The aforementioned damage to activities in the economy may have a negative effect on activity in the banking sector. This would primarily be as the result of the expected decline in income, in particular in the capital market field, and as a result of the possible impact on the ability of borrowers to service their loans, especially small businesses. At this stage, it is still not possible to estimate the extent of the impact as a result of the uncertainty that exists in respect of various factors.

Throughout the period of the hostilities, the **Bank** continued to provide banking services to the population of the north. Most of the branches were open during the hours when opening was permitted according to the instructions of the Commander of the Home Front, and the ATMs were loaded with cash and enabled customers of all the banks to withdraw cash.

In addition, the **Bank** operated 3 mobile bank units, to serve the northern residents.

For further details on activities during the hostilities see pages 33, 34 and 80 below.

Business Product and Economic Sectors

Israel's business sector product expanded in real terms in the first half of 2006 by some 7.0%, as compared with the corresponding period in 2005. This increase was affected by an expansion in most sectors of the economy. The Bank of Israel's companies survey, which was conducted prior to the outbreak of the hostilities in the north, pointed to a continuing upswing in economic activity during the second quarter of the year. According to companies' reports, the increase in activity was recorded in all sectors, and resulted from increases in both exports and local activities. The companies participating in the survey anticipated a continuation of the upswing in activity in the third quarter as well.

The improvement in tourism to Israel in recent years continued in the first half of 2006. The number of tourists arriving by air totaled some 891 thousand, an increase of 18.4% as compared with the corresponding period in 2005. This trend was greatly influenced by the stabilization of the security situation during that period. The hostilities in the north of the country are expected to have a negative impact in the coming period, since the sector is sensitive to security-related events, and to result in a reduction in the number of tourists coming to Israel. According to data published by the Central Bureau of Statistics for July, after the outbreak of hostilities in the north, the daily average number of

tourists arriving in Israel by air fell by some 40% as compared with the level before the commencement of hostilities.

The Budget and its Financing

In the first half of 2006 there was a surplus in the State Budget of some NIS 4.7 billion, as compared with the deficit target (without the granting of credit) for 2006 of some NIS 17.2 billion, representing some 3.0% of GDP. The budget surplus originates from a relatively low level of expenses, mainly because of the delay in the approval of the Budget Law, which was only approved in June, and also because of a marked increase in revenues from taxes of some 8.3% in real terms as compared with the corresponding period in 2005. According to Ministry of Finance data, state tax revenues exceeded the official estimate by some NIS 6 billion, although part of this increase was, according to the Ministry of Finance's announcement, the result of exceptional payments by various parties, mainly the banks.

On July 1, 2006 the VAT rate was reduced by one percentage point, from 16.5% to 15.5%. In consequence, the VAT rate for non-profit entities was reduced to 7.5% and for financial institutions to 15.5%. See page 24 for the effect of the reduction in the VAT rate on the Bank.

The implications of the hostilities in the north on the State budget are estimated by the Bank of Israel at an expected loss of tax revenues of some 0.3% of GDP. The significant expense of some NIS 2-3 billion for direct and indirect compensation will be financed by the compensation fund maintained by the Property Tax authorities and therefore it will not affect the deficit,

Foreign Trade, Capital Flows and Exchange Rates

Israel's trade deficit amounted in the first half of the year to some US\$3.6 billion as compared with some US\$3.4 billion in the corresponding period in 2005. However, eliminating the increase that derived from the increase in world oil prices, a decrease in the trade deficit was recorded. The source of this improvement was the swifter expansion of export of goods as compared with their import. The fast increase in export in the second quarter of the year (as compared with the first quarter) stood out, primarily in the high technology sectors (in particular the pharmaceuticals sector) and in medium-high technology. Together with the increase in exports, an expansion was recorded in the import of raw materials, which also supported the acceleration of industrial production, part of which is designated for export.

During the course of the first half of the year, the consistent increase in direct investments in Israel, of a long-term (strategic) nature, continued. In the first six months of the year these investments totaled some US\$3.7 billion, as compared with investments of some US\$5.6 billion in 2005 as a whole. However, the financial investments suffered from a high level of fluctuation. In particular, June was characterized by falls in prices on capital markets across the globe and in Israel which resulted in a contraction in the financial investments of foreign residents on the Tel Aviv Stock Exchange, a situation which could have caused a weakening of the shekel. However, Israeli households and institutional investors, who had invested considerable amounts abroad from the beginning of the year, realized a considerable volume of their overseas investments and thus offset the reduction of investments by foreign residents in Israel. This situation supported the strengthening of the shekel, both against the dollar and also against the basket of currencies, in June. Thus, the openness of the Israeli economy resulted, at a time of negative developments of a global nature, in the offsetting of incoming and outgoing financial capital flows, and this supported the relative stability of the exchange rate. According to Bank of Israel data, the level of activity of foreign financial institutions in shekel foreign currency trade has increased by a further degree since the outbreak of hostilities in the north and reached an average level of 30% of the overall volume of trade (in spot, excluding exchange transactions).

As a result of the positive background conditions of Israel's overseas accounts (the balance of payments, capital flows) and the weakening of the dollar worldwide, together with a lessening of the degree of political uncertainty that increased in the first quarter, the shekel strengthened by some

3.5% against the dollar in the period from January to June and by some 1.4% against the basket of currencies. Against the background of the worsening of the security situation, a certain degree of depreciation was recorded in the exchange rate of the shekel in the initial stages of the events in mid-July 2006, whereas towards the end of July the exchange rate of the shekel returned to the level that it held before the outbreak of the events in the north. The Governor of the Bank of Israel stated on 2 August 2006 that in the wake of the events in the north, especially high daily volumes of trade were recorded, a phenomenon that reflects a market that is functioning well, with a large presence of sellers and buyers.

In the first six months of the year total foreign currency credit to the public at the **Bank** declined by US\$ 332.9 million (3.89%).

The public's foreign currency and foreign currency-linked deposits with the **Bank** amounted at the end of June 2006 to some US\$ 17.6 billion, compared with US\$ 16.6 billion at the end of 2005.

The value of the foreign securities portfolio of customers of the **Bank** was up in that period, from some US\$ 7.0 billion at the end of 2005 to some US\$ 7.3 billion at the end of June 2006, an increase of 4.3%. Foreign currency conversion turnovers increased from some US\$ 53.8 billion in January to June 2005 to some US\$ 73.6 billion in January to June 2006, an increase of some 36.8%.

Inflation and Monetary Policy

In the first six months of 2006 the Consumer Price Index (CPI) rose by 1.6%, while in the 12 months ending June 2006 its increase totalled some 3.5%. A significant contribution to the increase in prices in this period was the transport and communications item, which rose by 4.4% and which contributed more than half of the increase in the index as a whole, because of the effect of the rise in oil prices. The food item (without vegetables and fruit), which increased by 3.4% (a contribution of some 0.5%), also contributed to the increase in the general index, primarily because of the effect of price increases of various raw materials, changes in the structure of competition in the local food market and an increase in local demand.

In the period under review, the Bank of Israel made a moderate increase in the interest rate, from 4.5% in December 2005 to 5.25% in June 2006. This was against the background of the central bank's evaluations that the fast pace of the expansion of growth acts to close the difference *vis-a-vis* the economy's potential output (the high pace of the increase in actual prices strengthened this position), while at the same time the increase in interest rates in the world and in particular in the USA continued. As against this, the effect of the strengthening of the shekel against the dollar enabled a measured increase in interest rates to be effected. The interest decision for August, which included an increase to 5.5%, was affected by the worsening of the security situation. In the Bank of Israel's words: "This increase in risk, including the inflationary risk, requires a certain degree of tightening of monetary policy."

The Capital Market

The shares and convertible securities index fell in the first six months of 2006 by some 6.4% following a steep upturn of some 32.8% in 2005. The fall in the prices in developing markets and the worsening of the security situation in the south of the country in May and June, during the course of which the index fell by 2.7% and 9.0% respectively, cast a shadow on the positive financial figures on the state of the economy, which were published during that period. In accordance with this trend, the Industrial Shares Index, which fell by 16.1%, was conspicuous. By comparison, the shares of real estate companies rose by some 27.3% during the period. The daily average turnover of the trade in shares and convertible securities on the stock market expanded by a considerable extent and amounted to a daily average of some NIS 1,351 million, as compared with a daily average of some NIS 895 million in 2005, an increase of some 51%.

During the course of July, with the increased hostilities in the north and in the south, falls were recorded in the market prices of shares. Towards the end of July, the prices returned to what they had been before the outbreak of hostilities. According to data provided by the Governor of the Bank of Israel on 2 August 2006, there was marked volatility in the shares and debentures markets, however trading was carried on in a continuous and normal manner throughout trading hours.

On 20 June 2006 the Tel Aviv Stock Exchange published the composition of the Tel-Div 20 Index. The new index, which has been in operation since 2 July 2006, includes the shares of the twenty companies included in the TA 100 Index with the highest annual dividend yield. This index will be updated twice a year, together with the other leading stock exchange indices, when the dividend yield will be measured over an entire year on the basis of the dividends actually paid by the companies. The weighting of the shares in the new index will be determined on the basis of their market value, with a limit of 9.5%. According to the announcement of the Stock Exchange, Leumi's shares form part of this index, with a weighting of 9.5%.

The increase in activity on the capital market is reflected in the increase in the volume of turnover on the capital market which led to an increase in income from customers' activities from some NIS 543 million in the period from January to June 2005 to some NIS 592 million in the first six months of 2006, an increase of 9.0%.

The CPI-linked government debenture index rose in the first six months of the year by some 1.8%, with a marked increase of some 2.3% in short term (up to two years) debentures. This was in consequence of a certain increase in the rate of inflation, which exceeded the government's target during the course of the period. Unlinked fixed-interest government debentures rose by a marginal rate of some 0.8%, while debentures with a term to redemption of more than five years posted a decline of some 0.2% with an increase in yields to redemption (for eight years) from some 6.2% at the end of December 2005 to some 6.5% at the end of June 2006.

Financial Assets of the Public

The value of the financial assets portfolio of the public amounted at the end of June 2006 to some NIS 1.65 trillion, an increase of some 0.9% since the beginning of the year. The value of all the components of the portfolio, except for Israeli equities, has increased since the beginning of the year. These figures show that in the first half of the year the public increased its financial assets (in terms of savings flows) at only a moderate rate, despite the rapid economic growth during this period. It is possible that the fruits of the growth were allocated primarily to an increase in private consumption and less to financial savings.

The total of the public's financial assets managed by the **Group** (deposits of the public, debentures and capital notes, securities portfolios including mutual funds and also provident funds and supplementary training funds) amounted at the end of June 2006 to some NIS 543 billion, compared with NIS 534 billion at the end of December 2005, an increase of 1.7%.

Bank Credit

During the first half of the year, credit to the business sector rose at a real annual rate of some 11.0%, against the background of the fast rate of expansion of economic activity. This credit includes both loans and debentures, tradeable and non-tradeable. The analysis of the proportions of banking and non-banking credit indicates that the trend of recent years towards a contraction in bank credit is continuing. Thus, in the months January to June, a real term decrease of some 1.7% in the volume of bank credit to the business sector was recorded, and its weighting in total credit to the business sector amounted at the end of June 2006 to some 57.5%, compared with some 61.1% at the end of 2005 and 68.0% at the end of 2004. Nonetheless, similar to the trend of recent years, a rise in non-bank credit was recorded, as an alternative to bank credit. However, this rise, at a yearly rate of some 32.5%, in

the first half of 2006, arose to a great extent from the expansion of direct credit from overseas (mostly from a debenture issue abroad by the Teva company). Credit to households also expanded in the first half of the year at a fast annual pace of some 8.1%, in real terms.

The **Bank's** credit to the public amounted at the end of June 2006 to some NIS 122 billion, a decrease of 0.4% as against the end of 2005, mainly as a result of the appreciation of the shekel against the US dollar.

Credit Rating of the State of Israel and Bank Leumi

Moody's credit rating company announced on 10 May 2006 that it was raising the foreign currency credit rating outlook of the State of Israel from "stable" to "positive". The announcement gives expression to the company's evaluation that Israeli society and the political and economic decision-makers have proved to be extremely robust in facing the many challenges of recent years. The company emphasized that Israel is demonstrating considerable growth per capita, in purchasing-power terms, and it is nearing a GDP per capita level that is more often associated with advanced economies than developing ones.

Further to this announcement, the company announced on 12 May 2006 that it was raising the foreign currency rating outlook for the deposits of five Israeli banks, including Leumi, from "stable" to "positive". The raising of the rating reflects the continuation of the high prospects of support by the Israeli authorities. On 2 August 2006, following the outbreak of the hostilities in the north, the company announced that it was not changing the credit rating and the forecast rating of the State of Israel

The S&P credit rating company announced on 28 February 2006 that it was raising the long-term credit rating of the Bank from BBB+ to A-. The rating outlook is "stable". The raising of the rating was explained by the company's evaluation that the government of Israel would provide significant assistance to the Bank in times of distress.

On 25 July 2006, following the outbreak of the hostilities in the north, the company re-confirmed the credit rating of the State of Israel. The forecast rating for the State remained "stable".

The Fitch rating company announced in 14 July 2006, after the outbreak of hostilities in the north, that the economy was starting from a strong opening position, which together with a stable policy framework, was expected to restrict the negative impact on the economy. The company did not change its rating or the forecast rating of the State of Israel.

At a press conference held by the Governor of the Bank of Israel on 2 August 2006, the Governor stated that "the trust placed by foreign investors in the Israeli economy remains firm despite the fighting on the northern border as is reflected in Israel's risk premiums and in the announcements by the credit rating companies". In addition, reports by foreign investment houses that were issued after the outbreak of hostilities contributed to the relative stability and they did not change their recommendations in respect of the Israeli capital market.

The Israeli rating company, Maalot, a strategic partner of S&P, announced on 11 May 2006 that it was raising the rating of the liabilities of the Bank from AA+ to AAA. This rating also relates to issues that the Bank makes through Leumi Finance Company, a wholly-owned subsidiary of the Bank, which is its financing arm. Within the context of these issues, the Bank undertakes to pay the holders of the securities (debentures and/or notes), the monies due in respect of the said securities, in accordance with their terms of issue. Furthermore, the rating also applies to the notes that Leumi Finance Company may issue during the coming year (up till April 2007) of up to NIS 4 billion. In the background of the decision was the significant improvement in profitability that principally derived from the boom in the capital market and the improvement in the credit portfolio. In Maalot's opinion, the reform of the capital market and the legislation enacted in its wake, which are described on pages 30 to 38 of the Annual Report for 2005, do not threaten the financial strength of the Bank.

Below are details of changes in the CPI and in the exchange rates:

	For three months ended 30 June		For six months ended 30 June		For the year
	2006	2005	2006	2005	2005
In percentages					
Rate of increase of the "known" CPI	1.16	0.80	1.26	0.50	2.7
Rate of increase (decrease) in the rate of the US dollar – nominal	(4.82)	4.88	(3.54)	6.17	6.8
Rate of increase (decrease) in the rate of the currency basket –nominal	(3.34)	2.59	(1.38)	2.08	1.7
Rate of increase (decrease) in the rate of the euro – nominal	(0.32)	(2.16)	3.62	5.95	(7.3)

General Environment and the Effect of External Factors on Activities

Description of the Banking Corporation's Business and Forward-Looking Information in the Directors' Report

On 30 June 2004, Amendment No. 23 to the Securities Law, 1968 was published, further to principles recommended by the Barnea Committee (the "Amendment to the Securities Law").

Together with the Amendment to the Securities Law, on 14 September 2004 an amendment to the Securities Regulations was published, further to the principles recommended by the Barnea Committee (the "Amendment to the Securities Regulations"). *Inter alia*, the Amendment to the Securities Regulations regulates the disclosure rules regarding the information required in a prospectus, substantially expands the disclosure required in periodic reports, changes the structure of the periodic report and also includes requirements for the disclosure of forward-looking information.

In accordance with the Amendment to the Securities Regulations, the requirement to expand the disclosure in the periodic reports (Regulations 8(b) and 8A of the Securities Regulations (Periodic and Immediate Reports)) does not apply to banking corporations.

In the light of this, the need arose to apply the requirements of expanded disclosure which were added to the Securities Regulations to banking corporations, pursuant to clarifications given by the Israel Securities Authority, subject to the changes required due to the nature of the business of banking corporations.

In accordance with the above, the Supervisor of Banks amended the public reporting directives and on 19 February 2006 published temporary provisions (the "Temporary Provisions") whereby additional information must be included in the Directors' Report, mostly based on the Amendment to the Securities Regulations, subject to the amendments that the Supervisor deemed appropriate to apply to the banking corporations. Pursuant to the Temporary Provisions, information has also been included in the Directors' Report, which does not fall into the category of a description of past facts, and is therefore forward-looking information, as defined in the Amendment to the Securities Law.

The Directors' Report includes, as mentioned above, in addition to data relating to the past, information that relates to the future, which is defined in the Securities Law, 1968 as "forward-looking information". Forward-looking information relates to a future event or matter, the realization of which is not certain and is not within the exclusive control of the Bank.

Forward-looking information is generally drafted by way of words or phrases such as "the Bank believes", "the Bank foresees", "the Bank expects", "the Bank intends", "the Bank plans", "the Bank estimates", "the Bank's policy", "the Bank's programs", "the Bank's forecast", "strategy", "aims", "likely to affect" and additional phrases testifying to the fact that the matter in question is a forecast of the future and not a past fact.

Forward-looking information included in the Directors' Report is based, *inter alia*, on forecasts of the future regarding various matters related to economic developments in Israel and abroad, and especially to the currency markets and the capital markets, to legislation, to directives of regulatory bodies, to the behavior of competitors, to technological developments and to personnel matters.

As a result of the inability to foresee with certainty that these forecasts will be realized, and the fact that in reality events may turn out differently from those forecasted, readers of the Report should relate to information defined as "forward-looking" with caution, since reliance on such information involves risks and uncertainty and the future financial and business results of the Leumi Group are likely to be materially different.

The Bank does not undertake to publish updates of the forward-looking information in this Report.

The Management of Current Account Credit Lines

In February 2005, the Supervisor of Banks issued a Proper Banking Management Directive on the subject of "The Management of Current Account Credit Lines", which took effect from 1 January 2006. The Directive is intended to minimize the uncertainty caused to both the customer and to the banking corporation as a result of the practice that allows for exceeding credit limits in current accounts.

Before the Directive took effect, the Bank of Israel made a number of concessions for the transition period, primarily: the deferral of the prohibition on the creation of excesses on current accounts (the prohibition took effect on 1 July 2006) and the possibility of unilaterally granting credit, even to a customer who has not signed the required documentation (this concession will be in force until 1 January 2007).

The Bank, while investing considerable resources, has adapted the computer systems, the procedures and the documentation that are necessary in order to implement the Directive. Also, the Bank has carried out appropriate training of its employees.

In addition, in order to implement the provisions, considerable efforts have been and are still being invested in signing up customers on updated credit lines and in the prevention/structuring of excess balances, while using, when necessary, and after the exercise of business judgment, the possibility of making temporary and unilateral credit lines available.

As a result of the early preparations made by the Bank, the entry into force of the prohibition on excesses (1 July 2006) was not accompanied by exceptional events and the Bank is operating in accordance with instructions which accord with Directive 325 and the guidelines issued by the Supervisor of Banks.

In the estimation of the Management of the Bank and taking into account the amounts of excess interest collected by the Bank, the implementation of the Directive will not have a material affect on the business of the Bank.

Legislation on the Reform of the Capital Market

On 10 August 2005 three laws were published in connection with the reform of the capital market, as follows:

The Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005;

The Financial Services (Control) (Engagement in Pension Counseling and Pension Marketing) Law, 2005;

The Financial Services (Control) (Provident Funds) Law, 2005.

For details on the subject of the capital market reform legislation see the Financial Statements for 2005.

For details on the implications of the legislation on the Bank see Note 8 to the Financial Statements.

Accounting Policy on Critical Subjects

The Financial Statements have been prepared in accordance with generally accepted accounting principles and the directives of the Supervisor of Banks and his guidelines relating to the preparation of the annual and quarterly financial statements of a banking corporation, as detailed in Note 1 to the Annual Financial Statements to 31 December 2005, other than as detailed in Note 2 to the Financial Statements.

The preparation of the Consolidated Financial Statements in accordance with generally accepted accounting principles and the directives of the Supervisor of Banks requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the amounts of income and expenses.

The actual results relating to these estimates may differ from the estimates and/or the assumptions.

The estimates and assumptions are generally based on economic forecasts, assumptions regarding the various markets and past experience after due consideration and which Management believes to be reasonable at the time of signature of the Financial Statements.

The principal critical accounting subjects referred to in the Annual Report to 31 December 2005 were as follows: provisions for doubtful debts, derivatives, securities, obligations regarding employee rights, obligations in respect of legal claims, buildings and equipment and taxes on income.

In the period January – June of 2006 there were no changes in the accounting policy on critical subjects as compared with that described in the Annual Report for 2005.

See pages 48 to 52 of the Annual Report for 2005 for further details.

Employee Rights

"Leumi alumni" are entitled, in addition to pension and/or severance payments, (as each chooses) to additional benefits, principally gifts on religious festivals and participation in the cost of additional welfare and social activities.

"Leumi alumni" – whoever ended their employment with the Bank, at any age, following completion of 25 years' employment with the Bank, or ended their employment at the age of 65 or more, following completion of at least 15 years' employment.

In the second quarter of 2006, the expected costs in respect of the above entitlements for the period following the period of employment were recorded pursuant to an actuarial calculation, as accrued as at 30 June 2006. The amount accrued as at this date amounted to some NIS 80 million, after the effect of taxes.

The Bank recorded the cost of the entire accumulated amount in salary expenses in the second quarter of 2006, and not by way of re-statement, pursuant to the American Interim Financial Report APB28 standard. According to the standard, in the determination of materiality for the purposes of financial reporting for the interim period, with regard to the effect of accounting changes or correction of errors, these should be related to the amount of the expected annual profit, and the effect on the profitability trend. Pursuant to the standard, separate disclosure should be made in the interim financial statements with regard to corrections that are material in relation to the interim period, even though they are not material in relation to the expected annual profit and profitability trend.

C. Description of the Group's Business According to Segments and Spheres of Activity

Development of Income, Expenses and Tax Provisions

Net Profit of the Leumi Group in the first half of 2006 amounted to NIS 1,490 million, compared with NIS 1,106 million in the corresponding period in 2005, an increase of 34.7%.

The increase in net profit of the Group in the first half of 2006 as compared with the corresponding period in 2005 is primarily explained by the following factors:*

1. An increase in the profit from extraordinary operations in consequence of the sale of some of the non-banking holdings, in respect of which a profit of NIS 718 million was recorded. See pages 55 and 56 below for further details.
2. A decline in the provision for doubtful debts in the sum of NIS 553 million, a decrease of 58.9% before the effect of taxes.
3. An increase in profit from net interest income before provision for doubtful debts in the amount of NIS 244 million, before the effect of taxes.
4. An increase in operating and other income of NIS 162 million, before the effect of taxes, principally in consequence of an increase in income from customers' activity in the capital market, the payment system services, credit management and credit cards.

On the other hand, the following factors partially offset the said increase:

1. An increase in operating and other expenses (including salaries) in the sum of NIS 852 million, an increase of 29.9%, before the effect of taxes. When neutralizing the special expenses, as detailed below, the increase is of 12.9%.

* Before minority interests in consolidated companies.

2. A decrease in the Group's share in the profits of companies included on the equity basis in the sum of NIS 163 million, net.
3. An effective tax rate which was higher in 2006 than the corresponding period in 2005 by 15 percentage points as detailed below.

Net Profit in the second quarter of 2006 amounted to NIS 378 million, compared with NIS 578 million in the corresponding period in 2005, a decrease of 34.6%.

The decrease in net profit of the Group in the second quarter of 2006 as compared with the corresponding period in 2005 is primarily explained by the following factors:*

1. A decrease in the Group's share in the profits of companies included on the equity basis in the sum of NIS 100 million.
2. An increase in operating and other expenses (mainly salaries) in the sum of NIS 451 million, an increase of 31.6%, before the effect of taxes. When neutralizing the special expenses, as detailed below, the increase is of 12.7%.
3. A decrease in the profit from extraordinary activities of NIS 26 million, net.

On the other hand, the following factors partially offset the said decrease:

1. A decline in the provision for doubtful debts in the sum of NIS 309 million, before the effect of taxes.
2. An increase in profit from net interest income before provision for doubtful debts in the amount of NIS 191 million, before the effect of taxes.
3. An increase in operating and other income in the sum of NIS 109 million, before the effect of taxes, primarily from a dividend, the payment system services and income from customers' activities in the capital market.
4. A decline in the rate of profits tax and salaries tax rate from 17% to 15.5%, as from 1 July 2006, which had a positive net effect of NIS 20 million.

Net interest income before provision for doubtful debts of the Leumi Group in the first half of 2006 amounted to NIS 3,441 million, compared with NIS 3,197 million in the corresponding period in 2005, an increase of 7.6%.

In the second quarter of the year, net interest income before provision for doubtful debts amounted to NIS 1,796 million, compared with NIS 1,605 million in the corresponding period in 2005, an increase of 11.9%.

The increase in net interest income before provision for doubtful debts in the Group in the first half of 2006 as compared with the corresponding period in 2005 stems mainly from an increase of 7.2% in the volume of financial activity and an increase of 0.26% in the total interest margin.

Furthermore, an expense in the sum of NIS 27 million principally from the adjustments to fair value of debentures for trading, compared with income of NIS 89 million in the corresponding period in 2005, from the sale of debentures and adjustments to fair value of debentures for trading, partly set-off the above increase.

* Before minority interests in consolidated companies.

The following table sets out the development of net interest income according to principal activity segments:

Segment	The first half of	The first half of	% Change
	2006	2005	
	NIS millions		
Households	1,067	897	19.0
Small businesses	424	381	11.3
Corporate banking	751	692	8.5
Commercial banking	570	504	13.1
Construction and real estate	323	318	1.6
Private banking	173	142	21.8
Financial management	123	240	(48.8)
Other	10	23	(56.5)
	3,441	3,197	7.6

Total Interest Margin (excluding transactions in derivatives) in the first half of 2006 was 2.03%, compared with 2.57% in the corresponding period of 2005. The interest margin including transactions in derivatives was 1.86% in the first half of 2006, compared with 1.60% in the corresponding period in 2005, and compared with 1.60% in all of 2005.

Most of the improvement in the interest margin originates from an increase in the interest margin in the unlinked shekel sector of 0.23%, which was also affected by a raising of interest rates by the Bank of Israel.

The ratio of net interest income before provision for doubtful debts to the average balance of the financial assets was 2.68%, compared with 2.66% (in annual terms) in the corresponding period in 2005.

The Provision for Doubtful Debts of the Leumi Group in the first half of 2006 amounted to NIS 386 million, compared with NIS 939 million in the corresponding period in 2005, a decrease of 58.9%. The provision for doubtful debts amounted to NIS 185 million in the second quarter of 2006, compared with NIS 494 million in the corresponding period in 2005, a decrease of 62.6%.

The decrease in the specific provision by the rate of 61.4% is a result of the continued trend of improvement in the economy and an improvement in the companies' positions. The hostilities in the north have not at this stage, affected the amount of the provision for doubtful debts. See below for further details with regard to the decrease in doubtful debts.

The additional and general provisions for doubtful debts in respect of risks that are not identified in the credit portfolio and that are based upon the risk characteristics in the credit portfolio, and also in respect of a sectoral credit deviation, increased in the first half of 2006 by NIS 35 million, compared with an increase in the sum of NIS 30 million in the corresponding period in 2005 and a decline of NIS 1 million in all of 2005.

The overall rate of the provision for doubtful debts in the first half of 2006 was 0.43% of total credit to the public (in annual terms), compared with a rate of 1.11% in the corresponding period in 2005 and compared with 0.80% in all of 2005. The rate of the overall provision for doubtful debts in relation to the overall credit risk (balance sheet and off-balance sheet) was 0.29%, 0.74% and 0.53% respectively.

The following table sets out the quarterly development of the provision for doubtful debts:

	2006		2005			
	Second Quarter	First Quarter	Fourth Quarter	Third Quarter	Second Quarter	First Quarter
	NIS millions					
Specific provision	184	167	313	205	477	432
Additional provision	1	34	8	(39)	17	13
Total	185	201	321	166	494	445
Provision as percentage of total credit to the public (on annual basis)	0.41%	0.45%	0.73%	0.38%	1.17%	1.06%

The aggregate balance of the general provision and the additional provision for doubtful debts (according to risk characteristics defined by the Supervisor of Banks) at the Bank and its consolidated subsidiaries amounted to NIS 1,075 million as at 30 June 2006 (constituting 0.6% of total credit to the public), as against NIS 1,040 million at the end of 2005.

This provision is presented without the effect of taxes. Having regard to statutory tax rate today, this provision is equivalent to a specific provision of some NIS 1,811 million, being some 1.02% of the total credit to the public.

The following table sets out the development of the provisions for doubtful debts according to principal activity segments:

Segment	First six months of 2006		First six months of 2005	
	NIS millions	In percentages*	NIS millions	In percentages*
Households	140	0.6	59	0.3
Small businesses	31	0.4	32	0.5
Corporate banking	90	0.3	632	2.4
Commercial banking	69	0.4	95	0.6
Construction and real estate	75	0.6	108	0.9

* Percentage of total credit at the end of the period on an annual basis.

Profit from Net Interest Income after Provision for Doubtful Debts of the Leumi Group in the first half of 2006 amounted to NIS 3,055 million, compared with NIS 2,258 million in the corresponding period in 2005, an increase of 35.3%. In the second quarter of 2006 profit from net interest income after provision for doubtful debts amounted to NIS 1,611 million, compared with NIS 1,111 million in the corresponding period in 2005, an increase of 45.0%.

Total Operating and Other Income of the Leumi Group in the first half of 2006 amounted to NIS 1,955 million, compared with NIS 1,793 million in the corresponding period in 2005, an increase of 9.0%. In the second quarter of 2006, total operating and other income amounted to NIS 1,015 million, compared with NIS 906 million in the corresponding period in 2005, an increase of 12.0%.

The increase in operating and other income mainly derives from an increase in income of some 30.0% in commissions from payment system services, when neutralizing the effect of new commissions in respect of the waiver of commissions on the operation of the commission baskets, the increase was of 12.9%, an increase of some 29.3% in commission for dealing with credits and preparing contracts, of some 9.0% in income from customers' operations in the capital market and some 14.2% in income from credit cards. On the other hand, income from account management charges declined by some 36.1% and partially offset these increases. When neutralizing compensatory income in respect of the

operation of the new commission baskets, which were recorded in other commission items, the decline was 10.5%.

The reform of the capital market came into effect as from the second quarter of 2006 and the **Bank** began to charge distribution fees in respect of mutual funds that it distributes. A total of NIS 30 million was collected in the second quarter.

The increase in income from profits on investments in shares derives from the recording of the partial repayment of a debt of a particular customer in the amount of NIS 50 million as a dividend, in accordance with the directives of the Supervisor of Banks. (In accordance with that same directive, the debt is recorded as an investment in shares that are available for sale).

The ratio of operating and other income to total income (i.e. net interest income before provision for doubtful debts and operating and other income) was 36.2%, compared with 35.9% in the corresponding period in 2005 and compared with 35.9% in all of 2005.

Operating and other income covered 52.8% of operating and other expenses, and on neutralizing special expenses, as detailed below, 61.6%, compared with cover of 62.9% in the corresponding period in 2005 and compared with 61.3% in all of 2005.

Total Operating and Other Expenses of the Leumi Group in the first half of 2006 amounted to NIS 3,701 million, compared with NIS 2,849 million in the corresponding period in 2005, an increase of 29.9%. On neutralizing special expenses, as detailed below, the rate of increase is 12.9%. In the second quarter of 2006, total operating and other expenses amounted to NIS 1,880 million, compared with NIS 1,429 million in the corresponding period in 2005, an increase of 31.6%. On neutralizing special expenses, as detailed below, the rate of the increase is 12.7%.

Salary expenses (including the cost of voluntary retirement) amounted in the first half of 2006 to NIS 2,441 million, an increase of 42.0% as compared with the corresponding period in 2005. The increase in salary expenses in the amount of NIS 722 million derives primarily from the adoption of new mortality tables published by the Supervisor of Insurance, which increased the actuarial obligation by the sum of NIS 136 million, and from a provision in respect of holiday gifts to alumni of the Bank in the sum of NIS 89 million (see Note 9 to the Financial Statements for further details), from an increase in the severance and pension provision as a result of an increase in the value of the liability for severance pay that was higher than the increase in the severance pay fund, by the sum of NIS 58 million, from the effect of recording the expenses in respect of the issue of options to the employees of NIS 88 million and from the effect of the recording of the benefit in respect of the sale of shares to the employees by the State in the amount of NIS 191 million. Most of the improvement in the interest margin derived from a rise in the interest margin in the unlinked shekel sector, by 0.23%, which was also affected by the raising of interest by the Bank of Israel. On neutralizing these amounts, the increase in salary expenses was 13.8%. The increase in salary expenses in the second quarter by the rate of some 31.6% derived primarily from the recording of the above special salary expenses, and on neutralizing these amounts, the increase in salary expenses was 14.9%.

Operating and other expenses (maintenance of buildings and equipment, depreciation and others) increased in the first half of 2006 by NIS 130 million, an increase of 11.5%, compared with the corresponding period in 2005.

Operating expenses constituted 68.6% of total income and 58.8% on neutralizing the special salary expenses detailed above, compared with 57.1% in the corresponding period in 2005 and compared with 58.7% in all of 2005.

Total operating and other expenses (in annual terms) constitute 2.74% of total assets, compared with 2.17% in the corresponding period in 2005, and compared with 2.22% in all of 2005.

Operating Profit before Taxes of the Leumi Group in the first half of 2006 amounted to NIS 1,309 million, compared with NIS 1,202 million in the corresponding period in 2005, an increase of 8.9% and on neutralizing special salary expenses, an increase of 48.3%. In the second quarter of 2006, operating profit before taxes amounted to NIS 746 million, compared with NIS 588 million in the corresponding period in 2005, an increase of 26.9% and on neutralizing special salary expenses, an increase of 71.2%.

Provision for Taxes on Operating Profit of the Leumi Group in the first half of 2006 amounted to NIS 638 million, compared with NIS 405 million in the corresponding period in 2005. The rate of provision for the said period was some 48.7% of pre-tax profit, compared with 33.7% in the corresponding period in 2005 (an increase of 15 percentage points).

The increase in the rate of the provision for taxes was principally affected by:

1. Exchange rate differentials in respect of overseas investments that are not included in the tax basis calculation were negative in the said period, compared with positive rates in the corresponding period in 2005, an effect of some 4.3 percentage points.
2. Unrecognized expenses relating to the issue of options and the sale of shares to the employees, an effect of some 3.5 percentage points.
3. The reduction of the rate of profits tax from 17% to 15.5% caused an adjustment of deferred taxes of NIS 25 million, an effect of some 1.9 percentage points. See page 75 below for further details.
4. The recording of deferred receivable taxes pursuant to an arrangement with the tax authorities in the first half of 2005 of some NIS 59 million.

On the other hand, the reduction of the company tax rate from 34% in the first half of 2005 to 31% in 2006 partially offset the said increase.

Operating Profit after Taxes in the first half of 2006 amounted to NIS 671 million, compared with NIS 797 million in the corresponding period in 2005, a decrease of 15.8% and an increase of 28.8% on neutralizing the special expenses. In the second quarter of 2006, operating profit after taxes amounted to NIS 348 million, compared with NIS 416 million in the corresponding period in 2005, a decrease of 16.3% and on neutralizing special salary expenses, an increase of 37.6%.

The Group's Share in Operating Profit after Taxes of Companies Included on the Equity Basis in the first half of 2006 amounted to NIS 98 million, compared with NIS 261 million in the corresponding period in 2005, a decrease of 62.5%. In the second quarter of 2006 the Group's share in operating profit after taxes of companies included on the equity basis amounted to NIS 20 million, compared with NIS 120 million in the corresponding period in 2005, a decrease of 83.3%. As from the second quarter of 2006, the recording of the profits on the equity basis was discontinued in respect of Africa Israel Investments, which was sold on 27 March 2006, and in respect of Migdal Insurance and Financial Holdings, 10% of the holdings in which were sold on 15 March 2006. Furthermore there was a decrease in the profit of The Israel Corporation.

Minority Interests in the Profits (Losses) of the Group in the first half of 2006 amounted to a profit NIS 2 million, compared with a loss of NIS 14 million in the corresponding period in 2005.

Net Operating Profit in the first half of 2006 amounted to NIS 767 million, compared with NIS 1,072 million in the corresponding period in 2005, a decrease of 28.5%. In the second quarter of 2006, net operating profit amounted to NIS 367 million, compared with NIS 541 million in the corresponding period in 2005, a decrease of 32.2%. Neutralizing special salary expenses, as detailed above, there was an increase of 5.2% and of 9.8%, respectively.

Net After-Tax Profit from Extraordinary Items in the first half of 2006 amounted to a profit of NIS 723 million, compared with NIS 34 million in the corresponding period in 2005. The profit derives from the sale of the Bank's holdings in Africa Israel Investments and the sale of 10% of the Bank's holdings in Migdal Insurance and Financial Holdings. For further details, see pages 55 and 56 below.

Ratio of Operating Profit before Taxes to Net Shareholders' Equity* in annual terms was 19.4% in the first half of 2006, compared with 18.6% in the corresponding period in 2005.

Ratio of Net Operating Profit to Shareholders' Equity (Net Return on Equity*) in annual terms was 9.7% in the first half of 2006, compared with 12.1% in the corresponding period in 2005.

Net Operating Profit per share reached NIS 0.542 in the first half of 2006, compared with NIS 0.758 in the corresponding period in 2005.

Net Profit per share reached NIS 1.053 in the first half of 2006, compared with NIS 0.782 in the corresponding period in 2005.

* Shareholders' equity together with minority interests, less capital investments in companies included on the equity basis. The profit does not include the profit of companies included on the equity basis.

Return on Shareholders' Equity in Annual Terms (excluding minority interests) of ^(a):

	2006	2005
	First half	
	%	
Net profit	19.5*	15.3
Net operating profit	9.8*	14.8

* Neutralizing special salary expenses 24.7% and 14.9% respectively.

	2006		2005			
	2nd Qtr	1st Qtr	4th Qtr	3rd Qtr	2nd Qtr	1st Qtr
	%					
Net profit	9.0	30.8(d)	11.5(c)	14.9	15.8(b)	14.9
Net operating profit	8.8	10.4	10.3	15.0	14.7	14.9

The return on equity was considerably affected by special salary expenses as detailed on page 23 of the Report.

Following are the returns on neutralizing these effects:

	2006	
	Second quarter	First quarter
	%	
Net profit	15.0	53.3(d)
Net operating profit	14.7	14.3

- (a) The calculation of the return relates to the shareholders' equity at the beginning of each period.
- (b) Includes a profit of NIS 34 million from extraordinary activities which reflects 0.9% of the return for the second quarter of 2005.
- (c) Includes a profit of NIS 46 million from extraordinary activities which reflects 1.1% of the return for the fourth quarter of 2005.
- (d) Includes a profit of NIS 712 million from extraordinary activities (as detailed on pages 55 and 56) which reflects 19.0% of the return for the first quarter of 2006.

Structure and Development of Assets and Liabilities⁽¹⁾

Total Assets of the Leumi Group on 30 June 2006 amounted to NIS 272.4 billion, compared with NIS 272.8 billion at the end of 2005, a decrease of 0.2% and an increase of 3.3% compared with 30 June 2005.

The value of the assets in or linked to foreign currency was some NIS 122.1 billion, some 44.8% of total assets. In the first half of 2006 the shekel appreciated against the US dollar by 3.54% and against the basket of currencies by 1.38%, and depreciated against the Euro by 3.62%. The change in the rate of exchange contributed to a decrease of 0.9% in total assets.

Deposits of the public amounted to NIS 219.4 billion on 30 June 2006, compared with NIS 221.8 billion on 31 December 2005, a decrease of 1.1%, and an increase of 1.4% compared with 30 June 2005. Most of the decrease is explained by the appreciation of the shekel against the US dollar.

The following table sets out the development of deposits of the public according to principal activity segment:

Segment	30 June 2006	31 December 2005	% Change
	NIS millions		
Households	111,801	110,364	1.3
Small businesses	11,777	11,391	3.4
Corporate banking	24,589	28,616	(14.1)
Commercial banking	23,496	23,227	1.2
Construction and real estate	2,526	3,150	(19.8)
Private banking	36,642	35,008	4.7
Financial Management and other	8,541	10,072	(15.2)

Debentures, Capital Notes and Subordinated Capital Notes totaled NIS 17.0 billion on 30 June 2006, compared with NIS 17.3 billion on 31 December 2005, a decrease of 1.3%, and an increase of 27.5% compared with 30 June 2005.

Off-balance sheet activity

The following table sets out the development of balances of the customers' off-balance sheet financial assets* with the Leumi Group:

	30 June 2006	31 December 2005	Change	
	NIS millions		NIS millions	%
Securities portfolios	257,400	245,579	11,821	4.8
of which: Mutual funds**	43,585	44,748	(1,163)	(2.6)
Provident funds***	39,336	38,620	716	1.9
Supplementary training funds	10,233	10,619	(386)	(3.6)
Total	306,969	294,818	12,151	4.1

* Including an increase in the market value of securities.

** Including funds of all the managers in the system.

*** Including assets of customers in respect of which the Group provides operating, management and custodian services.

(1) The changes in percentages were calculated according to the balances in NIS millions.

Credit to the public totaled NIS 178.0 billion on 30 June 2006, compared with NIS 177.3 billion on 31 December 2005, an increase of 0.4%, and an increase of 4.9%, as compared with 30 June 2005. The appreciation of the shekel against the US dollar offset some 0.8% of the growth in credit.

The balance of securities of companies in which the Group has invested totaled NIS 6,230 million on 30 June 2006, compared with NIS 6,330 million on 31 December 2005, a decrease of 1.6%.

The following table sets out the development of overall credit risk* to the public according to principal sectors of the economy:

Economy Sectors	30 June 2006		31 December 2005		Change
	Overall credit risk to the public	Proportion of total	Overall credit risk to the public	Proportion of total	
	NIS millions	%	NIS millions	%	
Agriculture	2,119	0.8	2,160	0.8	(1.9)
Industry	42,041	15.6	40,777	15.2	3.1
Construction and real estate	48,133	17.9	47,820	17.8	0.7
Electricity and water	2,874	1.1	2,743	1.0	4.8
Trade	30,676	11.4	30,340	11.3	1.1
Hotels, accommodation and food services	6,027	2.2	6,273	2.3	(3.9)
Transportation and storage	5,795	2.2	6,360	2.4	(8.9)
Communications and computer services	8,173	3.0	8,444	3.2	(3.2)
Financial services	30,442	11.3	33,967	12.7	(10.4)
Other business services	7,773	2.9	7,570	2.8	2.7
Public and community services	8,137	3.0	7,767	2.9	4.8
Private persons - housing loans	36,406	13.5	31,448	11.7	15.8
Private persons – other	40,608	15.1	42,234	15.9	(3.8)
Total	269,204	100	267,903	100	0.5

* Including off-balance sheet credit risk, investments of the public in debentures and other assets in respect of derivatives.

The following table sets out the development of credit to the public according to principal activity segments:

Segment	30 June 2006	31 December 2005	Change
	NIS millions		%
Households*	44,832	43,668	2.7
Small businesses	13,845	13,476	2.7
Commercial banking	35,008	32,350	8.2
Corporate banking	54,193	57,360	(5.5)
Construction and real estate	23,854	24,490	(2.6)
Private banking	4,805	4,678	2.7

* Credit to households includes also housing loans (mortgages). On neutralizing this credit, credit to households increased by 7.3%. Housing loans (mortgages) to households amounted to NIS 32.8 billion at the end of June 2006, and increased by a rate of 1.1%.

Merger of the Cable Companies

In May 2006 an agreement was signed to merge the activities of the cable companies in the field of broadcasting and the field of the national internal carrier.

Under the agreement, Matav Telecommunication Systems Ltd. (the "Merged Company") would purchase the activities of the other companies in these fields, in exchange for taking-over obligations and/or the allotment of shares in the merged company.

Financing principles were agreed upon for the Merged Company as part of the agreement. Negotiations for the finalization of the financing agreement are taking place, and it has not yet been signed.

Upon completion of the merger, the owners of each of the cable companies will hold shares in the Merged Company, pursuant to the relative number of cable television subscribers that each company had on 30 September 2005 and in accordance with additional adjustments as determined in the merger agreement..

Upon completion of the merger agreement, the Bank is expected to hold some 15.3% of the shares of the Merged Company.

In the estimation of the Management of the Bank, the procedure detailed above will not have a material effect on the Bank's Financial Statements.

Agreement regarding Tower

On 24 August 2006 the banks signed an agreement with Tower Semiconductor Ltd., pursuant to a memorandum of understanding signed in May 2006. Under this agreement, the Bank will convert debt of US\$ 79 million to convertible capital notes in the ratio of US\$ 2 of debt to US\$ 1 convertible capital note, in an amount of some US\$ 40 million. According to a preliminary calculation, the capital notes represent a holding of some 13% of the shares of the company (some 10% on full dilution). Further, a reorganization of the loans will be carried out, so that their repayment will commence in 2009, with a corresponding reduction in the interest payment. In parallel, The Israel Corporation announced an investment of US\$ 100 million in convertible notes.

In the estimation of the Management of the Bank, the reorganization of the loans of the company will not have a material effect on the Bank's Financial Statements.

Problem Loans – the following table sets out the development of the problem loans ⁽¹⁾⁽⁶⁾ according to the classifications determined in directives of the Supervisor of Banks:

	30 June 2006	30 June 2005	31 December 2005
	(NIS millions)		
Non-accrual	2,643	2,912	2,431
Restructured (2)	894	921	985
To be restructured (3)	1,148	1,057	1,070
In temporary arrears	784	739	698
Under special supervision*	12,614	12,218	12,485
Total balance sheet credit to problem borrowers (1)	18,083	17,847	17,669
Off-balance sheet credit risk to problem borrowers (1) (5)*	2,067	2,022	2,060
Other assets in respect of derivatives of problem borrowers	62	89	154
Total overall credit risk in respect of problem borrowers (1)	20,212	19,958	19,883
Assets received in respect of repaid credit	29	16	24
*of which: debts for which there is a specific provision (4)	6,386	6,707	6,936
*of which: credit for housing for which there is a provision according to the extent of the arrears	775	603	673

- (1) Not including problem loans that are covered by collateral that are permitted to be deducted for the purpose of restrictions on the obligations of a borrower and a group of borrowers (Proper Banking Management Directive No. 313).
- (2) Credit that was restructured during the course of the current year and also credit that was restructured in previous years with a waiver of income.
- (3) Credit to borrowers in respect whereof there is a decision of the banking corporation's management for a restructure, but the restructure has not yet been implemented.
- (4) Apart from credit for housing in respect of which there is a provision in accordance with the extent of the arrears.
- (5) As calculated for the purposes of limits on the obligations of a borrower and a group of borrowers, except for guarantees given by a borrower to secure an obligation of a third party.
- (6) Credit to problem borrowers as detailed in the disclosure format.

Credit to Governments as at 30 June 2006 totaled NIS 691 million, compared with NIS 848 million as at 31 December 2005, a decrease of 18.5% and, compared with 30 June 2005, a decrease of 25.6%.

Securities amounted to NIS 47.8 billion as at 30 June 2006, similar to 31 December 2005, and an increase of 3.7% compared with 30 June 2005.

The Bank is a member of the Stock Exchange Clearing House Ltd and the Maof Clearing House Ltd.

As at 30 June 2006, the Bank had pledged debentures in the sum of NIS 112 million to the Stock Exchange Clearing House and debentures in the sum of NIS 1,355 million to the Maof Clearing House, to secure its customers' operations and in respect of the clearing house members' mutual guarantee.

On 29 May 2006, Leumi & Co Investment House Ltd. purchased 5% of the share capital of Cellcom Israel Ltd from Discount Investment Corp. Ltd for a total consideration of some NIS 328 million.

Operational Segments in the Group

The Group operates in different operational segments through the Bank and its subsidiaries in all fields of banking and financial services. Furthermore, the Group invests in non-banking corporations that operate in various fields, including insurance, real estate, shipping, energy, industry and others.

The operational segments are according to characteristics that were determined by the Bank of Israel. A detailed description of the operational segments and the manner of their measurement is detailed in the Annual Report for 2005.

The following table sets out details of the net profit according to operational segments:

Segments	For the six months ending			Net profit on neutralization of special salary expenses*	Change as compared with June 2005
	30 June 2006	30 June 2005	Change		
	NIS millions		%	NIS millions	%
Households	150	252	(40.5)	265	5.2
Small businesses	78	98	(20.4)	117	19.4
Corporate banking	304	(59)	+	321	+
Commercial banking	204	163	25.2	229	40.5
Construction and real estate	135	107	26.2	140	30.8
Private banking	17	18	(5.6)	28	55.6
Financial management and other**	602	527	14.2	770	41.0
Total	1,490	1,106	34.7	1,870	66.2

* on neutralizing special salary expenses, as detailed on page 23 above.

**including profit from extraordinary items, in the amount of NIS 718 million.

1. Households

The following tables set out the profit and loss of the households segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the three months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	(792)	18	1	354	(419)
Inter-segmental	1,212	(1)	(2)	(242)	967
Operating and other income:					
From external sources	124	92	67	28	311
Inter-segmental	2	43	42	1	88
Total income	546	152	108	141	947
Provisions for doubtful debts	20	1	-	18	39
Operating and other expenses:					
External	581	96	90	50	817
Inter-segmental	-	1	-	2	3
Operating profit (loss) before taxes	(55)	54	18	71	88
Provision for taxes	(23)	19	7	23	26
Net profit (loss)	(32)	35	11	48	62

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the three months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	(712)	14	1	568	(129)
Inter-segmental	1,054	-	(1)	(480)	573
Operating and other income:					
From external sources	121	78	55	32	286
Inter-segmental	-	39	90	1	130
Total income	463	131	145	121	860
Provisions for doubtful debts	3	1	-	18	22
Operating and other expenses:					
External	396	80	93	42	611
Inter-segmental	-	-	-	2	2
Operating profit before taxes	64	50	52	59	225
Provision for taxes	26	19	23	23	91
Net profit	38	31	29	36	134

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the six months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	(1,409)	34	3	716	(656)
Inter-segmental	2,237	(2)	(3)	(509)	1,723
Operating and other income:					
From external sources	240	178	142	59	619
Inter-segmental	2	84	132	3	221
Total income	1,070	294	274	269	1,907
Provisions for doubtful debts	36	2	-	102	140
Operating and other expenses:					
External	1,052	190	187	99	1,528
Inter-segmental	-	1	-	5	6
Operating profit (loss) before taxes	(18)	101	87	63	233
Provision for taxes	(7)	33	35	22	83
Net profit (loss)	(11)	68	52	41	150
% Return on equity					10.0
Average balance of assets	10,215	1,361	107	33,138	44,821
Average balance of liabilities	104,212	50	-	12,654	116,916
Average balance of risk assets	9,049	5,754	118	27,055	41,976
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	57,531	-	57,531
Average balance of securities	-	-	33,821	-	33,821
Average balance of other assets under management	287	-	-	8,509	8,796
Balance of credit to the public as of 30 June 2006	10,585	974	85	33,188	44,832
Balance of deposits of the public as of 30 June 2006	103,220	4	-	8,577	111,801

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the six months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	(1,188)	26	1	867	(294)
Inter-segmental	1,876	1	(1)	(685)	1,191
Operating and other income:					
From external sources	243	151	123	65	582
Inter-segmental	1	74	167	3	245
Total income	932	252	290	250	1,724
Provisions for doubtful debts	19	1	-	39	59
Operating and other expenses:					
External	791	158	190	86	1,225
Inter-segmental	-	-	-	5	5
Operating profit before taxes	122	93	100	120	435
Provision for taxes	52	36	44	51	183
Net profit	70	57	56	69	252
% Return on equity					18.4
Average balance of assets	9,106	1,123	47	32,346	42,622
Average balance of liabilities	102,318	47	-	11,977	114,342
Average balance of risk assets	7,892	5,195	47	25,541	38,675
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	50,895	-	50,895
Average balance of securities	-	-	25,942	-	25,942
Average balance of other assets under management	287	-	-	8,676	8,963
Balance of credit to the public as of 31 December 2005	9,846	879	130	32,813	43,668
Balance of deposits of the public as of 31 December 2005	101,594	3	-	8,767	110,364

Effects of the Hostilities in the North on the Activities of the Households Line

Throughout the period of hostilities in the north, branches of the Bank and of The Arab Israel Bank situated on the front line operated in accordance with the directives of the Home Front Command and the Bank of Israel. Despite the limitations, the Bank arranged to provide business support to its customers, in order to preserve, as far as possible, normal economic and banking activities for the residents of the north:

- For purposes of answering the banking needs of the residents of the north – the LeumiCall center operated every day until 11:00 pm, while giving priority to residents of the north.
- Automated mobile bank branches were operated to provide banking services to customers living on the front line.
- An arrangement was set up to enable customers in the north of all the banks to cash cheques in an amount of up to NIS 600.
- Commission rates on cash withdrawals by holders of accounts at other branches were reduced for all customers of the Bank.
- Leumi allowed all northern residents to receive low interest assistance loans with favourable repayment terms. The loans granted are in an amount of up to NIS 50,000 for

business owners, and an amount of one month's salary or NIS 10,000 for salary earners (repayment spread over 18 months, with the option of postponing repayments for 3 months). The loans are commission-free.

- Reserve duty soldiers who received emergency mobilization orders due to the war in the north, were entitled to receive assistance loans of up to NIS 10,000 on preferential terms (re-payment spread over 18 months, with the option of postponing repayments for 3 months). The loans granted were commission-free.
- Leumi Card allowed its business customers to receive loans on special terms (up to NIS 45,000 for a period of up to 24 months, with the first repayment being a month after the granting of the loan) and an exemption from minimum commission charges.
- Leumi Mortgage Bank allowed mortgage customers who are residents of the north to defer mortgage repayments for up to 4 months.

At this stage, the Bank is unable to estimate the effect of the war on the business activities of the households and small businesses segment, due to the fact that most of the effect, if any, will become apparent in the coming months. In addition, the operation of compensation arrangements or the receipt of government guarantees may reduce the effect of the hostilities on the customers.

Main Changes in the Scope of Activity

Total credit to the public in the households segment increased by NIS 1,164 million compared with the end of 2005, an increase of 2.7%. On neutralizing housing loans, credit grew by 7.3% and housing loans grew by 1.1%. Deposits of the public rose by NIS 1,437 million compared with the end of 2005, an increase of 1.3%.

Pension Counseling

Following the legislation of August 2005, implementing the reform in the capital market, the Bank is making preparations to obtain a license to engage in pension counseling from the Supervisor of the Capital Market, Insurance and Savings.

The Bank intends to begin pension counseling activities this year, subject to receipt of the said license.

As a pre-condition for the receipt of license, the banking activities must be adapted to the new business environment. The Bank has been making preparations for this during the course of 2006, as follows:

Structural adaptation – as part of the implementation of the reform, Leumi is required to sell its holdings in mutual fund and provident fund management companies, and to reduce its holdings in other companies, such as insurance companies. For additional details regarding the sales undertaken by the Bank, see pages 65 to 67 and Note 8.

Recruiting and training of personnel - the Bank is training investment counselors as pension counselors, and is also recruiting and training pension counselors for the branches and districts.

Mechanized preparations – the Bank is developing a counseling support system, which will assist the pension counselors in advising customers regarding investments in pension products adapted to their particulars, needs and preferences. In addition, the Bank is preparing to set-up two-way interfaces with institutional bodies who manage pension products, for the purposes of transfer of information and the ongoing carrying-out of activities.

Preparation of procedures and work routines – work procedures are being written and adapted to the new business environment and work routines are being developed for pension counselors, to ensure the existence of correct work processes.

Signing of distribution agreements – the Bank is in the advanced stages of negotiations with most of the institutional bodies who manage pension products to finalize agreements for the arrangement of distribution of pension products. So far, the Bank and The Arab Israel Bank Ltd. have signed distribution agreements with Halman-Aldubi Provident Funds Ltd. and Halman-Aldubi Pension Funds Ltd.

Main Changes in Net Profit

Net profit in the households segment totaled NIS 150 million in the first half of 2006, compared with NIS 252 million in the corresponding period in 2005, a decrease of 40.5%. The net profit on neutralizing the expenses as detailed below amounted to NIS 265 million, an increase of 5.2%. The decrease in profit stems from an increase in the provisions for doubtful debts in the mortgage sector (Leumi Mortgage Bank, see Note 2B to the Financial Statements) and an increase in operating expenses of NIS 304 million, of which some NIS 150 million is from the effect of the benefit in respect of the sale of shares to employees and the allotment of options to employees. Total income grew by NIS 183 million, which partially offset the aforesaid.

2. Small Businesses

The following tables set out the profit and loss of the small businesses segment:

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the three months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	253	4	2	2	261
Inter-segmental	(39)	(3)	(2)	(2)	(46)
Operating and other income:					
From external sources	94	18	4	-	116
Inter-segmental	-	(7)	3	-	(4)
Total income	308	12	7	-	327
Provisions for doubtful debts	22	-	-	-	22
Operating and other expenses:					
External	247	14	4	-	265
Inter-segmental	-	-	-	-	-
Operating profit (loss) before taxes	39	(2)	3	-	40
Provision for taxes	14	-	1	-	15
Operating profit (loss) after taxes	25	(2)	2	-	25
Share of profits of companies included on the equity basis	-	1	-	-	1
Net profit (loss)	25	(1)	2	-	26

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the three months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	213	4	1	2	220
Inter-segmental	(21)	(2)	(2)	(1)	(26)
Operating and other income:					
From external sources	86	26	6	-	118
Inter-segmental	2	(15)	5	-	(8)
Total income	280	13	10	1	304
Provisions for doubtful debts	26	-	-	-	26
Operating and other expenses:					
External	177	13	7	-	197
Inter-segmental	1	-	-	-	1
Operating profit before taxes	76	-	3	1	80
Provision for taxes	36	-	-	-	36
Net profit	40	-	3	1	44

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the six months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	475	9	5	4	493
Inter-segmental	(57)	(4)	(5)	(3)	(69)
Operating and other income:					
From external sources	182	42	8	-	232
Inter-segmental	1	(18)	10	-	(7)
Total income	601	29	18	1	649
Provisions for doubtful debts	31	-	-	-	31
Operating and other expenses:					
External	452	26	11	-	489
Inter-segmental	-	-	-	-	-
Operating profit before taxes	118	3	7	1	129
Provision for taxes	47	2	3	-	52
Operating profit after taxes	71	1	4	1	77
Share in profits of companies included on the equity basis	-	1	-	-	1
Net profit (loss)	71	2	4	1	78
% Return on equity					19.7
Average balance of assets	13,157	174	189	99	13,619
Average balance of liabilities	11,608	67	-	-	11,675
Average balance of risk assets	10,354	709	218	98	11,379
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	5,802	-	5,802
Average balance of securities	-	-	2,592	-	2,592
Average balance of other assets under management	437	-	-	-	437
Balance of credit to the public as of 30 June 2006	13,460	156	129	100	13,845
Balance of deposits of the public as of 30 June 2006	11,777	-	-	-	11,777

	Banking and finance	Credit cards	Capital market	Mortgages	Total
For the six months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	416	9	3	3	431
Inter-segmental	(42)	(3)	(3)	(2)	(50)
Operating and other income:					
From external sources	175	50	9	-	234
Inter-segmental	1	(27)	13	-	(13)
Total income	550	29	22	1	602
Provisions for doubtful debts	32	-	-	-	32
Operating and other expenses:					
External	356	25	13	-	394
Inter-segmental	-	-	-	-	-
Operating profit before taxes	162	4	9	1	176
Provision for taxes	73	2	3	-	78
Net profit	89	2	6	1	98
% Return on equity					26.9
Average balance of assets	12,100	187	177	105	12,569
Average balance of liabilities	10,361	77	-	-	10,438
Average balance of risk assets	9,418	747	177	105	10,447
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	4,954	-	4,954
Average balance of securities	-	-	1,811	-	1,811
Average balance of other assets under management	432	-	-	-	432
Balance of credit to the public as of 31 December 2005	12,973	155	250	98	13,476
Balance of deposits of the public as of 31 December 2005	11,391	-	-	-	11,391

Hostilities in the North

At this early stage, it is not possible to estimate the effect of the hostilities in the north due to uncertainty regarding various factors, such as the compensation arrangements of the government which have yet to be finally determined.

Main Changes in the Scope of the Activity

Total credit to the public in the segment increased by NIS 369 million as compared with the end of 2005, an increase of 2.7%. Total deposits of the public increased by NIS 386 million, an increase of 3.4%.

Main Changes in the Net Profit

Net profit in the small businesses segment totaled NIS 78 million in the first half of 2006, compared with NIS 98 million in the corresponding period in 2005, a decrease of 20.4%. The reduction in profit stemmed from an increase of NIS 95 million in operating expenses, of which

NIS 52 million was special salary expenses. On the other hand, income grew by NIS 47 million, which partially offset the increase in expenses. On neutralizing special salary expenses, the net profit amounted to NIS 117 million, an increase of 19.4%.

3. Corporate Banking

The following tables set out the profit and loss of the corporate banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the three months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	689	4	1	60	754
Inter-segmental	(431)	(1)	(1)	40	(393)
Operating and other income:					
From external sources	89	36	5	11	141
Inter-segmental	1	(30)	2	-	(27)
Total income	348	9	7	111	475
Provisions for doubtful debts	82	-	-	-	82
Operating and other expenses:					
External	84	20	4	39	147
Inter-segmental	1	-	-	32	33
Operating profit (loss) before taxes	181	(11)	3	40	213
Provision for taxes	70	(4)	1	11	78
Net profit (loss)	111	(7)	2	29	135

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the three months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	277	2	-	65	344
Inter-segmental	(31)	-	-	41	10
Operating and other income:					
From external sources	40	21	5	12	78
Inter-segmental	1	(17)	2	-	(14)
Total income	287	6	7	118	418
Provisions for doubtful debts	383	-	-	8	391
Operating and other expenses:					
External	71	12	4	42	129
Inter-segmental	2	-	-	29	31
Operating profit (loss) before taxes	(169)	(6)	3	39	(133)
Provision for taxes	(75)	(3)	1	13	(64)
Net profit (loss)	(94)	(3)	2	26	(69)

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the six months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	1,200	7	1	123	1,331
Inter-segmental	(662)	(2)	(1)	85	(580)
Operating and other income:					
From external sources	136	64	10	22	232
Inter-segmental	1	(53)	5	-	(47)
Total income	675	16	15	230	936
Provisions for doubtful debts	90	-	-	-	90
Operating and other expenses:					
External	166	34	8	81	289
Inter-segmental	1	-	-	67	68
Operating profit (loss) before taxes	418	(18)	7	82	489
Provision for taxes	166	(6)	3	22	185
Net profit (loss)	252	(12)	4	60	304
% Return on equity					14.0
Average balance of assets	47,136	40	29	10,948	58,153
Average balance of liabilities	19,246	129	-	13,040	32,415
Average balance of risk assets	49,693	164	34	11,614	61,505
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	4,433	53	4,486
Average balance of securities	-	-	46,898	1,112	48,010
Average balance of other assets under management	689	-	-	-	689
Balance of credit to the public as of 30 June 2006	43,846	1	18	10,328	54,193
Balance of deposits of the public as of 30 June 2006	13,879	-	-	10,710	24,589

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the six months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	667	3	-	122	792
Inter-segmental	(173)	-	-	73	(100)
Operating and other income:					
From external sources	75	40	10	23	148
Inter-segmental	3	(33)	6	-	(24)
Total income	572	10	16	218	816
Provisions for doubtful debts	624	-	-	8	632
Operating and other expenses:					
External	141	24	7	79	251
Inter-segmental	2	-	-	57	59
Operating profit (loss) before taxes	(195)	(14)	9	74	(126)
Provision for taxes	(88)	(5)	4	22	(67)
Net profit (loss)	(107)	(9)	5	52	(59)
% Return on equity					(2.7)

Average balance of assets	46,568	26	20	9,760	56,374
Average balance of liabilities	19,662	109	-	12,135	31,906
Average balance of risk assets	48,320	132	20	9,813	58,285
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	4,567	-	4,567
Average balance of securities	-	-	35,493	955	36,448
Average balance of other assets under management	723	-	-	-	723
Balance of credit to the public as of 31 December 2005	47,065	1	39	10,255	57,360
Balance of deposits of the public as of 31 December 2005	16,405	-	-	12,211	28,616

Main Changes in the Scope of Activity

Total credit to the public in the segment decreased by NIS 3,167 million, 5.5%, as compared with the end of 2005. The decrease arose mainly from the reduction in one large credit which was made available towards the end of 2005 and the appreciation of the shekel as against the dollar; and total deposits of the public decreased by NIS 4,027 million, 14.1%, mainly "jumbo" deposits.

Main Changes in Net Profit

Net profit in the corporate banking segment totaled NIS 304 million in the first half of 2006, compared with a loss of NIS 59 million in the corresponding period in 2005. The increase in profit mainly stems from a decline of NIS 542 million in provisions for doubtful debts. Further, income rose by NIS 120 million, 14.7%, which was partly offset by the increase in expenses by NIS 47 million, 15.2%.

Hostilities in the North

At this early stage, it is not possible to estimate the effect of the hostilities in the north due to uncertainty regarding various factors, such as the compensation arrangements of the government which have yet to be finally determined.

4. Commercial Banking

The following tables set out the profit and loss of the commercial banking segment:

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas activities	Total
For the three months ending 30 June 2006						
NIS millions						
Net interest income:						
From external sources	355	3	1	4	64	427
Inter-segmental	(119)	(1)	(1)	(4)	(11)	(136)
Operating and other income:						
From external sources	67	10	20	-	8	105
Inter-segmental	-	(8)	3	-	1	(4)
Total income	303	4	23	-	62	392
Provisions for doubtful debts	37	-	-	-	3	40
Operating and other expenses:						
External	152	6	6	-	36	200
Inter-segmental	4	(1)	-	-	-	3
Operating profit (loss) before taxes	110	(1)	17	-	23	149
Provision for taxes	46	(1)	7	-	6	58
Net profit	64	-	10	-	17	91

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas activities	Total
For the three months ending 30 June 2005						
NIS millions						
Net interest income:						
From external sources	263	1	-	10	59	333
Inter-segmental	(63)	-	-	(8)	(8)	(79)
Operating and other income:						
From external sources	53	11	18	1	8	91
Inter-segmental	1	(8)	1	-	-	(6)
Total income	254	4	19	3	59	339
Provisions for doubtful debts	40	-	-	(1)	(4)	35
Operating and other expenses:						
External	100	6	6	-	30	142
Inter-segmental	2	-	-	-	-	2
Operating profit (loss) before taxes	112	(2)	13	4	33	160
Provision for taxes	48	-	5	1	10	64
Net profit (loss)	64	(2)	8	3	23	96

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas activities	Total
For the six months ending 30 June 2006						
NIS millions						
Net interest income:						
From external sources	646	5	2	9	124	786
Inter-segmental	(183)	(2)	(2)	(7)	(22)	(216)
Operating and other income:						
From external sources	130	20	39	-	17	206
Inter-segmental	-	(14)	9	-	1	(4)
Total income	593	9	48	2	120	772
Provisions for doubtful debts	62	-	-	4	3	69
Operating and other expenses:						
External	271	10	14	1	67	363
Inter-segmental	8	(1)	-	-	-	7
Operating profit (loss) before taxes	252	-	34	(3)	50	333
Provision for taxes	103	-	14	(1)	13	129
Net profit (loss)	149	-	20	(2)	37	204
% Return on equity						17.1
Average balance of assets	27,629	48	80	361	9,003	37,121
Average balance of liabilities	17,367	40	-	304	7,655	25,366
Average balance of risk assets	27,801	245	93	372	5,541	34,052
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	4,815	-	162	4,977
Average balance of securities	-	-	48,615	-	2,011	50,626
Average balance of other assets under management	1,254	-	-	-	-	1,254
Balance of credit to the public as of 30 June 2006	28,275	56	55	310	6,312	35,008
Balance of deposits of the public as of 30 June 2006	15,469	-	-	72	7,955	23,496

	Banking and finance in Israel	Credit cards	Capital market	Mortgages	Overseas activities	Total
For the six months ending 30 June 2005						
NIS millions						
Net interest income:						
From external sources	532	3	1	14	106	656
Inter-segmental	(123)	(1)	(1)	(11)	(16)	(152)
Operating and other income:						
From external sources	108	21	29	1	14	173
Inter-segmental	1	(15)	12	-	-	(2)
Total income	518	8	41	4	104	675
Provisions for doubtful debts	102	-	-	(2)	(5)	95
Operating and other expenses:						
External	211	10	15	2	58	296
Inter-segmental	6	1	-	-	-	7
Operating profit (loss) before taxes	199	(3)	26	4	51	277
Provision for taxes	88	(1)	11	1	15	114
Net profit (loss)	111	(2)	15	3	36	163
% Return on equity						14.8

Average balance of assets	26,061	46	98	434	8,280	34,919
Average balance of liabilities	15,255	51	-	415	7,147	22,868
Average balance of risk assets	25,011	180	98	420	4,982	30,691
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	4,672	-	-	4,672
Average balance of securities	-	-	30,345	-	1,874	32,219
Average balance of other assets under management	1,214	-	-	-	-	1,214
Balance of credit to the public as of 31 December 2005	26,412	43	104	325	5,466	32,350
Balance of deposits of the public as of 31 December 2005	16,351	-	-	60	6,816	23,227

Main Changes in the Scope of Activity

Total credit to the public in the segment increased by NIS 2,658 million, 8.2%, as compared with the end of 2005, and total deposits of the public increased by NIS 269 million, 1.2%.

Main Changes in Net Profit

Net profit in the commercial banking segment totaled NIS 204 million in the first half of 2006, compared with NIS 163 million in the corresponding period in 2005, an increase at the rate of 25.2%. On neutralizing special salary expenses the net profit amounted to NIS 229 million, an increase of 40.5%. The increase in profit arose from an increase in income of NIS 97 million, 14.4%, and a decrease of NIS 26 million, 27.4%, in provisions for doubtful debts. Expenses increased by NIS 67 million, of which special salary expenses were NIS 33 million.

Net profit of the segment from activities of the Bank in Israel rose by 34.4% and there was no change in activities of the segment in the U.K.

Hostilities in the North

At this early stage, it is not possible to estimate the effect of the hostilities in the north due to uncertainty regarding various factors, such as the compensation arrangements of the government which have yet to be finally determined.

5. The Construction and Real-Estate Segment

The following tables set out the profit and loss of the construction and real estate division:

	Banking and finance in Israel	Capital market	Overseas activities	Total
For the three months ending 30 June 2006				
NIS millions				
Net interest income:				
From external sources	446	-	19	465
Inter-segmental	(302)	-	(7)	(309)
Operating and other income:				
From external sources	14	1	-	15
Inter-segmental	-	-	-	-
Total income	158	1	12	171
Provisions for doubtful debts	24	-	-	24
Operating and other expenses:				
External	24	-	1	25
Inter-segmental	-	-	2	2
Operating profit before taxes	110	1	9	120
Provision for taxes	44	1	2	47
Net profit	66	-	7	73

	Banking and finance in Israel	Capital market	Overseas activities	Total
For the three months ending 30 June 2005				
NIS millions				
Net interest income:				
From external sources	390	-	18	408
Inter-segmental	(234)	-	(6)	(240)
Operating and other income:				
From external sources	8	1	-	9
Inter-segmental	-	-	-	-
Total income	164	1	12	177
Provisions for doubtful debts	3	-	3	6
Operating and other expenses:				
External	17	-	2	19
Inter-segmental	-	-	2	2
Operating profit before taxes	144	1	5	150
Provision for taxes	61	1	3	65
Net profit	83	-	2	85

	Banking and finance in Israel	Capital market	Overseas activities	Total
For the six months ending 30 June 2006				
NIS millions				
Net interest income:				
From external sources	793	-	39	832
Inter-segmental	(494)	-	(15)	(509)
Operating and other income:				
From external sources	27	2	-	29
Inter-segmental	-	-	-	-
Total income	326	2	24	352
Provisions for doubtful debts	75	-	-	75
Operating and other expenses:				
External	44	-	3	47
Inter-segmental	-	-	5	5
Operating profit before taxes	207	2	16	225
Provision for taxes	84	1	5	90
Net profit	123	1	11	135
% Return on equity				12.3
Average balance of assets	23,674	-	996	24,670
Average balance of liabilities	2,752	-	313	3,065
Average balance of risk assets	29,720	-	1,136	30,856
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	208	-	208
Average balance of securities	-	10,647	6	10,653
Average balance of other assets under management	78	-	-	78
Balance of credit to the public as of 30 June 2006	23,008	-	846	23,854
Balance of deposits of the public as of 30 June 2006	2,242	-	284	2,526

	Banking and finance in Israel	Capital market	Overseas activities	Total
For the six months ending 30 June 2005				
NIS millions				
Net interest income:				
From external sources	696	-	33	729
Inter-segmental	(401)	-	(10)	(411)
Operating and other income:				
From external sources	18	2	1	21
Inter-segmental	-	-	-	-
Total income	313	2	24	339
Provisions for doubtful debts	105	-	3	108
Operating and other expenses:				
External	35	-	3	38
Inter-segmental	-	-	4	4
Operating profit before taxes	173	2	14	189
Provision for taxes	76	1	5	82
Net profit	97	1	9	107
% Return on equity				9.7

Average balance of assets	25,439	-	987	26,426
Average balance of liabilities	2,399	-	215	2,614
Average balance of risk assets	29,332	-	999	30,331
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	190	-	190
Average balance of securities	-	9,205	4	9,209
Average balance of other assets under management	20	-	-	20
Balance of credit to the public as of 31 December 2005	23,407	-	1,083	24,490
Balance of deposits of the public as of 31 December 2005	2,785	-	365	3,150

Main Changes in the Scope of Activity

Total credit to the public in the construction and real estate segment decreased by NIS 636 million, 2.6%, as compared with the end of 2005, and total deposits of the public decreased by NIS 624 million, 19.8%.

Main Changes in Net Profit

Net profit in the construction and real estate segment totaled NIS 135 million in the first half of 2006, compared with NIS 107 million in the corresponding period in 2005, an increase at the rate of 26.2%. The increase in profit mainly stems from a decline of NIS 33 million, 30.6%, in provisions for doubtful debts. Total income grew by NIS 13 million, which was offset by a corresponding increase in expenses.

Hostilities in the North

At this early stage, it is not possible to estimate the effect of the hostilities in the north due to uncertainty regarding various factors, such as the compensation arrangements of the government which have yet to be finally determined.

6. Private Banking

The following tables set out the profit and loss of private banking:

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the three months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	(195)	-	-	(35)	(230)
Inter-segmental	232	-	-	79	311
Operating and other income:					
From external sources	9	-	24	61	94
Inter-segmental	-	-	3	2	5
Total income	46	-	27	107	180
Operating and other expenses:					
External	52	-	18	71	141
Inter-segmental	(1)	-	-	18	17
Operating profit (loss) before taxes	(5)	-	9	18	22
Provision for taxes	(2)	-	2	6	6
Operating profit (loss) after taxes	(3)	-	7	12	16
Minority interests in profits of consolidated companies	-	-	-	(3)	(3)
Net profit (loss)	(3)	-	7	9	13

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the three months ending 30 June 2005					
NIS millions					
Net interest income:					
From external sources	(178)	-	-	(19)	(197)
Inter-segmental	210	-	-	59	269
Operating and other income:					
From external sources	8	-	23	53	84
Inter-segmental	1	-	4	1	6
Total income	41	-	27	94	162
Provisions for doubtful debts	-	-	-	1	1
Operating and other expenses:					
External	38	1	14	80	133
Inter-segmental	-	-	-	16	16
Operating profit (loss) before taxes	3	(1)	13	(3)	12
Provision for taxes	1	-	6	-	7
Operating profit (loss) after taxes	2	(1)	7	(3)	5
Minority interests in (profits) losses of consolidated companies	(2)	-	-	2	-
Net profit (loss)	-	(1)	7	(1)	5

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the six months ending 30 June 2006					
NIS millions					
Net interest income:					
From external sources	(429)	-	-	(65)	(494)
Inter-segmental	512	-	-	155	667
Operating and other income:					
From external sources	20	-	48	120	188
Inter-segmental	1	-	8	4	13
Total income	104	-	56	214	374
Operating and other expenses:					
External	105	1	34	171	311
Inter-segmental	(1)	-	-	39	38
Operating profit (loss) before taxes	-	(1)	22	4	25
Provision for taxes	-	-	7	2	9
Operating profit (loss) after taxes	-	(1)	15	2	16
Minority interests in losses of consolidated companies	-	-	-	1	1
Net profit (loss)	-	(1)	15	3	17
% Return on equity					10.3
Average balance of assets	1,749	6	-	6,432	8,187
Average balance of liabilities	24,999	-	-	12,927	37,926
Average balance of risk assets	946	42	-	3,655	4,643
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	3,298	1,651	4,949
Average balance of securities	-	-	25,829	35,097	60,926
Average balance of other assets under management	451	-	-	-	451
Balance of credit to the public as of 30 June 2006	1,652	6	-	3,147	4,805
Balance of deposits of the public as of 30 June 2006	25,514	-	-	11,128	36,642

	Banking and finance in Israel	Credit cards	Capital market	Overseas activities	Total
For the six months ending 30 June 2005 NIS millions					
Net interest income:					
From external sources	(308)	-	-	(24)	(332)
Inter-segmental	373	-	-	101	474
Operating and other income:					
From external sources	16	-	45	113	174
Inter-segmental	1	-	9	3	13
Total income	82	-	54	193	329
Provisions for doubtful debts	-	-	-	1	1
Operating and other expenses:					
External	76	1	29	158	264
Inter-segmental	-	-	-	31	31
Operating profit (loss) before taxes	6	(1)	25	3	33
Provision for taxes	2	-	11	1	14
Operating profit after taxes	4	(1)	14	2	19
Minority interests in profits of consolidated companies	-	-	-	(1)	(1)
Net profit (loss)	4	(1)	14	1	18
% Return on equity					11.9
Average balance of assets	1,588	5	-	5,959	7,552
Average balance of liabilities	22,115	-	-	11,413	33,528
Average balance of risk assets	837	38	-	3,329	4,204
Average balance of assets of provident funds, mutual funds and supplementary training funds	-	-	2,633	-	2,633
Average balance of securities	-	-	20,880	33,453	54,333
Average balance of other assets under management	517	-	-	-	517
Balance of credit to the public as of 31 December 2005	1,667	6	-	3,005	4,678
Balance of deposits of the public as of 31 December 2005	23,746	-	-	11,262	35,008

Main Changes in the Scope of Activity

Total credit to the public in the private banking segment increased by NIS 127 million, 2.7% as compared with the end of 2005, and total deposits of the public rose by NIS 1,634 million, 4.7%.

Main Changes in Net Profit

The net profit in the private banking segment totaled NIS 17 million in the first half of 2006, compared with NIS 18 million in the corresponding period in 2005. Total income of the segment grew by NIS 45 million, 13.7%, but was offset by an increase in expenses. The decline in profit stems mainly from the negative contribution of some NIS 10 million of the Swiss subsidiary, compared with a negative contribution of NIS 1 million in the corresponding period of 2005. Net profit of the segment from activities in Israel decreased by NIS 7 million, and on neutralizing the special salary expenses, net profit grew by NIS 5 million, 29.4%.

7. Financial Management

The profit in the financial management segment totaled NIS 646 million in the first half of 2006, compared with a profit of NIS 386 million in the corresponding period of 2005. The increase in net profit stems mainly from extraordinary profit of NIS 718 million from the sale of companies included on the equity basis.

On the other hand, the following factors partially offset the above profit:

- An increase in special operating expenses, which were not attributed to the other operating segments, as detailed below: the adoption of the new mortality tables published by the Supervisor of Insurance, a provision in respect of gifts for religious festivals for alumni of the Bank (see Note 9 to the Financial Statements) and an increase in provisions for severance pay and pensions as a result of the increase in the amount of the obligation for severance pay which was greater than the increase in value of the severance pay fund. In total, these three items caused a reduction of some NIS 167 million in net profit.
- The decline in financing profit as a result of the decline in market value of debentures for trading and a decline in the profit from the sale of available for sale debentures caused a reduction of some NIS 69 million in the net profit.
- Negative exchange rate differentials in respect of the overseas investments, mainly in the USA, which led to a decrease in net profit of some NIS 55 million; the tax effect is explained on page 24.
- A decrease in the profits from the Group's companies included on the equity basis in the amount of NIS 159 million, as explained on pages 54 and 55.

Profit from extraordinary items –

On 15 March 2006 the Bank and Leumi Real Holdings sold 10.0% out of their holdings in the fully paid share capital of Migdal Insurance & Financial Holdings and in consequence thereof the rate of the Bank's holding in the share capital of Migdal Holdings declined to 9.98%. Net profit after tax from the said sale totaled NIS 237 million and was recorded as profit from extraordinary items.

On 27 March 2006 the Bank sold all its holdings in Africa Israel Investments. Net profit after tax from the said sale totaled NIS 480 million and was recorded as profit from extraordinary items.

See pages 55 and 56 below for further details in connection with the said sales.

8. **Others** – this segment also includes activities not allocated to the other segments.

This segment includes the other activities of the Group, none of which amounts to a profit segment under the directives of the Bank of Israel.

This activity mainly includes: part of the activities of the capital market companies that are not allocated to other segments and credit card activities.

In the first half of 2006 the loss of the "Others" segment amounted to NIS 44 million, as compared with a profit of NIS 141 million in the corresponding period in 2005.

The following table sets out details of the main changes in NIS millions:

	For the six months ending 30 June		
	2006	2005	Change in amount
Extraordinary profit	4	32	(28)
Operating activity at the Bank	23	21	2
Pia	7	1	6
Psagot Ofek	26	16	10
Leumi & Co.	(4)	18	(22)
Other companies in Israel	6	(3)	9
Overseas companies	18	16	2
Tax adjustments ⁽¹⁾	(124)	40	(164)
Total	(44)	141	(185)

(1) Tax differentials between tax calculations in the segments and the effective tax in the consolidated Report

9. Companies Included on the Equity Basis (Non-Banking) (presented in the Financial Management Segment)

This includes the operating results of the Group's non-banking investments, and is presented in the Financial Management segment.

The total investments of the Leumi Group in companies included on the equity basis was NIS 1,224 million as at 30 June 2006, compared with some NIS 2,064 million as at 31 December 2005.

The following table sets out the main changes:

Name of Company	Balance Sheet Value (in NIS millions)			Market Value (in NIS millions)	
	30 June 2006	31 December 2005	% change	30 June 2006	31 December 2005
The Israel Corporation Ltd.	1,100	1,066	3.2	2,201	2,363
Migdal Insurance and Financial Holdings Ltd. (1)	-	534	-	-	1,355
Africa Israel Investments Ltd. (2)	-	315	-	-	1,197
Af-Sar Ltd.	-	46	-	-	-
Keshet Broadcasting Ltd.	13	11	18.2	-	-
Others	111	92	20.7	-	-
Total	1,224	2,064	(40.7)	2,201	4,915

1. On 15 March 2006 the Bank sold 10% of the share capital of Migdal Insurance and Financial Holdings Ltd, and from 31 March 2006 the balance of the investment appears under "shares available for sale" in the securities item.

2. On 27 March 2006 the Bank sold its entire holdings in Africa Israel Investments.

The contribution to the profit of the Group of the companies included on the equity basis in the first half of 2006 amounted to NIS 98 million, compared with NIS 261 million in the corresponding period in 2005.

The decline in the contribution to profit derived principally from the cessation of the recording of the profits of Migdal Holdings and Africa Israel on the equity basis as of the second quarter of the year, and the decline in the profits of The Israel Corporation.

The following table sets out the companies' contribution to the Group's net profit (in NIS millions):

	For the six months ending 30 June		
	2006	2005	% change
The Israel Corporation Ltd.	62	161	(61.5)
Migdal Insurance and Financial Holdings Ltd.	23	52	-
Africa Israel Investments Ltd.	12	41	-
Af-Sar Ltd.	-	2	-
Keshet Broadcasting Ltd.	1	1	-
Others	-	4	-
	98	261	(62.5)

Holdings in Non-banking Holding Corporations (Conglomerates)

The Bank's holdings in non-banking corporations are subject to restrictions determined in the Banking (Licensing) Law, 1981 (the "Banking Law"). The Banking Law determines, *inter alia*, in Section 24A to the Law that a banking corporation is entitled to hold means of control in only one conglomerate (a "Non-Banking Holding Corporation") - a corporation whose capital exceeds some NIS 1,767 million and which operates in more than three branches of the economy). The Bank has a holding in one conglomerate - The Israel Corporation Ltd. See below with regard to the Bank's holdings in Migdal Insurance and Financial Holdings Ltd. and with regard to the sale of Africa Israel Investments Ltd.

Migdal Insurance and Financial Holdings Ltd. ("Migdal Holdings")

According to the notification to the Bank at the end of June 2005 by Migdal Holdings, and following the examination conducted by the Bank pursuant thereto (based on data and information provided by the Migdal Group), the Bank notified the Bank of Israel during July 2005 that pursuant to the Bank of Israel's interpretation of Section 24A of the Banking Law (an interpretation with which the Bank disagrees), as of the end of March 2005, Migdal Holdings (the company in which the Bank has holdings), operates in more than three branches of the economy and as such is also defined as a "Non-banking Holding Corporation" ("conglomerate"). Therefore, the Bank requested a reasonable transition period for complying with the requirements of the Banking Law in this regard. The Bank further requested the Bank of Israel's assistance in amending the legislation approved following the Bachar Committee's recommendations so that their recommendations regarding the banks' holdings in insurance companies would also apply to the Bank's holdings in Migdal Holdings, and that the Bank would be able to continue to hold part of its holdings in Migdal Holdings.

Following the enactment of the legislation with regard to the reform of the capital market (see Note 8 to the Financial Statements) and without prejudice to the above, and in addition thereto, the Bank was required to sell part of its holdings in Migdal Holdings so that it would no longer hold more than 10% of any type of means of control in Migdal Holdings. The Bank has carried out the sale as detailed below.

Sale of Two Non-Banking Holding Corporations

The Bank of Israel advised the Bank that it is required to sell its holdings in two conglomerates (Africa Israel and/or Migdal Holdings and/or The Israel Corporation) as soon as possible and no later than 30 September 2006. Should one of the two corporations being sold be Migdal Holdings, the Bank would be entitled to sell its holdings in Migdal Holdings in stages by 31 March 2008 as

follows: by 31 March 2007 the holdings of the Bank in Migdal Holdings would not exceed 10%, and by 31 March 2008, the Bank would be required to sell the balance of its holdings in Migdal Holdings (if until such time the Banking Law is not amended so that insurance companies are explicitly excepted from the provisions of Section 24 of the Banking Law).

On 18 January 2006 the Bank notified the Bank of Israel of its intention to sell its holdings in Africa Israel and in Migdal Holdings.

On 1 February 2006, the Board of Directors approved entering into a transaction for the sale of the Bank's entire holdings in Africa Israel to Mr. Lev Leviev (the controlling shareholder of Africa Israel) or a company controlled by him, at a price of NIS 150 per share, reflecting a company value of NIS 7,075 million. On 13 February 2006 an agreement was signed for the sale. The transaction was completed on 27 March 2006. The total consideration to the Bank for the transaction was some NIS 1,131 million. The net profit from the transaction is some NIS 480 million.

On 5 March 2006 an agreement was signed between the Bank and Leumi Real Holdings Ltd., a wholly owned subsidiary of the Bank ("Leumi Holdings") and Participatie Maatschappij Graafschap Holland N.V. (the "Purchaser"), a wholly owned subsidiary of Assicurazioni Generali S.p.A., for the sale of shares in Migdal Holdings constituting 10% of the issued and fully paid share capital of the company owned by the Bank and Leumi Holdings for a total consideration of some US\$ 142 million.

After receipt of the approval of the Supervisor of Insurance, the transaction was completed on 15 March 2006. The net profit from the transaction is some NIS 237 million.

Following the completion of the transaction, 9.98% of the issued and fully paid share capital of Migdal Holdings remains in the hands of the Bank.

Af-Sar Ltd.

An option agreement was signed between the Bank and Africa Israel Investments Ltd. on 31 August 2003, pursuant to which the Bank was granted a put option to sell all of its shares in Af-Sar Ltd. (20% of the shares of Af-Sar Ltd.) to Africa Israel at any time up to 8 March 2006.

On 8 March 2008 the Bank notified Africa Israel Properties Ltd. of the exercise of the put option under the option agreement. The transaction was completed on 9 April 2006 for a consideration of NIS 51.4 million. The net profit from the transaction is some NIS 2 million.

Activities in Products

A. Capital market operations - these operations include the distribution of mutual funds, provident funds and supplementary training funds and portfolio management. In addition, these activities include the activities of Leumi & Co. Investment House Ltd., which specializes in the provision of investment banking services, business and financial services, capital raising, underwriting, organizing public and private issues, economic advice and valuations and of Psagot Ofek Investment House Ltd. which engages in portfolio management and brokerage activities.

A principal part of the capital market activities are in the process of being sold by the Bank in consequence of the reform in the capital market, in a number of transactions that are anticipated to be concluded during 2006. The majority of the assets managed by the said subsidiaries are not consolidated in the Group's Financial Statements.

The following tables set out details of the activities in the capital market as presented in the various operational segments:

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Other	Total
For the three months ending on 30 June 2006								
In NIS millions								
Net interest income	(1)	-	-	-	-	-	3	2
Operating and other income	109	27	7	23	7	1	151	325
Total income	108	27	7	23	7	1	154	327
Operating and other expenses	90	18	4	6	4	-	88	210
Operating profit before taxes	18	9	3	17	3	1	66	117
Net profit	11	7	2	10	2	-	41	73

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Other	Total
For the three months ending on 30 June 2005								
In NIS millions								
Net interest income	-	-	(1)	-	-	-	7	6
Operating and other income	145	27	11	19	7	1	83	293
Total income	145	27	10	19	7	1	90	299
Operating and other expenses	93	14	7	6	4	-	73	197
Operating profit before taxes	52	13	3	13	3	1	17	102
Net profit	29	7	3	8	2	-	11	60

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Other	Total
For the six months ending on 30 June 2006								
In NIS millions								
Net interest income	-	-	-	-	-	-	9	9
Operating and other income	274	56	18	48	15	2	225	638
Total income	274	56	18	48	15	2	234	647
Operating and other expenses	187	34	11	14	8	-	161	415
Operating profit before taxes	87	22	7	34	7	2	73	232
Net profit	52	15	4	20	4	1	40	136

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Real Estate	Other	Total
For the six months ending on 30 June 2005								
In NIS millions								
Net interest income	-	-	-	-	-	-	13	13
Operating and other income	290	54	22	41	16	2	170	595
Total income	290	54	22	41	16	2	183	608
Operating and other expenses	190	29	13	15	7	-	136	390
Operating profit before taxes	100	25	9	26	9	2	47	218
Net profit	56	14	6	15	5	1	32	129

Net profit from the capital market operations amounted to NIS 136 million in the first half of 2006, compared with NIS 129 million in the corresponding period in 2005, an increase of 5.4%.

B. Credit Cards - Leumi Card

This activity mainly includes the issue of credit cards to private customers and providing acquiring services for businesses.

The principal credit card activities are carried out by the subsidiary, Leumi Card, which engages in the issue of credit cards, the provision of acquiring services and the development of payment solutions.

Leumi Card ended the first half of the year with a net profit of NIS 39 million, compared with NIS 26 million in the corresponding period in 2005, an increase of 46.6%.

In the first half of 2006, the volume of activity of Leumi Card credit card holders rose by 13% compared with the activity in the corresponding period of 2005, higher than the overall growth of the whole credit card market, which, according to publications of the Central Bureau of Statistics, stood at 8.8%; the number of cards grew by some 13%. In addition, the number of businesses acquiring through the company is some 40,000, and the volume of clearing increased by 14%. In the first half of 2006, Leumi Card issued some 500 thousand pre-paid gift-cards, the volume of the transactions being carried through them being of over NIS 150 million. Leumi Checks – a limited partnership - carries out the granting of undertakings that checks will be paid and the discounting of checks, and presently deals with some 5,000 businesses.

The following tables set out details of the credit card activities as presented in the various operational segments:

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
For the three months ending on 30 June 2006						
In NIS millions						
Net interest income	17	-	1	2	3	23
Operating and other income	135	-	11	2	6	154
Total income	152	-	12	4	9	177
Provisions for doubtful debts	1	-	-	-	-	1
Operating and other expenses	97	-	14	5	20	136
Operating profit (loss) before taxes	54	-	(2)	(1)	(11)	40
Net profit (loss)	35	-	(1)	-	(7)	27

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
For the three months ending on 30 June 2005						
In NIS millions						
Net interest income	14	-	2	1	2	19
Operating and other income	117	-	11	3	4	135
Total income	131	-	13	4	6	154
Provisions for doubtful debts	1	-	-	-	-	1
Operating and other expenses	80	1	13	6	12	112
Operating profit (loss) before taxes	50	(1)	-	(2)	(6)	41
Net profit (loss)	31	(1)	-	(2)	(3)	25

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
For the six months ending on 30 June 2006						
In NIS millions						
Net interest income	32	-	5	3	5	45
Operating and other income	262	-	24	6	11	303
Total income	294	-	29	9	16	348
Provisions for doubtful debts	2	-	-	-	-	2
Operating and other expenses	191	1	26	9	34	261
Operating profit (loss) before taxes	101	(1)	3	-	(18)	85
Net profit (loss)	68	(1)	2	-	(12)	57

	House-holds	Private banking	Small businesses	Commercial banking	Corporate banking	Total
For the six months ending on 30 June 2005						
In NIS millions						
Net interest income	27	-	6	2	3	38
Operating and other income	225	-	23	6	7	261
Total income	252	-	29	8	10	299
Provisions for doubtful debts	1	-	-	-	-	1
Operating and other expenses	158	1	25	11	24	219
Operating profit (loss) before taxes	93	(1)	4	(3)	(14)	79
Net profit (loss)	57	(1)	2	(2)	(9)	47

Net profit from the credit card operations amounted to some NIS 57 million in the first half of 2006, compared with NIS 47 million in the corresponding period in 2005, an increase of 21.3%.

Interchange Fees

During the last few months, contacts have been held between Leumi Card Ltd., Israel Credit Cards Ltd. and Isracard Ltd. regarding the entering into of a local consensual arrangement relating to the arrangement of cross-acquiring of Visa and MasterCard credit cards between the three said credit card companies. A draft of the agreement was filed with the Director General of the Antitrust Authority for her approval, for the purpose of bringing the consensual arrangement to the Antitrust Tribunal, which would make the proceedings underway in the Tribunal in this regard unnecessary in as far as they relate to Visa cards.

The agreement of all the parties to the consensual arrangement to its filing with the Tribunal is not yet forthcoming, and therefore the Director General's representative notified the Tribunal on 16 July 2006 that the parties have yet to reach a consensual arrangement in this regard.

At the same time, the Accountant General of the Ministry of Finance has contacted the credit card companies, in order to gauge their position with regard to possible legislation that would regulate the opening of the credit card market for cross-acquiring of all the credit cards therein.

The period of the cross-acquiring arrangement between the Bank, Leumi Card Ltd., Israel Discount Bank Ltd., the First International Bank of Israel Ltd. and Israel Credit Cards Ltd. which was brought for the approval of the Antitrust Tribunal is due to end on 6 September 2006.

The company intends to request that the Antitrust Tribunal extend the period of the temporary permit regarding the restrictive arrangement.

On 2 August 2006, the representative of the Antitrust Director General notified the representative of the parties to the arrangement that in light of the expected end of the cross-acquiring arrangement, due to the fact that an acquiring arrangement between the Visa companies or between them and Isracard Ltd. had not been filed with the antitrust supervisory authority in place of the expiring agreement, in order to continue joint acquiring of Visa cards the parties must file an application for the approval of a restrictive arrangement with the Antitrust Tribunal, or file an exemption application with the Antitrust General Director, pursuant to section 14 of the Restrictive Trade Practices Law.

On 24 August 2006, the comments of the General Director on the arrangement proposed by the credit-card companies were received. If the text of the arrangement is agreed, it will be submitted to the Antitrust Tribunal in the near future.

Customer Clubs

In July 2006, an agreement was signed for the establishment of a new customer club for customers of the Supersol supermarket chain, on the basis of credit cards to be issued by Leumi Card. The

agreement is an operating agreement for the activities of the customer club for a period of 10 years. At the same time, a separate entity will be established for the purpose of operating the club (the "Club Company"), in which Supersol and Leumi Card will be partners. A founders' agreement is expected to be signed within 60 days, which will secure the rights of Leumi Card in the initiative.

Profit Centers in the Group

The following table sets out details of the contribution of the Group's major profit centers to net operating profit:

	For the first half			For the first half		
	2006*	2005*	Change	2006**	2005**	Change
	NIS millions		%	NIS millions		%
The Bank	369	453	(18.5)	396	406	(2.5)
Consolidated companies in Israel (1)	194	198	(2.0)	194	198	(2.0)
Overseas consolidated companies (2)	104	161	(35.4)	77	208	(63.0)
Non-banking companies (1)	100	260	(61.5)	100	260	(61.5)
Net operating profit	767	1,072	(28.5)	767	1,072	(28.5)
Overseas' subsidiaries profit, in nominal terms (US\$ millions) (3)	36.6	28.2	29.6	36.6	28.2	29.6

* Translation adjustments in respect of overseas investments were offset against translation adjustments of the financing sources at the Bank after the effect of taxes.

** According to the financial statements

(1) Non-banking companies of Leumi & Co and Leumi Card were included in the data of the consolidated companies in Israel.

(2) After certain adjustments to Israeli accounting principles.

(3) As reported by the overseas subsidiaries, including overseas branches and minority interests.

Following are the Main Changes in the Contribution of the Profit Centers (after translation adjustments):

- The decline in net operating profit at the Bank principally derived from an increase in salary expenses as explained above on page 23 and from an increase in the rate of the provision for taxes, which were partially offset by a decrease in the provisions for doubtful debts and an increase in operating and other income. On neutralizing the effect of the special salary expenses, net operating profit grew by NIS 266 million, a rate of 56.4%.
- The decrease in the net operating profit of consolidated companies in Israel primarily derived from the decrease in the profit of Leumi Mortgage Bank by NIS 34.8 million and of Leumi & Co., by NIS 22.5 million. On the other hand, Leumi Card increased its contribution to profit by NIS 12.3 million.
- The decrease in the profit of overseas subsidiaries derived mainly from negative exchange rate differentials in respect of the investment, as compared with positive exchange rate differentials in the corresponding period in 2005.
- The decline in the contribution of companies included on the equity basis principally derived from a decrease in the profits of The Israel Corporation and also from the cessation of the recording of equity profits from Migdal Insurance and Financial Holdings and Africa Israel Investments, as of the second quarter of 2006.

The overseas subsidiaries' profits in nominal terms as published by them (including the Bank's overseas branches and minority interests) totaled some US\$ 37 million, an increase of US\$ 8 million. The contribution of the overseas subsidiaries in shekels, after certain adjustments to Israeli accounting principles, totaled NIS 104 million, compared with NIS 161 million in the corresponding period in

2005. Excluding the effect of the translation adjustment in respect of the net cost of financing sources, the profit of the overseas subsidiaries amounted to NIS 77 million, as compared with NIS 208 million in the corresponding period in 2005, an decrease of NIS 131 million, mostly arising from negative exchange rate differentials in respect of the overseas investments.

The following table sets out a summary of the above data:

	January to June	
	2006	2005
	NIS millions	
Profits of the subsidiaries in shekels (the Group's share)	127	120
Exchange rate differentials on the investment	(50)	88
Exchange rate differentials on the net cost of financing sources	27	(47)
Total contribution of the subsidiaries (after offset of net financing sources)	104	161

Activities of Major Subsidiaries and Affiliates

Consolidated Subsidiaries in Israel

The Bank's investments in consolidated subsidiaries in Israel amounted to NIS 4,520 million on 30 June 2006, compared with NIS 4,178 million on 31 December 2005. The contribution to net profit was NIS 194.3 million in the first half of 2006, compared with NIS 199.2 million in the corresponding period in 2005, a decrease of 2.5%.

The following table sets out the contribution of the major consolidated companies in Israel to the net profit of the Group:

	Return on Group's Investment		Contribution to Group's Profit (1)		
	For the period ended June 30		For the period ended June 30		Change
	2006	2005	2006	2005	
	%		NIS millions		%
Leumi Mortgage Bank	3.3	7.8	28.8	63.6	(54.7)
Arab Israel Bank	22.2	25.7	33.8	37.3	(9.4)
Leumi Card	-	-	38.7	26.4	46.6
Leumi & Co. Investment House (2)	-	29.9	(2.0)	20.5	-
Psagot Ofek Investment House	57.1	41.1	25.5	14.5	75.9
Leumi Real Holdings	12.5	13.1	17.5	15.2	15.1
Leumi Leasing and Investments	5.1	3.5	17.5	11.7	49.6
Others	8.3	2.4	34.5	10.0	-
Total consolidated subsidiaries in Israel	9.5	10.6	194.3	199.2	(2.5)

(1) The profit (loss) shown is according to the Group's share in the results.

(2) Including the profit and/or loss of the companies included on the equity basis of Leumi & Co.

See Notes 3, 5 and 6 to the Financial Statements in connection with legal claims and other matters relating to consolidated companies.

Leumi Mortgage Bank Ltd.

Leumi Mortgage Bank's profit for the first half of the year amounted to NIS 29 million, compared with a profit of NIS 64 million in the corresponding period in 2005. In the second quarter the net profit amounted to NIS 43 million, compared with a profit of NIS 34 million in the corresponding period in 2005.

The decline in the profit in the first half of the year derives primarily from the increase of some NIS 70 million in provisions for doubtful debts, of which some NIS 64 million was the result of the implementation of the directives issued by the Supervisor of Banks as from 1 January 2006. See Note 2B to the Financial Statements for further details.

Due to the hostilities in the north, Leumi Mortgage Bank permitted hundreds of borrowers in the north to defer up to four monthly mortgage payments. The overall amount of the deferred payments that have been approved, and/or will be approved, is expected to amount to some NIS 10 million. The amounts that have been approved, as aforesaid, will be spread over current repayments, together with the balance of the loan. This approval will terminate at the end of August 2006

Overseas Consolidated Subsidiaries

The Bank's investments in overseas consolidated subsidiaries amounted to NIS 4,299 million on 30 June 2006, compared with NIS 4,220 million on 31 December 2005.

The contribution of the overseas consolidated subsidiaries to the net profit of the Group as reported in shekels, in the first half of 2006, after offsetting translation adjustments, amounted to a profit of NIS 103.6 million, compared with a profit of NIS 160.6 million in the corresponding period in 2005. Most of the decline arises from negative exchange rate differentials in respect of the investment, compared with positive exchange rate differentials in the corresponding period in 2005.

The following table sets out the contribution of the major overseas consolidated companies to the net profit of the Group:

	Return on Group's Investment		Contribution to Group's Profit ^(*)		
	For the period ended June 30		For the period ended June 30		
	2006	2005	2006	2005	Change
	%		NIS millions		%
Leumi USA (BLC)	1.7	11.2	19.5	118.9	(83.6)
Leumi UK	12.4	9.4	54.9	40.8	34.6
Leumi Switzerland	-	-	(1.9)	(13.1)	-
Leumi Luxembourg	11.7	0.7	6.2	0.4	-
Leumi Re	55.5	48.5	24.3	10.9	-
Others	0.5	3.3	0.6	2.7	(83.3)
Total foreign consolidated subsidiaries	4.9	8.2	103.6	160.6	(35.5)

(*) Translation adjustments in respect of the overseas investments were offset against translation adjustments in respect of the Bank's financing sources after the effect of taxes in the amount of NIS 27 million (NIS (47) million in 2005). The sums offset were:

Leumi USA	- NIS 49 million in 2006, compared with NIS (74) million in 2005;
Leumi UK	- NIS (14) million in 2006, compared with NIS 7 million in 2005;
Leumi Switzerland	- NIS (11) million in 2006, compared with NIS 22 million in 2005.

The decrease in the contribution to profit derives mainly from the effect of the appreciation of the exchange rate of the shekel against the dollar, which was partially offset by the effect of the depreciation of the shekel against the euro, the pound sterling and the Swiss franc. The effect of the exchange rate differentials was to decrease pre-tax profit by NIS 50 million in the first half of 2006, compared with an increase of pre-tax profit by NIS 88 million in the corresponding period in 2005. Financing income that was earned by the Bank, and which offset part of these exchange rate differences, totaled some NIS 27 million in the first half of 2006, compared with expenses of NIS 47 million in the corresponding period in 2005.

The following table sets out details of the net profit of the overseas subsidiaries as reported by them:

	For the six months ended June 30		
	2006	2005	Change
	millions		%
Leumi USA (BLC) (US\$)	12.4	13.5	(8.4)
Leumi (UK) (£)	5.6	5.5	1.2
Leumi Switzerland (CHF)	5.6	0.2	-
Leumi Luxembourg (euro)	0.8	0.4	84.0
Leumi Re (US\$)	5.8	2.1	-

The nominal profit of the overseas consolidated subsidiaries as reported by them in the first half of 2006 totaled US\$ 35.3 million, compared with US\$ 26.3 million in the corresponding period in 2005, an increase of 34.1%.

Following is a summary of the assets and liabilities of the Bank's overseas subsidiaries (in US dollar millions* before offsetting mutual balances):

	30 June	31 December
	2006	2005
Credit to the public	4,764	4,429
Deposits with banks	1,977	1,954
Securities	3,748	4,162
Other assets	396	342
Total	10,885	10,887
Deposits of the public	7,976	7,707
Deposits from banks	510	419
Other liabilities	1,346	1,742
Shareholders' equity	1,053	1,019
Total	10,885	10,887
Total deposits on trust and managed securities	9,171	8,676

* The translation into US dollars is a translation of convenience of the data according to the representative exchange rate on 30 June 2006 and 31 December 2005.

Bank Leumi USA and the Bank's agency in New York

As the result of examinations conducted by the supervisory authorities in the USA, Bank Leumi USA and the Bank's agency in New York have agreed to take certain steps, primarily to improve and strengthen the controls and procedures for the prevention of money laundering.

Leumi France

Further to the information provided on page 148 of the Financial Statements for the year 2005.

In July 2006 the investigating judge decided that there is no basis for the claims against Leumi France and its senior employees in connection with involvement in the money laundering matter in which various bodies in France were involved, and the case against them was closed.

Eurom Bank S.A.

On 23 October 2005 the Bank and Kolal B.V. ("Kolal"), the controlling shareholder of Eurom Bank S.A., signed an agreement according to which the Bank would acquire control of Eurom Bank from Kolal.

On 4 August 2006 the transaction between the Bank and Kolal was completed, pursuant to which the Bank acquired from Kolal over 99% of the issued and paid up share capital of Eurom Bank, for a consideration of some US\$ 46 million. An advance and amounts paid to cover loans and expenses in an aggregate US\$ 12 million were offset from this amount.

The following are principal data of Eurom Bank as at 30 June 2006:

total assets – US\$ 160 million.

total credit to the public – US\$ 72 million.

total deposits of the public - US\$ 136 million.

shareholders' equity – US\$ 20 million.

Eurom Bank has 32 branches throughout Romania and employs some 500 employees. Leumi considers this acquisition to be a business opportunity for developing commercial activities in Romania and for expanding activities to Eastern Europe. The Bank intends to increase the shareholders' equity of Eurom Bank by a further US\$ 20 million.

Eurom Bank will change its name to Bank Leumi Romania.

Capital Market and Financial Services Activities of the Bank and the Group

The activities of the Group include a variety of capital market services for all customer sectors, including institutional entities, businesses and households, including: counseling on securities and financial assets, the provision of securities brokerage services to customers, the provision of securities custodian services, management and underwriting of securities issues, activities in the fields of options, futures contracts and structured products, services for portfolio managers who manage their customers' portfolios at the Bank, the provision of services connected with the lending and borrowing of securities and more.

The Group also provides varied financial services through subsidiaries that specialize in additional fields, such as credit card issuing and operation and trust services.

In the first half of 2006, subsidiary companies of the Bank engaged in additional activities: management of provident funds, supplementary training funds and mutual funds and the management of discretionary securities portfolios. These activities were sold by the Bank, as the result of the reform of the capital market, in a number of transactions that are expected to be completed during the course of 2006. Most of the assets managed by these subsidiary companies are not consolidated in the Financial Statements of the Group.

The following table sets out details of income from management fees from mutual funds and provident funds, including supplementary training funds (in NIS millions):

	First Half		Year
	2006	2005	2005
Mutual funds	234	201	427
Provident funds	110	100	201
Supplementary training funds	14	15	32
Total	358	316	660

Following the reform, the Group's activities in the capital market will focus mainly on the provision of investment counseling, the field of pension counseling when the Bank receives a license to engage in this activity, the provision of various services in connection with customers' activities in securities and the provision of operating services to entities operating in the capital market.

Also, the Bank is expected to begin to act as a chief market-maker in Israeli government debentures, having been appointed by the Ministry of Finance to be one of the chief market-makers. Market-making trading is expected to begin on 4 September 2006. Furthermore, as from 24 April 2006, the Bank has been acting as a market maker for futures contracts on Shahr government debentures, it having been appointed by the Tel Aviv Stock Exchange as a market maker for the said contracts.

For further details in respect of the effect of the reform of the capital market and the sale of the holdings in mutual funds and provident funds, see Note 8 to the Financial Statements.

Mutual Funds

The value of the assets of the mutual funds managed by the Group in Israel on 30 June 2006 was NIS 30.5 billion, as compared with NIS 33.8 billion at the end of 2005. The value of the assets of the mutual funds managed by the Group at the end of June 2006 constituted 26.69% of all mutual funds in the sector.

In connection with the notice from the Tel Aviv District of the State Attorney's Office that was received by the Bank and by subsidiary companies, and similar notices that were received by a number of employees of the Bank and of the subsidiary companies, in the matter of alleged offences pursuant to section 82 of the Joint Investment Trust Law, see below on page 74.

The Group operates two mutual fund management companies in Israel:

Leumi-Pia - on 30 June 2006 Leumi-Pia managed 52 mutual funds with assets totaling some NIS 13.1 billion, compared with NIS 15.1 billion at the end of 2005. Its share of total assets of the mutual funds sector at the end of June 2006 was 11.53%.

Following the reform of the capital market, the Bank decided on 15 September 2005 to sell its holdings in Leumi-Pia, at a price of some NIS 535 million, to Harel Insurance Investments Ltd. The sale is subject to the signing of an agreement by the parties and the receipt of regulatory approvals. As part of the negotiations for the signing of an agreement between the parties, an understanding exists between the parties whereby the assets and activities of the company will be sold at prices that reflect the structure of the planned transaction.

Psagot - on 30 June 2006 Psagot managed 59 mutual funds with assets totaling some NIS 17.4 billion, compared with NIS 18.7 billion at the end of 2005. The company's share of total assets of the sector at the end of June 2006 was 15.17%.

On 28 November 2005 the Bank, together with Psagot Ofek Investment House Ltd. and its subsidiaries, including Psagot Managers of Mutual Funds – Leumi Ltd. (the "Psagot Ofek Group"), decided to enter into a binding agreement of principles for the sale of goodwill, activities, assets and liabilities relating to all the assets of the Psagot Ofek Group, with York Capital Management ("York"), on behalf of entities managed by it, at a price of NIS 1,350 million. In addition, the Bank received an option to purchase from York half the means of control in the company that will manage the portfolio management activities. On 23 June 2006 the signing of a detailed agreement between the parties was completed, that is based on the binding agreement of principles and includes a mechanism for adjustment of the consideration, in accordance with the volume of assets to be managed by the Psagot Ofek Group's mutual funds close to the date of the completion of the transaction, and in accordance with the Psagot Ofek Group's financial statements as at the date of the completion of the transaction. According to the mechanism for adjustment of the price pursuant to the volume of assets, as at 24 August 2006 the consideration will be reduced by some NIS 50 million. The agreement also contains various detailed terms with regard to the transaction and its execution, as well as the relations between the Bank, the Psagot Ofek Group and York following the completion of the transaction. In addition, the Bank waived the said option. The completion of the transaction is conditional upon the fulfillment of conditions precedent and the receipt of regulatory approvals, including the receipt of approvals from the Israel Securities Authority. On 2 July 2006 the signing of an additional agreement was completed, pursuant to which the date for the fulfillment of the pre-conditions for the completion of the purchase was extended until 28 September 2006. Following the said extension, it was agreed that amounts accrued in the Psagot Ofek Group amounting to NIS 20 million would be transferred to York, with the activities and assets purchased at the time of the completion of the transaction. York deposited an advance in the sum of NIS 200 million on account of the consideration.

Provident Funds

The provident funds managed by the Leumi Group include provident funds for the self-employed, provident funds for salaried employees, central funds for severance pay and a fund for the payment of sick pay.

The value of the assets of the provident funds managed by the Leumi Group (excluding Ofek Gemel) on 30 June 2006 was some NIS 34.6 billion, compared with some NIS 35.2 billion at the end of 2005.

The Group, through Leumi Gemel Ltd, provides operating and other services to corporate and private funds outside of the Group. The total value of the assets of these funds amounted to NIS 3.9 billion as at 30 June 2006, compared with NIS 2.6 billion at the end of 2005.

Following the legislation on the reform of the capital market, on 26 November 2005, the Bank decided to enter into agreements together with Leumi Gemel Ltd. for the sale of the goodwill, activities, assets and liabilities relating to the provident funds managed by Leumi Gemel Ltd.

A group of five provident funds, the largest of which are the Otzma, Taoz and Rimon provident funds and the management system of these provident funds, was sold to Harel Insurance Investments Ltd., at a price of NIS 675 million. The other provident funds, the largest of which are Sion, the Central Severance Pay Fund, Tzur and Sagi, were sold to Prizma Investment House Ltd. (formerly A. Solomon Investments Ltd.), or a company under its control, at a price of NIS 473 million. As mentioned above, the Leumi Group will continue to provide operating services in relation to the provident funds that were sold, subject to the signing of operating agreements. The transactions are subject to regulatory approvals.

Employees' Supplementary Training Funds

Kahal Employees Supplementary Training Fund Ltd. ("Kahal") (which is under the joint management of the Bank and Israel Discount Bank Ltd.) – the value of the assets managed by Kahal and Kahal Paths Supplementary Training Fund (managed by Kahal Management of Study Funds (1996) Ltd. ("Kahal Management"), a joint subsidiary of the Bank and Israel Discount Bank Ltd.) reached some NIS 10.2 billion on 30 June 2006, compared with some NIS 10.6 billion as at the end of 2005.

Following the reform of the capital market, on 26 May 2006, an agreement was signed between the Bank, Israel Discount Bank Ltd., Kahal and Kahal Management, and between Migdal Capital Markets (1965) Ltd. on behalf of a company under its control and Migdal Insurance and Financial Holdings Ltd. on behalf of a company under its control (the "Purchaser"), for the sale of the goodwill, management rights, additional rights and means of control of the banks in Kahal, and for the sale of the goodwill, activities, assets and liabilities relating to the supplementary training funds managed by Kahal Management, for a consideration of NIS 260 million. Such amount will be adjusted in accordance with the volume of the supplementary training fund assets being sold as at the date of completion. The Bank's share of the consideration amount is NIS 149.5 million.

It has been agreed that the Bank will enter into an agreement with Kahal and with the Purchaser for the provision of operating services by the Bank to the funds sold, and also a distribution agreement, under which the Bank will distribute the funds.

Completion of the transaction is subject to the fulfillment of certain conditions and receipt of regulatory approvals.

Non-Banking Activities of Companies Included on the Equity Basis

Total investments of the Group in companies included on the equity basis amounted to NIS 1,224 million on 30 June 2006, compared with NIS 2,064 million on 31 December 2005.

In the first quarter of 2006 the Bank sold all of its holdings in Africa Israel Investments and 10.0% out of its holdings in Migdal Insurance and Financial Holdings Ltd. As a result, from 31 March 2006 the balance of the holding in Migdal was classified as an investment in securities, in the available for sale portfolio.

In the first half of 2006, the contribution of companies included on the equity basis to net profit amounted to a profit of some NIS 98 million, compared with a profit of some NIS 261 million in the corresponding period in 2005. In the second quarter of the year the contribution to net profit amounted to a profit of some NIS 20 million, compared with some NIS 120 million in the corresponding period in 2005.

Details of the Group's investment in the major company included on the equity basis follow:

The Israel Corporation Ltd.

The Israel Corporation Ltd is a holding company whose principal holdings are in the areas of chemicals (holding 53% of the shares of Israel Chemicals Ltd.), shipping (holding some 97.5% of Zim Integrated Shipping Services Ltd.) and additional interests.

The net profit in the first half of 2006 totaled some NIS 408 million, compared with a profit of some NIS 806 million in the corresponding period in 2005.

The consolidated assets of the Israel Corporation totaled some NIS 25.1 billion as at 30 June 2006, compared with NIS 25.8 billion at the end of 2005.

Shareholders' equity totaled some NIS 5,466 million as at 30 June 2006, compared with some NIS 5,398 million at the end of 2005.

Exposure to Risk and Methods of Risk Management

Market Risk and Liquidity Risk Management

The business results, shareholders' equity, cash-flows and the value of the Bank may be adversely affected by market risks arising from volatility in interest rates, exchange rates, the CPI, security prices in Israel and abroad and other economic indices, that affect the value of the Bank's assets or liabilities.

Ongoing market risk management is intended to assist in achieving business goals by estimating the damage that can result from exposure to the said risks, together with the anticipated profit from managing the risks. The management is based on forecasts and ongoing evaluations of developments in the capital and financial markets. The market risk management policy includes limits on the financial exposure. The limits are intended to reduce damage that may occur as a result of unexpected market changes. The system of limits defines the effect of exposure of the economic value, accounting profit and the liquidity situation to unexpected changes in interest rates, the CPI, exchange rates, etc.

The management of market risks at the Bank also includes the subsidiaries in Israel, with the exception of Leumi Mortgage Bank and Leumi & Co. Investment House Ltd., which have independent market risk policies and management, due to the dissimilar nature of their activity as compared with the Bank.

All the subsidiaries have adopted an independent policy for market risk management and frameworks for market risk exposures in a uniform format as set by the Bank, in addition to their own internal frameworks. These frameworks have been examined by the Bank's Manager of Market Risks and found to be appropriate.

Information regarding the position of the exposures according to the frameworks that have been determined is received from the subsidiaries once a month or upon request, and is taken into account in the overview of the Group's exposures.

Basis Exposure

The basis exposure risk is expressed as the loss that may occur in consequence of changes in the CPI and exchange rates, in consequence of the differentials between the value of the assets and the liabilities, including the effect of futures transactions, in each of the linkage sectors

The exposure to the basis risks is defined as a percentage of the Bank's exposed capital. With the transition to nominal accounting, capital was defined as an unlinked shekel source.

The exposed capital includes shareholders' funds and certain reserves, less investments in subsidiaries and affiliates and fixed assets, with the addition of investments in overseas subsidiaries that are financed from deposits in foreign currency.

The following table sets out the actual exposure at Group level compared with the limits fixed by the Board of Directors. The data is presented in terms of percentage of the exposed capital:

	30 June 2006	30 June 2005*	31 December 2005*	Approved Limits Maximum Surplus (or Deficit)
Unlinked	(41.7%)	(31.3%)	(14.2%)	50% -(100%)
CPI-linked	37.8%	33.7%	14.8%	100% -(50%)
Foreign currency	3.9%	(2.4%)	(0.6%)	25% -(10%)

* Reclassified

The mix of the investment of exposed capital between the various linkage sectors is determined on an ongoing basis within the limits set out above, and on the basis of forecasts regarding relevant market variables.

During the first half of 2006, an average of some 23% of the exposed capital was invested in the CPI-linked sector, the balance being invested in the unlinked shekel sector. No significant amount of capital was routed to the foreign currency (and foreign currency-linked) sector.

In the first half the capital invested in the CPI-linked sector fluctuated between 11.7% and 37.8%. During the first half of 2006 the Group complied with all the basis exposure limits approved by the Board of Directors.

Interest Exposure

The exposure to changes in interest arises from the lack of matching between the interest payment dates and the interest adjustment dates of the assets and liabilities in each of the sectors. For the purpose of managing interest risk, gap reports are examined, on the gap between the assets and liabilities in future periods, and comparisons are made of the average life span of the assets, liabilities and capital in each sector. In addition, in each sector measurement of the exposure to changes in interest is carried out, relating to the potential erosion of the economic capital and the annual accounting profit in consequence of a parallel shift of the yield curve in each of the sectors by 1%.

The following table sets out a summary of the interest exposure at the Group level (in NIS millions):

	Potential Erosion of Economic Value			Potential Erosion of Annual Profit*		
	30 June 2006	30 June 2005	31 December 2005	30 June 2006	30 June 2005	31 December 2005
Effect of a change of 1% in the yield curve						
Actual	636	518	420	184	107	156

* The maximum erosion in annual profit, on the basis of an examination of the next three years.

The interest exposure limits are to a maximum change in the economic value at the Group level of NIS 1,000 million, and to a change in the annual profit of NIS 500 million.

In the first six months of 2006 the Group adopted a policy of increasing the life spans of the assets, and therefore the potential erosion increased from NIS 420 million to NIS 636 million. In this

period, the potential erosion in the economic value and annual profit fluctuated between NIS 480 million and NIS 653 million, and between NIS 126 million and NIS 203 million respectively.

During the first half of 2006 the Bank complied with all the interest exposure limits that had been set by the Board of Directors.

Value at Risk (VAR)

VAR is an estimate of the maximum potential loss arising from the given composition of a portfolio (the forecast decrease in present value of assets less liabilities) over a given time horizon (holding period) and at a given confidence level, due to possible changes in the market values. The VAR is calculated once a month at the Group level, and more frequently at the Bank level and for the trading portfolios.

The VAR calculations and the limits in VAR terms are based on the parametric approach, with a confidence level of 99%, and a holding period of two weeks.

In order to test the validity of the VAR model, the Bank performs daily backtesting by comparing the actual difference in the fair value of the Bank with the VAR change estimated by the model. The tests performed thus far confirm the validity of the model.

The Bank also periodically calculates the VAR using historical simulation, and examines any difference between the two calculation methods. VAR using the historical simulation method enables risk measurement without reliance on a specific underlying distribution structure.

The VAR of the option book in the trading portfolio is examined using both the parametric and Monte Carlo simulation method (this method is used to test the non-linear risk components). The differences observed between the two methods are not significant.

The following table sets out estimates of VAR amounts at the Group level:

	30 June 2006	30 June 2005	31 December 2005
	NIS millions		
Total VAR	287	103	148
VAR of MTM re-valued portfolios	47	29	37

The Board of Directors' VAR limits are NIS 500 million at Group level and a limit of NIS 300 million for the VAR of Mark to Market re-valued portfolios.

During the first half of 2006, there was a significant increase in the VAR, arising mostly from changes in the make up of the Bank's investments and changes in classification. The changes in yields and correlations between the principal variables (interest rates, exchange rate differentials and inflation) did not have a major effect.

During this period, the VAR fluctuated between NIS 148 million and NIS 287 million.

The Group complied with the limits during the first half of 2006.

Liquidity Risk

Liquidity is determined as the ability of the corporation to finance increases in assets and comply with its liability payments. The ability to comply with liquidity risk involves uncertainty regarding the possibility of raising sources and/or realizing assets in an unexpected manner within a short period, without causing a significant loss.

The Bank implements an overall liquidity risk management policy in Israeli and foreign currency (including foreign currency linked), pursuant to the directives of the Bank of Israel. The purpose of the policy is to support the achievement of business goals while evaluating and limiting losses that may arise from exposure to liquidity risks.

The Bank maintains ongoing monitoring over the liquidity position and liquidity risk indices. Liquidity risk is measured and managed through an internal model whose purpose is to evaluate and monitor the liquid means at the Bank's disposal, in various scenarios.

As a part of its planning for an extreme scenario, an emergency plan has been prepared, including the strategy for managing a liquidity crisis, including the appointment of a management team, responsible for dealing with the crisis and defining the procedures and steps required to deal therewith, including the production of sources as speedily as possible in time of crisis.

As well as the model described above, Leumi operates an additional measurement system for early warning of exceptional and unexpected developments in liquidity risk.

As required by the Bank of Israel's Directive No. 342, the Board of Directors has approved the policy for managing liquidity risks and determined limits, with effect from the beginning of 2005, as follows: the liquidity ratio must be higher than 1 and the liquidity gap must be higher than zero in each of the scenarios during the planned periods of one day, one week and one month.

The Bank complied with the limits during the first half of 2006.

For further details regarding management of market risks, see pages 158-168 of the Annual Report for 2005.

Credit Risk

In order to improve credit risk management and to make adjustments to regulatory requirements, an independent credit risk management unit was established.

The unit will conduct an independent examination of the credit risks and the risk aspects.

Authority with regard to granting credit at the various levels has been determined on the basis of the size of the credit facility, the borrower's risk rating and the nature of the application, while maintaining the principle of decision-making by senior staff on complex credit applications or those with a high risk.

For further details regarding credit risks, see pages 172-176 of the Annual Report for 2005.

See pages 168-171 of the Annual Report for 2005 with regard to **operating risks and legal risks**.

Linkage Status and Liquidity Status

Linkage Status

During the first half of the year, the exposure in the CPI-linked sector increased from a level of some NIS 1.3 billion to a level of some NIS 3.8 billion, against the background of the expectations of an increase in the inflation rate. The increase in the investment in the CPI-linked sector was principally made by way of purchasing CPI-linked debentures.

The following table sets out the status of assets and liabilities classified according to linkage basis:

	As at 30 June 2006			As at 31 December 2005		
	Unlinked NIS millions	CPI-linked	Foreign	Unlinked	CPI-linked	Foreign
			Currency(2)			Currency(2)
Total assets (1)	92,674	57,358	124,753	95,849	55,234	127,349
Total liabilities (1)	85,864	53,520	124,687	87,460	53,972	127,070
Total exposure in sector	6,810	3,838	66	8,389	1,262	279

(1) including forward transactions and options

(2) including foreign-currency-linked.

Funding and Liquidity Status

Liquidity Status

The System -

In the first half of 2006, the net volume of *Makam* issues by the Bank of Israel increased by NIS 6.2 billion, together with a reduction of NIS 3.6 billion in the volume of the monetary tenders for deposits with the Bank of Israel.

The average volume of the tenders during the first half of the year stood at some NIS 4.0 billion.

At the same time, the Bank of Israel recommenced during the period the tenders for monetary loans as an additional instrument for managing monetary policy. The average volume of the tenders during the first half of the year stood at some NIS 1.8 billion.

The balance of the banking system's *Makam* holdings was some NIS 13 billion at the end of June 2006, a decline of some NIS 1.0 billion as compared with December 2005.

From March 2006, the Bank of Israel has increased the volume of the "repo" tender to an amount of NIS 500 million par value, while reducing the holding term to one week and increasing the frequency of holding the tenders from every two weeks to every week.

On 16 August 2005, the Bank of Israel gave notice of changes to the monetary instruments for the operation of the current interest rate policy, the principal changes being:

Commencing 1 September 2005, the Bank of Israel has been providing a "monetary loan window" for the banks, without a ceiling, against the provision of security, at a rate of interest of 1% above the Bank of Israel's interest rate, such being the rate it announces each month.

Along with monetary loans, the Bank of Israel operates a new monetary instrument – the "surplus liquidity deposit window" at the Bank of Israel, without tender and at an interest rate of 1% below the Bank of Israel's interest rate. At the same time, the payment of interest on liquidity surpluses ceased.

During the first half of 2006 the utilization of these tools by the banking system continued to be at a low frequency and in negligible amounts.

On 4 July 2006 the Bank of Israel announced a reduction of the interest rate of liquidity deficits at the Bank of Israel to the Bank of Israel's interest rate plus 4%, compared with an interest rate of 48% up to the date of the change.

During the first half of the year, the public increased its financial assets at a moderate rate. The development of bank credit also indicates a low level of expansion, despite the rapid growth in the economy, this being against the background of continuous growth in non-banking credit.

The Bank -

As mentioned with regard to the system, there was also a decline at Leumi in the volume of deposits made at the Bank of Israel, together with the utilization of the monetary loan tenders operated by the Bank of Israel during the first half of 2006.

The structure of the Bank's assets and liabilities continues to indicate a high level of liquidity.

The Bank has a liquid and high-quality securities portfolio (in shekels and foreign currency) of some NIS 31.6 billion, which is mainly invested in Israeli government debentures or in foreign securities with an average rating of A+.

The ratio of the Bank's liquid assets – cash, bank deposits and securities (excluding shares) was 36.0% of the Bank's total assets as at 30 June 2006, as compared with some 36.2% as at 31 December 2005. The ratio of such liquid assets in relation to total liabilities stood at 39.0%, similar to 31 December 2005.

Leumi monitors its liquidity status and indices that are intended to warn of changes in the liquidity position, *inter alia*, using an internal model that was developed at the Bank pursuant to a directive of the Bank of Israel. The various assumptions forming the basis of the model are examined and updated on an ongoing basis according to developments in the major relevant parameters.

Funding (in the Bank) -

In the first half of 2006 the transition of monies from shekel deposits to the capital market continued.

The volume of the securities portfolio of the Bank's customers increased by some NIS 12.4 billion during the period under review.

No significant accrual was recorded in the provident funds and supplementary training funds.

The volume of credit to the public remained virtually unchanged during the first half of 2006 (a decline of some NIS 0.4 billion). There was an increase in unlinked credit totaling some NIS 2.6 billion, 4.5%, and there was a decline in foreign currency credit amounting to some NIS 2.9 billion, some 7.3%. There was no significant change in the balance of CPI-linked credit.

The balance of deposits of the public at the Bank declined during the first half of the year by some NIS 1.1 billion. The major decline was in shekel deposits, which was partially offset by an increase in foreign currency deposits.

Total deposits of the public in the **unlinked sector** at the Bank declined by NIS 2.5 billion, a rate of 3.1%, and at the end of June 2006 reached NIS 78.9 billion. The major part of the decrease was in the deposits exceeding NIS 10 million.

The balance of deposits of the public **in foreign currency and linked to foreign currency** increased by some NIS 1.8 billion, an increase of 2.4%. The increase in the balance was notwithstanding the appreciation in the shekel and against the background of the increase in

overseas interest rates. On deducting the effect of the inter-currency exchange rates, the balance increased by some NIS 3.1 billion.

The balance of the deposits of the public **in the CPI-linked sector** declined by some NIS 0.4 billion, a decrease of some 1.5%.

Legal Proceedings

A. In the Annual Report for 2005 details were given in the Directors' Report of legal proceedings, civil and other, to which the Bank and consolidated subsidiaries are a party.

At the date of the publication of this Report, no material changes had occurred in the said proceedings, except as set forth below.

None of the proceedings pending against the Bank involves a sum exceeding 1% of the Bank's shareholders' equity as of 30 June 2006, some NIS 173 million, except the proceedings detailed in Notes 3 to 6 to the Financial Statements.

For details regarding an application for the approval of a class action filed in April 2006, see Note 4B to the Financial Statements.

In the opinion of the Management of the Bank, based on legal opinions, appropriate provisions were recorded in the Financial Statements to cover possible damages in respect of all of the claims.

See Note 3 to the Financial Statements for further details.

B. Further to the report in paragraphs 2.1 and 2.2 on page 185 of the Annual Report for 2005, set forth below are further details:

1. The disciplinary tribunal established under the Regulation of Investment Advice and Investment Portfolio Management Law, 1995 (the "Advice Law") decided to adopt the arrangement reached between the State Attorney on the one side and the investment counselors' representatives on the other side, and decided to impose disciplinary sanctions by way of warning and reprimand on a number of investment counselors at the Bank, such being in respect of breach of the provisions of section 16(a) of the Advice Law.
2. In addition, the Bank and its subsidiary companies, Psagot Ofek Investment House Ltd., Psagot Managers of Mutual Funds-Leumi Ltd. and Leumi-Pia Trust Management Co. Ltd., received notice from the Tel Aviv District of the State Attorney's Office (Taxation and Economics) according to which the Bank and the said subsidiaries had been granted the right to a hearing before the State Attorney in respect of offences attributed to them under the Joint Investment Trust Law (sections 82 and 124(15) (in the form prevailing at the relevant time) and 124(18)).

Similar notice was given to senior employees of the Bank and the said subsidiaries.

During July and August 2006 hearings were held for the Bank, the subsidiaries and their officers. The decision of the State Attorney's Office has not yet been made.

3. The proceedings detailed in paragraph 2.4 at page 185 of the 2005 Annual Report and Note 18 O(7) of the said Annual Report were discontinued.

Description of the Taxation Position

On 27 June 2006 the Value Added Tax (Tax Rate on Non-Profit Organisations and Financial Institutions) Order, 2006 (the "Amendment") was published. In consequence of the Amendment, the salary tax and profit tax rates that apply to financial institutions were reduced from 17% to 15.5%, with effect from 1 July 2006.

On 25 July 2005, the Knesset passed the Income Tax (Amendment No. 147 and Temporary Provision) Ordinance, 2005 (the "Amendment"). The Amendment provided for a gradual reduction of the tax rate for companies from 34% in 2005 to 25% in the following manner: for the 2005 tax year the tax rate was 34%, for 2006 it is 31%, for 2007 it will be 29%, for 2008 it will be 27%, for 2009 it will be 26%, and from 2010 and thereafter the tax rate will be 25%.

By virtue of the Bank being a "financial institution" for the purposes of the Value Added Tax Law, the reduction of company tax and reduction of the profit tax rate will result in a decrease of the overall tax rate that will apply to the Bank, so that for 2005 the overall tax rate that applied to a "financial institution" was 43.59%, the tax rate for 2006 is 40.65%, for 2007 - 38.53%, for 2008 - 36.80%, for 2009 - 35.93% and from 2010 and thereafter the tax rate will be 35.06%.

For the effects of the said changes, see page 24 of the Report above.

D. Additional Matters

Organizational Structure

The Leumi Group's organizational structure, according to business lines and head-office services, as described below, combines the activity of companies in the fields of banking, finance, the capital market and financial services.

In March and July, 2006, Leumi announced changes in its Management. In parallel, Leumi announced changes in its organizational structure for the purpose of supporting the achievement of the Group's strategic aims, against the background of the changes occurring in the banking environment and the capital and financial markets and in Leumi's fields of business.

Details of the changes follow:

Dr. Ehud Shapira, Senior Deputy Chief Executive Officer of Leumi and Acting CEO in the absence of the President and CEO, Head of Corporate and International Banking and Manager of Credit Risks, retired from his positions in the Group on 30 June 2006, after 35 years with the Bank. Following his retirement:

Rakefet Russak-Aminoach, Head of Corporate Division, was appointed Manager of Credit Risks and made responsible for the Construction and Real Estate Division.

The responsibility for the Special Credits Department was transferred to **Michael Bar-Haim**, Head of the Commercial Banking Division.

The responsibility for the Group's banking activities abroad was transferred to **Zvi Itskovitch**, as Head of the International and Private Banking Division. Under this change, the Division, which was responsible for the subsidiaries in Switzerland and Luxembourg and all the Group's representative offices world-wide, has in addition been made responsible for the Bank's other overseas subsidiaries, in the USA, the United Kingdom, Uruguay and Jersey, and the branches in Georgetown and Panama.

Dov Gilboa, Head of the Investments Division, Member of the Bank's Management, retires from his positions on 31 August 2006, after 31 years with the Bank.

Dr. Ehud Shapira and Dov Gilboa will act as advisers to the Group's Management after their retirement, each in his particular field of expertise.

Zeev Nahari was appointed Senior Deputy Chief Executive Officer and Acting CEO in the absence of the President and CEO. His responsibilities have been expanded to include responsibility for the Finance and Economics Division, Accounting and the Capital Markets Division.

Professor Daniel Tsiddon, Head of Group Strategy, has been made a Member of the Bank's Management with effect from 1 August 2006, and Head of the Capital Markets Division with effect from 10 August 2006. The Capital Markets Division is a new Division, responsible for the activity of the Bank's dealing rooms and capital market services, the management of the nostro and relations with overseas financial institutions.

Menachem Schwartz, the Bank's Chief Accounting Officer, has been appointed Head of Accounting and a Member of the Management of the Bank with effect from 1 August 2006.

Leumi's investment counseling will be in an independent unit. The unit, headed by **Shmuel Zlotnik**, will report to David Bar Lev, a Member of the Bank's Management, who serves as Head of Human Resources.

Leumi is organized in four business lines that focus on different market sectors, and each business line specializes in the provision of service to a group of customers. This form of organization enables the customers to enjoy a high standard of professional service, diverse distribution channels, products that are adapted to their requirements and fast and flexible decision-making processes.

Following is a description of the responsibility for Leumi's four business lines:

- 1. Corporate Division** - responsible for formulating the Group's credit policy, and managing and dealing with the Group's overall credit risks, credit procedures and collateral policy. It is also responsible for designing special transactions, such as project financing in Israel and abroad, financing controlling interest transactions, examining investment plans, and international trade and financing. The Corporate Division manages the activity of Israel's large business customers on the basis of sectoral expertise and synergy between the sectors. This line of business also includes the Construction and Real Estate Division that is responsible for the activity of Israel's large building and contracting companies, with specific expertise and skill in the sphere.
- 2. Commercial Banking Division** - manages the activity with regard to middle-market companies, through 25 commercial branches organized on a geographic basis in four commercial districts, as well as the principal branch in Tel Aviv. The Division's organizational structure is unique in the Israeli banking system, and provides a "one stop shop" for its comprehensive and extensive services.
- 3. Banking Division** - manages the activity of the private customers and small business customers, who receive the full range of services by means of 176 branches organized in eight districts on a geographic basis and by means of a variety of technological/direct distribution channels, including LeumiCall, which provides services through the telephone and internet. The Division is also responsible for the e-business section and the e-venture technological initiatives. The services and products are adapted to all the customer sectors differentially according to the nature of their banking activity, their

characteristics and their needs. The customers of the Division are segmented into the following sectors: the retail sector, “gold” banking and the business banking sector. The Division coordinates the retail operations in the Group, including The Arab Israel Bank, Leumi Mortgage Bank and Leumicard.

- 4. International and Private Banking Division** - is responsible for the banking activity of the Group overseas, and for managing private banking in Israel and worldwide. The activities of all the Bank's units abroad are concentrated in this Division. In addition, the Division includes the private banking centers in Israel for residents and non-residents and the Bank Leumi le-Israel Trust Company Ltd. The Division's activities also include supervision and co-ordination between the Bank in Israel and the overseas units, and the provision of services, at international standards, to wealthy customers.

As well as the division between the business lines, the Leumi Group has head office units which provide services to the business lines.

Capital Markets Division is responsible for managing the Bank's assets in Israeli currency and foreign exchange; the activity of all the Bank's dealing rooms (Israeli currency, foreign exchange and Israeli and foreign securities); developing innovative financial products and investment products; management of the assets and liabilities of the Bank and management of financial risks; formulation of the Bank's policy on prices, commissions and financial margins, relations with financial institutions abroad; and co-ordination of the Bank's capital market services.

Finance and Economics Division is responsible for the tax planning of the Bank and the Group; preparation of the expense budget and supervision of its implementation; coordination of the business plan of the Bank, managing profit centers and financial measurement, monitoring economic developments and preparation of reviews of branches of the economy and economic forecasts.

Accounting is responsible for the management, development and determination of the Bank's accounting guidelines, preparation of the financial statements of the Bank and the Group and preparation of reports to the Bank of Israel.

Human Resources is responsible for the formulation and implementation of the Bank's human resources policy and, within this overall context, for selection and placement of employees, remuneration of employees, salaries, labor relations, development and advancement of employees, banking training - managerial and general, assimilation of the “Leumi Way” code of ethics, internal communications, internal information, social responsibility, care of the individual, organizational counseling and development and employee welfare.

Operations, Information Systems and Administration is responsible for the computerized, operational and logistical deployment of the Bank and the Group. It enables Leumi's strategy to be carried out and supports the effort to be the leading bank in business and technology. In this connection, it co-ordinates the formulation and determination of the strategy, policy and activity regarding computers, systems, operations, technology, organization and methods, information security, overseas units' operations, real-estate, procurement and security.

Investment Counseling is responsible for the Bank's policy regarding counseling on investment in securities and financial instruments, development of systems in the investments field and research on capital and financial market subjects.

Group Strategy is responsible for the strategic planning of the Group and for mergers and acquisitions abroad.

External Relations and Public Affairs is responsible for Bank and Group advertising, for the spokesperson's office and public relations, charitable donations, sponsorships, community relations, and the subject of regulation.

Internal Audit Division is responsible for the internal auditing of the Leumi Group. The audit is carried out in accordance with the Audit Law, Bank of Israel directives and generally accepted professional standards. The audit deals, in an independent, impartial manner, with the examination and evaluation of the Group's internal control systems, including: examination of the work and control systems, preservation of the Bank's assets, reduction of exposures, maintenance of the rules of ethics and proper management, the carrying-out of the instructions of the Board of Directors and the Management of the Bank and the Bank's guidelines, and examination of operational efficiency. The Chief Internal Auditor reports to the Chairman of the Board of Directors.

Legal Division is responsible for overall legal counsel to the Bank and its subsidiaries in Israel. Its Head, the Chief Legal Adviser, is responsible for the Group's Chief Compliance Officer, who deals with implementing the Bank's compliance plan in respect of consumer directives, the Prohibition on Money Laundering Law and the Prevention of Terror Law. The Chief Legal Adviser is also responsible for the Customer Relations Department.

Risk Management Control Department, is responsible for mapping, identifying and measuring all the risks in the Group and creating an infrastructure for examining the risks inherent in new activities. The department carries out risk control at the Group level in Israel and abroad, and develops methods for measuring and controlling risks, including calculating economic capital. Furthermore, the department controls and coordinates the risk management policy documents and carries out the loan review process. The preparations for adopting the rules of the Basel Accord in the Group, in accordance with the relevant Bank of Israel directives, are an important part of the department's activity.

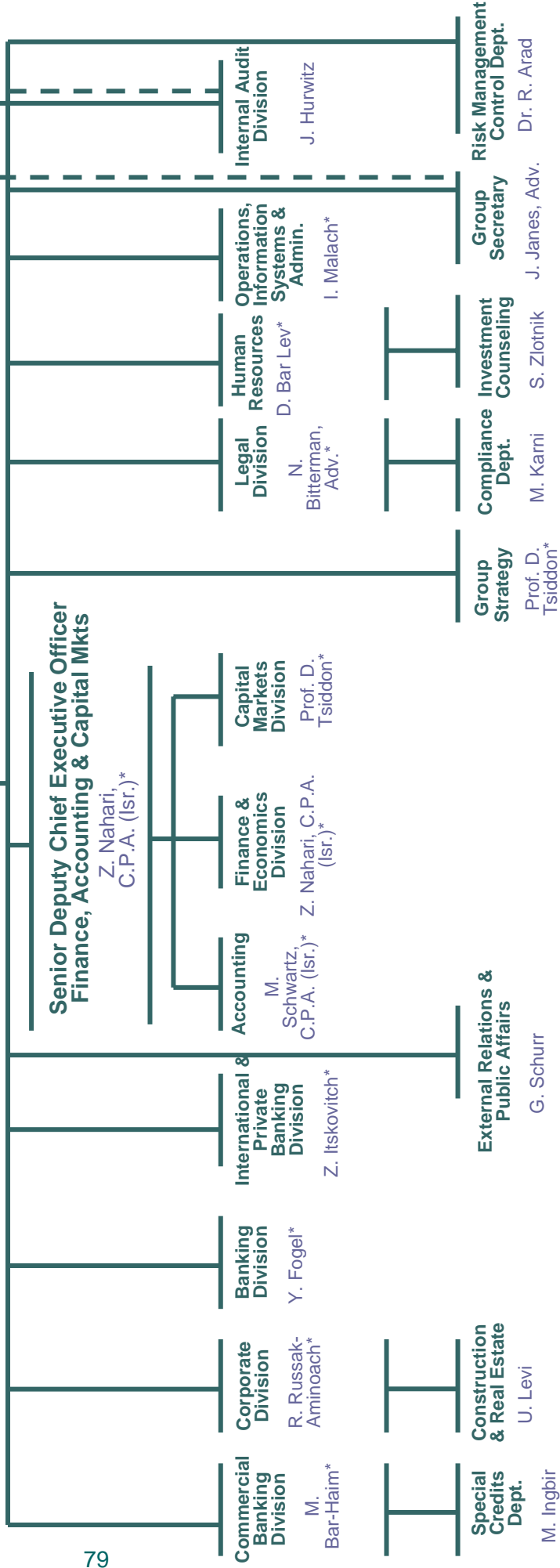
Leumi – Organizational Structure

Board of Directors

E. Raff, Chairman

President & Chief Executive Officer

G. Maor*



*Member of Management

Leumi for the Community

The Group's Activity for the Community in Consequence of the Hostilities in the North

During the period of hostilities in the north of the country, Leumi as a leading business entity in the economy, joined in the community efforts.

In such context, Leumi distributed thousands of kits of games and books to the children on the front line in the north, assisted in distributing food to bomb shelters in the north, donated tens of thousands of shekels to the hospitals in Nahariya, Safed and Tiberias, provided assistance in funding transport to summer day camps for children of the town of Sderot, donated computers to families in Sderot whose homes had been damaged, was attentive to the requirements of the public and lent a supportive and encouraging hand to the residents of the front line, as is expected of a strong business group like the Leumi Group.

Social Involvement

Leumi, which was founded as part of the Zionist vision, has since its establishment acted to develop the economy, the society and the communities in which it operates.

Leumi continues to expand its involvement in the community and society and supports the achievement of important objectives in various social spheres, primarily education, and also culture, health, welfare, the community and more.

The Group's involvement in the community is undertaken in a number of ways:

- donations through organizations (institutions and non-profit societies) that operate to promote social projects that concentrate on the education and welfare of children and young people;
- involvement by means of providing sponsorships for educational and cultural activities;
- individual care for sections of the population suffering serious hardship;
- the involvement of employees and managers of the Bank in social projects.

"Leumi Tomorrow - The Centennial Fund for Endowing Israel's Future Generation"

Kamcha Da'Pascha (Food for Passover) - On the occasion of Passover, Leumi distributed 1,260 food parcels to needy families, as part of a *kamcha da'pascha* campaign. This is the second year that the campaign was conducted through a donation by Leumi and employee participation. Each parcel, having a value of NIS 350, contained kosher-for-Passover basic food commodities. The products were packed and distributed by employees on a voluntary basis.

Conclusion of the 2005-2006 Year of Activity

The fifth year of activity of "Leumi Tomorrow - The Centennial Fund for Endowing Israel's Future Generation" is about to close. Of the 51 army preparation groups of "Youth Leading Change", 13 were directly funded by "Leumi Tomorrow".

During the second quarter, Leumi Tomorrow's activities in the field of education and accessibility to higher education continued, in cooperation with the Ben Gurion University of the Negev, Haifa University, the Herzlia Interdisciplinary Center, The Tel Hai College in the Galilee panhandle, the Shevach School in Tel Aviv and the matriculation study centers in various towns.

During the course of the second quarter, Leumi Tomorrow added the following activities:

Cooperation with Tel Aviv University - English and mathematics reinforcement studies project for some 40 youngsters from the Ethiopian community, in which context students will assist pupils for a year in anticipation of the matriculation examinations in return for a scholarship;

Joint activity of the Leumi Group and the "Unistream" Non-Profit Society, the object whereof is to foster social business leadership among youth and to encourage youth to establish and lead business ventures. The activity program is based on a three year plan and focuses on leadership and self-empowerment, business entrepreneurship and involvement for the benefit of the community.

"Atidim" - Futures

The "Atidim" program is a wide-reaching national program which began in 1999 and is intended to assist with the realization of the untapped potential of gifted youth throughout the country. The program aspires to develop excellence, strengthen educational infrastructure and empower human capital in outlying areas.

Leumi is accompanying and supporting the project to the amount of NIS 20 million over five years.

Some 14,000 pupils and students participate in the various study and enrichment programs of "Leumi Tomorrow - the Centennial Fund for Endowing Israel's Future Generation".

"Young Israel Entrepreneurs - Established by Leumi"

Leumi is one of the partners of the project and has supported it for more than 15 years since its establishment. Each year more than 3,000 young people from all around the country participate in an educational and challenging program, during the course of which they gain experience in establishing and managing businesses while learning the essential aspects of business promotion and practice. The participants in the program come from all the sectors of Israeli society – veteran Israelis, new immigrants and young people from the Arab sector.

Regional competitions were held during May to June 2006, from which the 10 winning groups went on to the national competition

Involvement of Employees and Managers

Hundreds of Leumi's employees and managers are involved in volunteer activity in different frameworks: instructing groups of "Young Entrepreneurs", assisting IDF preparation groups of the "Youth Leading Change" Non-Profit Society, assisting at matriculation study centers and assisting families through "Equal Opportunities".

Maala Social Responsibility Index

Maala's rating examines the large companies in the economy according to their compliance with social responsibility criteria. The rating is based upon detailed criteria in four central spheres, out of all the social responsibility spheres of businesses: environment, business ethics, work environment and human rights and community contacts.

Leumi is rated in the top 10 of all the large companies in the economy that are rated by the *Maala* social responsibility index.

Scope of Donations and Sponsorships

In the first half of 2006 the Leumi Group made donations and granted sponsorships for social and community objects in an amount of some NIS 8.7 million, of which donations constitute some NIS 6.5 million.

Internal Auditor

Details regarding the Internal Audit Division of the Group, including the professional standards according to which the Internal Audit Division operates, the annual and multi-year work plan and the considerations for determining it, were included in the 2005 Annual Report.

There were no material changes in these details during the reporting period.

Annual reports of subsidiaries and overseas subsidiaries for 2005 were submitted on 8 May 2006 and discussed by the Audit Committee on 13 June 2006 and 9 July 2006.

Evaluation of Controls and Procedures

Evaluation of Disclosure Controls and Procedures for the Financial Statements

On 15 November 2004, the Supervisor of Banks published a Directive regarding the certification to be attached to the quarterly and annual statements of banking corporations, to be signed by the chief executive officer and chief accountant/treasurer of the bank or the person actually carrying out this task (in Leumi, the Head of the Finance and Economics Division) as from the financial statements for the period ending 30 June 2005. On 18 July 2005, the Supervisor of Banks published an amended text of the certification. The text of the certification in the Directive is based on the directives of the SEC and relates to the requirements of section 302 of the Sarbanes-Oxley Act (SOX). According to the Supervisor's Directive, the certification is not brought into effect under the extensive requirements of section 404 of the SOX Act which requires the existence of a system of internal controls according to a defined and accepted framework which is far wider in extent than the disclosure controls required to be operated in relation to the Financial Statements to 30 June 2005 and thereafter.

With the assistance of external consultants, the Bank has determined procedures and set up a disclosure committee, headed by the President and Chief Executive Officer of the Bank, and including members of Management and other senior officers in the manner required to fulfill the requirements of the Directive.

The Management of the Bank, together with the President and Chief Executive Officer and the Head of the Finance and Economics Division, have evaluated as at the end of the period covered by this Report, the effectiveness of the disclosure controls and procedures of the Bank. On the basis of this evaluation, the President and Chief Executive Officer of the Bank and the Head of the Finance and Economics Division have concluded that, as at the end of the said period, the disclosure controls and procedures of the Bank are effective for the recording, processing, summarizing and reporting of the information that the Bank is required to disclose in its quarterly financial statements, in accordance with the Directives on reporting to the public of the Supervisor of Banks and at the time required in these Directives.

During the quarter ending 30 June 2006, no material change to the internal controls on financial reporting of the Bank occurred that materially affected or is reasonably anticipated to materially affect the Bank's internal control of financial reporting.

Management's Responsibility for the Internal Control of Financial Reporting (SOX Act 404)

On 5 December 2005 the Supervisor of Banks published a circular detailing provisions for the application of the requirements of section 404 of the SOX Act. In section 404, the SEC and the Public Company Accounting Oversight Board determined provisions as to management's responsibility for the internal control over financial reporting and as to the external auditors' opinion with regard to the audit of the internal control over financial reporting.

The Supervisor's directives in the said circular prescribe that:

- banking corporations shall apply the requirements of section 404 and also the SEC's directives that were published thereunder.
- proper internal control requires the existence of a control system in accordance with a defined and recognized framework, and the COSO model meets with the requirements and can be used in order to assess the internal control.
- application of the directive's requirements requires the upgrading and/or establishment of an infrastructure system of internal controls at the bank and the process of developing such systems obliges the bank to deploy and to determine interim stages and targets until the full application thereof.
- the preliminary preparations to carry out the project at the Bank and the subsidiaries must be completed by the date of publication of the report for the first quarter of 2006.
- the project must be completed by the end of the first half of 2008, so that the external auditors' audit will commence in June 2008 and will be completed by the date of the December 2008 Report.

The Management of the Bank is taking action to implement the execution of the project at the Bank and the subsidiaries, with the cooperation of external consultants.

Changes in the Composition of the Board of Directors

As reported in the 2005 Annual Report, Mr Itzhak Hoffi retired from the Board of Directors on 30 January 2006 and Adv. Rena Shashua-Hasson completed her tenure on 31 January 2006.

At the Annual General Meeting held on 3 July 2006 Mr. Chaim Yaron completed his tenure as a Director, and Mr. Barouch Bahat, who retired by rotation pursuant to the Bank's Articles of Association, did not offer himself for reelection.

At the said Meeting Ms. Zipora Gal Yam, Prof. Arie Gans, Mr. Doron Cohen and Prof. Efraim Sadka were elected as new Directors.

The said Meeting also elected Mr. Meir Dayan as an External Director for a further term of three years.

At the meeting of the Board of Directors held on 30 August 2006, it was decided to approve and publish the Group's condensed unaudited consolidated Financial Statements as at 30 June 2006, and for the periods ending on that date.

During the period January - June 2006 the Board of Directors held 24 plenary meetings and 50 committee meetings.

Eitan Raff
Chairman of the Board of Directors

Galia Maor
President and Chief Executive Officer

30 August 2006

Rates of Financing Income and Expenses (on a Consolidated Basis) (a)
Reported Amounts

	For the three months ended 30 June						
	2006			2005			
	Average balance (b)	Rate of income (expenses)			Average balance (b)	Rate of income (expenses)	
		Financing income (expenses)	Excluding the effect of derivatives	Including the effect of derivatives		Financing income (expenses)	Excluding the effect of derivatives
(NIS millions)		%	%	(NIS millions)	%	%	
Israeli currency - unlinked							
Assets (c) (d)	81,922	1,490	7.50	75,746	1,133	6.11	
Effect of embedded and ALM derivatives (e)	13,813	161		17,620	145		
Total assets	95,735	1,651	7.10	93,366	1,278		5.58
Liabilities (d)	80,317	(799)	(4.04)	79,406	(569)	(2.90)	
Effect of embedded and ALM derivatives (e)	6,554	(26)		6,251	2		
Total liabilities	86,871	(825)	(3.85)	85,657	(567)		(2.68)
Interest margin			3.46			3.21	2.90
Israeli currency – linked to the CPI							
Assets (c) (d)	57,097	1,379	10.01	54,955	1,075	8.06	
Effect of embedded and ALM derivatives (e)	262	3		110	(2)		
Total assets	57,359	1,382	9.99	55,065	1,073		8.02
Liabilities (d)	47,238	(1,029)	(9.00)	48,055	(842)	(7.19)	
Effect of embedded and ALM derivatives (e)	3,922	(50)		2,069	(24)		
Total liabilities	51,160	(1,079)	(8.71)	50,124	(866)		(7.09)
Interest margin			1.01			0.87	0.93
Foreign currency – (including Israeli currency linked to foreign currency)							
Assets (c) (d)	121,071	(3,009)	(9.58)	112,803	5,063	19.20	
Effect of derivatives: (e)							
Hedging derivatives	4,351	72		4,490	72		
Embedded derivatives and ALM	52,762	(1,224)		47,567	892		
Total assets	178,184	(4,161)	(9.02)	164,860	6,027		15.45
Liabilities (d)	116,538	3,295	10.84	102,735	(4,022)	(16.60)	
Effect of derivatives: (e)							
Hedging derivatives	4,247	(40)		4,428	(40)		
Embedded derivatives and ALM	55,950	1,452		56,619	(1,475)		
Total liabilities	176,735	4,707	10.23	163,782	(5,537)		(14.22)
Interest margin			1.26			2.60	1.23

See footnotes on page 86.

Rates of Financing Income and Expenses (on a Consolidated Basis) (a) Reported Amounts

	For the three months ended 30 June							
	2006			2005				
	Average balance (b) (NIS millions)	Financing income (expenses)	Rate of income (expenses)		Average balance (b) (NIS millions)	Financing income (expenses)	Rate of income (expenses)	
			Excluding the effect of derivatives %	Including the effect of derivatives %			Excluding the effect of derivatives %	Including the effect of derivatives %
Total monetary assets generating interest								
Income (d) (f)	260,090	(140)	(0.21)	243,504	7,271	12.49		
Effect of derivatives: (e)								
Hedging derivatives	4,351	72		4,490	72			
Embedded derivatives and ALM	66,837	(1,060)		65,297	1,035			
Total assets	331,278	(1,128)	(1.35)	313,291	8,378		11.13	
Total monetary liabilities generating interest								
expenses (d)	244,093	1,467	2.38	230,196	(5,433)	(9.78)		
Effect of derivatives: (e)								
Hedging derivatives	4,247	(40)		4,428	(40)			
Embedded derivatives and ALM	66,426	1,376		64,939	(1,497)			
Total liabilities	314,766	2,803	3.51	299,563	(6,970)		(9.64)	
Interest margin			2.17			2.71	1.49	
In respect of options		(15)			(34)			
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivatives and embedded derivatives which have been separated) (e)		1			3			
Financing commissions and other financing income (g)		84			266			
Other financing expenses		51			(38)			
Net interest income before provision for doubtful debts		1,796			1,605			
Provision for doubtful debts (including general and supplementary provision)		(185)			(494)			
Net interest income after provision for doubtful debts		1,611			1,111			
Monetary assets generating interest income (d) (f)	260,090			243,504				
Assets derived from derivative instruments (h)	3,782			3,022				
Other monetary assets (d)	2,894			3,170				
General provision and supplementary provision for doubtful debts	(1,071)			(1,051)				
Total monetary assets	265,695			248,645				
Monetary liabilities generating interest expenses (d)	244,093			230,196				
Liabilities derived from derivative instruments (h)	3,596			2,687				
Other monetary liabilities (d)	6,666			6,121				
Total monetary liabilities	254,355			239,004				
Total monetary assets exceed monetary liabilities	11,340			9,641				
Non-monetary assets	7,614			7,615				
Non-monetary liabilities	1,671			1,792				
Total capital resources	17,283			15,464				

See footnotes on page 86.

- (a) The data in this exhibit includes before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).
- (b) Based on monthly opening balances, and quarterly opening balances in foreign subsidiaries, except for the unlinked Israeli currency sector where the average balance is based on daily figures, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.
- (c) The average balance of unrealized profits (losses) from adjustment to fair value of debentures held for trading and available for sale has been deducted from (added to) the average balance of the assets as follows:
 The unlinked Israeli currency sector for the three and six month periods amounts to NIS 30 million and NIS 60 million respectively.
 The linked Israeli currency sector for the three and six month periods amounts to NIS 6 million and NIS 6 million respectively.
 The foreign currency sector (which includes foreign currency - linked Israeli sector) for the three and six month periods amounts to NIS (195) million and NIS (174) million respectively.
- (d) Excluding derivative instruments.
- (e) Includes hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives, which constitute part of the Bank's asset and liability management system.
- (f) The average balance of unrealized losses on adjustment to fair value of debentures held for trading and available for sale has been added to the average balance of the assets in the various sectors.
 The three month and six month period amounts to NIS (159) million and NIS (108) million respectively.
- (g) This includes profits and losses on sales of investments in debentures and adjustments to fair value of debentures held for trading.
- (h) Includes the average balance for derivative instruments (does not include average of off-balance sheet derivative instruments).

Rates of Financing Income and Expenses (on a Consolidated Basis) (a)
Nominal U.S. \$

	For the three months ended 30 June							
	2006				2005			
	Average balance (b) (\$ millions)	Financing income (expenses)	Rate of income (expenses)		Average balance (b) (\$ millions)	Financing income (expenses)	Rate of income (expenses)	
			Excluding the effect of derivatives	Including the effect of derivatives			Excluding the effect of derivatives	Including the effect of derivatives
		%	%			%	%	
Foreign currency:								
Local operations (including Israeli currency linked to foreign currency)								
Assets (c) (d)	16,760	218	5.31	16,721	165	4.01		
Effect of derivatives: (e)								
Hedging derivatives	951	16		1,025	16			
Embedded derivatives and ALM	11,498	3		10,810	(4)			
Total assets	29,209	237	3.29	28,556	177		2.51	
Liabilities (d)	16,585	(135)	(3.31)	14,973	(92)	(2.48)		
Effect of derivatives: (e)								
Hedging derivatives	933	(9)		1,019	(9)			
Embedded derivatives and ALM	12,159	11		12,843	(20)			
Total liabilities	29,677	(133)	(1.81)	28,835	(121)		(1.70)	
Interest margin			2.00			1.53	0.81	
Foreign currency – Foreign operations (integrated operations)								
Assets (c) (d)	9,505	122	5.25	9,060	95	4.26		
Effect of embedded and ALM derivatives (e)	40	-		45	2			
Total assets	9,545	122	5.24	9,105	97		4.37	
Liabilities (d)	8,717	(84)	(3.93)	8,508	(59)	(2.79)		
Effect of embedded and ALM derivatives (e)	74	(1)		76	-			
Total liabilities	8,791	(85)	(3.94)	8,584	(59)		(2.75)	
Interest margin			1.32			1.47	1.62	
Total:								
Monetary assets in foreign currency generating financing income (c) (d)	26,265	340	5.29	25,781	260	4.10		
Effect of derivatives: (e)								
Hedging derivatives	951	16		1,025	16			
Embedded derivatives and ALM	11,538	3		10,855	(2)			
Total assets	38,754	359	3.77	37,661	274		2.96	
Monetary liabilities in foreign currency generating financing expense (d)	25,302	(219)	(3.52)	23,481	(151)	(2.59)		
Effect of derivatives: (e)								
Hedging derivatives	933	(9)		1,019	(9)			
Embedded derivatives and ALM	12,233	10		12,919	(20)			
Total liabilities	38,468	(218)	(2.29)	37,419	(180)		(1.94)	
Interest margin			1.77			1.51	1.02	

See footnotes on page 88.

- (a) The data in this exhibit includes before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).
- (b) Based on monthly opening balances for the Bank and subsidiaries in Israel and on quarterly opening balances for foreign subsidiaries, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.
- (c) The average balance of unrealized losses on adjustment to fair value of debentures held for trading and available for sale has been added to the average balance of the assets for local and foreign operations, in the amount of US\$ (42) million.
- (d) Excluding derivative instruments.
- (e) Includes hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives, which constitute part of the Bank's asset and liability management system.

Rates of Financing Income and Expenses (on a Consolidated Basis) (a)
Reported Amounts

	For the six months ended 30 June					
	2006			2005		
	Average balance (b)	Rate of income (expenses)		Average balance (b)	Rate of income (expenses)	
		Financing income (expenses)	Excluding the effect of derivatives		Including the effect of derivatives	Financing income (expenses)
(NIS millions)	%	%	(NIS millions)	%	%	
Israeli currency - unlinked						
Assets (c) (d)	82,102	2,890	7.17	76,300	2,309	6.14
Effect of embedded and ALM derivatives (e)	15,146	272		17,152	252	
Total assets	97,248	3,162	6.61	93,452	2,561	5.56
Liabilities (d)	80,670	(1,516)	(3.79)	78,850	(1,162)	(2.97)
Effect of embedded and ALM derivatives (e)	6,941	(39)		5,990	(1)	
Total liabilities	87,611	(1,555)	(3.58)	84,840	(1,163)	(2.76)
Interest margin			3.38			3.17
3.03						2.80
Israeli currency – linked to the CPI						
Assets (c) (d)	56,080	2,149	7.81	54,330	1,711	6.40
Effect of embedded and ALM derivatives (e)	244	6		132	(1)	
Total assets	56,324	2,155	7.80	54,462	1,710	6.38
Liabilities (d)	47,325	(1,587)	(6.82)	47,802	(1,274)	(5.40)
Effect of embedded and ALM derivatives (e)	3,858	(106)		2,188	(48)	
Total liabilities	51,183	(1,693)	(6.72)	49,990	(1,322)	(5.36)
Interest margin			0.99			1.00
			1.08			1.02
Foreign currency – (including Israeli currency linked to foreign currency)						
Assets (c) (d)	120,672	451	0.75	110,915	6,369	11.82
Effect of derivatives: (e)						
Hedging derivatives	4,615	101		4,650	99	
Embedded derivatives and ALM	50,515	(316)		48,271	497	
Total assets	175,802	236	0.27	163,836	6,965	8.68
Liabilities (d)	115,690	366	0.63	101,499	(4,555)	(9.18)
Effect of derivatives: (e)						
Hedging derivatives	4,518	(87)		4,591	(88)	
Embedded derivatives and ALM	54,805	556		56,934	(1,297)	
Total liabilities	175,013	835	0.95	163,024	(5,940)	(7.42)
Interest margin			1.38			2.64
			1.22			1.26

See footnotes on page 86.

Rates of Financing Income and Expenses (on a Consolidated Basis) (a) Reported Amounts

	For the six months ended 30 June							
	2006			2005				
	Average balance (b)	Financing income (expenses)	Rate of income (expenses)		Average balance (b)	Financing income (expenses)	Rate of income (expenses)	
			Excluding the effect of derivatives	Including the effect of derivatives			Excluding the effect of derivatives	Including the effect of derivatives
(NIS millions)		%	%	(NIS millions)		%	%	
Total monetary assets generating interest								
Income (d) (f)	258,854	5,490	4.29	241,545	10,389	8.79		
Effect of derivatives: (e)								
Hedging derivatives	4,615	101		4,650	99			
Embedded derivatives and ALM	65,905	(38)		65,555	748			
Total assets	329,374	5,553	3.40	311,750	11,236		7.34	
Total monetary liabilities generating interest								
expenses (d)	243,685	(2,737)	(2.26)	228,151	(6,991)	(6.22)		
Effect of derivatives: (e)								
Hedging derivatives	4,518	(87)		4,591	(88)			
Embedded derivatives and ALM	65,604	411		65,112	(1,346)			
Total liabilities	313,807	(2,413)	(1.54)	297,854	(8,425)		(5.74)	
Interest margin			2.03			2.57	1.60	
In respect of options		5			(45)			
In respect of other derivatives (excluding options, hedging derivative instruments, ALM derivatives and embedded derivatives which have been separated) (e)		2			11			
Financing commissions and other financing income (g)		271			452			
Other financing expenses		23			(32)			
Net interest income before provision for doubtful debts		3,441			3,197			
Provision for doubtful debts (including general and supplementary provision)		(386)			(939)			
Net interest income after provision for doubtful debts		3,055			2,258			
Monetary assets generating interest income (d) (f)	258,854			241,545				
Assets derived from derivative instruments (h)	3,761			3,285				
Other monetary assets (d)	3,077			3,194				
General provision and supplementary provision for doubtful debts	(1,054)			(1,044)				
Total monetary assets	264,638			246,980				
Monetary liabilities generating interest expenses								
(d)	243,685			228,151				
Liabilities derived from derivative instruments (h)	3,605			2,820				
Other monetary liabilities (d)	6,816			6,604				
Total monetary liabilities	254,106			237,575				
Total monetary assets exceed monetary liabilities	10,532			9,405				
Non-monetary assets	7,542			7,635				
Non-monetary liabilities	1,433			1,814				
Total capital resources	16,641			15,226				

See footnotes on page 86.

Rates of Financing Income and Expenses (on a Consolidated Basis) (a)
Nominal U.S. \$

	For the six months ended 30 June							
	2006				2005			
	Average balance (b) (\$ millions)	Financing income (expenses)	Rate of income (expenses)		Average balance (b) (\$ millions)	Financing income (expenses)	Rate of income (expenses)	
			Excluding the effect of derivatives	Including the effect of derivatives			Excluding the effect of derivatives	Including the effect of derivatives
		%	%			%	%	
Foreign currency:								
Local operations (including Israeli currency linked to foreign currency)								
Assets (c) (d)	16,669	407	4.94	16,605	308	3.74		
Effect of derivatives: (e)								
Hedging derivatives	1,001	22		1,066	23			
Embedded derivatives and ALM	10,926	5		10,998	(1)			
Total assets	28,596	434	3.06	28,669	330		2.31	
Liabilities (d)	16,270	(250)	(3.09)	14,950	(144)	(1.94)		
Effect of derivatives: (e)								
Hedging derivatives	983	(19)		1,056	(20)			
Embedded derivatives and ALM	11,824	7		12,953	(23)			
Total liabilities	29,077	(262)	(1.81)	28,959	(187)		(1.30)	
Interest margin			1.85			1.80	1.01	
Foreign currency – Foreign operations (integrated operations)								
Assets (c) (d)	9,460	236	5.05	8,861	181	4.13		
Effect of embedded and ALM derivatives (e)	41	5		63	5			
Total assets	9,501	241	5.14	8,924	186		4.20	
Liabilities (d)	8,785	(162)	(3.73)	8,354	(108)	(2.61)		
Effect of embedded and ALM derivatives (e)	72	(1)		92	-			
Total liabilities	8,857	(163)	(3.72)	8,446	(108)		(2.58)	
Interest margin			1.32			1.52	1.62	
Total:								
Monetary assets in foreign currency generating financing income (c) (d)	26,129	643	4.98	25,466	489	3.88		
Effect of derivatives: (e)								
Hedging derivatives	1,001	22		1,066	23			
Embedded derivatives and ALM	10,967	10		11,061	4			
Total assets	38,097	675	3.57	37,593	516		2.76	
Monetary liabilities in foreign currency generating financing expense (d)	25,055	(412)	(3.31)	23,304	(252)	(2.18)		
Effect of derivatives: (e)								
Hedging derivatives	983	(19)		1,056	(20)			
Embedded derivatives and ALM	11,896	6		13,045	(23)			
Total liabilities	37,934	(425)	(2.25)	37,405	(295)		(1.59)	
Interest margin			1.67			1.70	1.17	

See footnotes on page 92.

- (a) The data in this exhibit includes before and after the effect of derivative instruments (including the effect of off-balance sheet derivative instruments).
- (b) Based on monthly opening balances for the Bank and subsidiaries in Israel and on quarterly opening balances for foreign subsidiaries, and after deduction of the average balance sheet balance of the specific provision for doubtful debts.
- (c) The average balance of unrealized losses on adjustment to fair value of debentures held for trading and available for sale has been added to the average balance of the assets for local and foreign operations, in the amount of US\$ (37) million.
- (d) Excluding derivative instruments.
- (e) Includes hedging derivative instruments (excluding options), embedded derivatives which have been separated, and ALM derivatives, which constitute part of the Bank's asset and liability management system.

Certification

I, Galia Maor, certify that:

1. I have reviewed the Quarterly Report of Bank Leumi le-Israel B.M. (the "Bank") for the quarter ended 30 June 2006 (the "Report").
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to prevent the statements included therein from being, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the Report.
3. Based on my knowledge, the Quarterly Financial Statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in the Report.
4. I and the Bank's other certifying officers are responsible for establishing and maintaining the disclosure controls and procedures required for the Bank's Report and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and those corporations, particularly during the period in which the Report is being prepared;
 - (b) evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and
 - (c) disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. I and the Bank's other certifying officers have disclosed to the Joint External Auditors, the Board of Directors and the Audit Committee of the Board of Directors, based on our most recent evaluation of internal control over financial reporting:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

The above does not prejudice my responsibility or the responsibility of any other person, pursuant to any law.

30 August 2006

Galia Maor
President and Chief Executive Officer

Certification

I, Zeev Nahari, certify that:

1. I have reviewed the Quarterly Report of Bank Leumi le-Israel B.M. (the "Bank") for the quarter ended 30 June 2006 (the "Report").
2. Based on my knowledge, the Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to prevent the statements included therein from being, in light of the circumstances under which such statements were made, misleading with respect to the period covered by the Report.
3. Based on my knowledge, the Quarterly Financial Statements, and other financial information included in the Report, fairly present in all material respects the financial condition, results of operations and changes in shareholders' equity of the Bank as of, and for, the periods presented in the Report.
4. I and the Bank's other certifying officers are responsible for establishing and maintaining the disclosure controls and procedures required for the Bank's Report and have:
 - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Bank, including its consolidated corporations, is made known to us by others within the Bank and those corporations, particularly during the period in which the Report is being prepared;
 - (b) evaluated the effectiveness of the Bank's disclosure controls and procedures and presented our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the Report, based on our evaluation; and
 - (c) disclosed in the Report any change in the Bank's internal control over financial reporting that occurred during this quarter that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting; and
5. I and the Bank's other certifying officers have disclosed to the Joint External Auditors, the Board of Directors and the Audit Committee of the Board of Directors, based on our most recent evaluation of internal control over financial reporting:
 - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Bank's ability to record, process, summarize and report financial information; and
 - (b) any fraud, whether or not material, that involves Management or other employees who have a significant role in the Bank's internal control over financial reporting.

The above does not prejudice my responsibility or the responsibility of any other person, pursuant to any law.

30 August 2006

Zeev Nahari
Senior Deputy Chief Executive Officer
Head of Finance and Economics Division



Somekh Chaikin



Kost Forer Gabbay & Kasierer
3 Aminadav St.
Tel-Aviv 67067, Israel

To the Board of Directors of Bank Leumi le-Israel B.M.

Dear Sirs,

Re: Review of the Unaudited Condensed Interim Consolidated Financial Statements for the three month and six month period ended 30 June 2006

At your request, we have reviewed the condensed interim consolidated balance sheet of Bank Leumi le-Israel B.M. (the "Bank") and its subsidiaries (the "Group") as at 30 June 2006 and the condensed interim consolidated statements of profit and loss and the condensed interim statement of changes in shareholders' equity for the three month and six month periods then ended.

Our review was carried out in accordance with the procedures prescribed by the Institute of Certified Public Accountants in Israel. The procedures included, inter alia, reading the said financial statements, reading the minutes of the Shareholders' Meetings and the Meetings of the Board of Directors and its committees, as well as making inquiries of the persons responsible for financial and accounting matters at the Bank.

We were given reports issued by other auditors regarding their review of the condensed interim financial statements of the foreign subsidiaries, whose assets constitute some 2% of the total consolidated assets in the condensed interim consolidated balance sheet as at 30 June 2006, and whose net interest income before provision for doubtful debts constitutes some 8% and some 3% of the total consolidated net interest income before provision for doubtful debts included in the condensed consolidated statement of profit and loss for the three month and six month periods then ended, respectively.

Since our review was limited in scope and does not constitute an audit in accordance with generally accepted auditing standards, we do not express an opinion on the interim consolidated financial statements.

In carrying out our review, including reading the above mentioned reports of other auditors, nothing came to our attention to indicate that there is a need for any material modifications in the said condensed interim financial statements in order for them to be considered as interim financial statements that are drawn up in conformity with generally accepted accounting principles and with directives and guidelines of the Supervisor of Banks.

We draw attention to the contents of Notes 4 and 6 to the condensed interim financial statements regarding claims against the Bank and against a subsidiary, including applications for their approval as class actions. The Bank is unable to estimate the effect of the above claims on the Bank, if any, on its financial position and operating results, and whether or not they will be material. Furthermore, we draw attention to the contents of Note 8 to the condensed interim financial statements regarding capital market reform legislation. The Note states, inter alia, that the implementation of the provisions of the legislation in their entirety is likely to have negative effects on the Group's businesses, the scope of which cannot at this stage be accurately evaluated in light of the uncertainties which still exist regarding various matters.

Somekh Chaikin
Certified Public Accountants (Isr.)

Kost Forer Gabbay & Kasierer
Certified Public Accountants (Isr.)

30 August 2006

Condensed Consolidated Balance Sheet as at 30 June 2006
Reported amounts

	30 June 2006	30 June 2005	31 December 2005
	(Unaudited)	(Unaudited)	(Audited)
	(NIS millions)		
Assets			
Cash and deposits with banks	34,335	35,403	35,381
Securities	47,787	46,080	47,825
Credit to the public	177,974	169,674	177,255
Credit to governments	691	929	848
Investments in companies included on the equity basis	1,224	1,825	2,064
Buildings and equipment	2,951	2,773	2,843
Other assets	7,426	6,914	6,608
Total assets	272,388	263,598	272,824
Liabilities and equity capital			
Deposits of the public	219,372	216,423	221,828
Deposits from banks	6,258	5,539	4,347
Deposits from governments	1,796	2,588	2,225
Debentures, bonds and subordinated notes	17,022	13,346	17,253
Other liabilities	10,435	9,367	10,966
Total liabilities	254,883	247,263	256,619
Minority interest	154	249	205
Shareholders' equity	17,351	16,086	16,000
Total liabilities and equity capital	272,388	263,598	272,824

The accompanying notes are an integral part of these Financial Statements.

Eitan Raff
 Chairman of the
 Board of Directors

Galia Maor
 President and Chief
 Executive Officer

Zeev Nahari
 Senior Deputy Chief Executive Officer
 Head of Finance and Economics Division

Date of approval of the Financial Statements: 30 August 2006

**Condensed Consolidated Statement of Profit and Loss
For the Periods Ended 30 June 2006
Reported Amounts**

	For the Three Months		For the Six Months		For the Year
	Ended 30 June		Ended 30 June		Ended
	2006	2005	2006	2005	31 December
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)	(Audited)
(NIS millions)					
Net interest income before provision for doubtful debts	1,796	1,605	3,441	3,197	6,628
Provision for doubtful debts	185	494	386	939	1,426
Net interest income after provision for doubtful debts	1,611	1,111	3,055	2,258	5,202
Operating and other income					
Operating commissions	736	696	1,478	1,389	2,810
Profits from investments in shares, net	82	18	86	25	43
Other income	197	192	391	379	865
Total operating and other income	1,015	906	1,955	1,793	3,718
Operating and other expenses					
Salaries and related expenses	1,252	855	2,441	1,719	3,627
Building and equipment maintenance and depreciation	297	283	584	560	1,168
Other expenses	331	291	676	570	1,275
Total operating and other expenses	1,880	1,429	3,701	2,849	6,070
Operating profit before taxes	746	588	1,309	1,202	2,850
Provision for taxes on operating profit	398	172	638	405	1,193
Operating profit after taxes	348	416	671	797	1,657
Equity in after-tax operating profits of companies included on the equity basis	20	120	98	261	378
Minority interest in after-tax operating (profits) losses of subsidiaries	(1)	5	(2)	14	24
Net operating profit	367	541	767	1,072	2,059
After-tax profit from extraordinary items	11	37	723	34	77
Net profit for the period	378	578	1,490	1,106	2,136
(NIS)					
Profit per share					
Net operating profit	0.260	0.383	0.542	0.758	1.456
After-tax profit from extraordinary items	0.008	0.026	0.511	0.024	0.054
Total	0.268	0.409	1.053	0.782	1.510
(Thousands)					
Number of shares for the above computation	1,414,233	1,414,233	1,414,233	1,414,233	1,414,233

The accompanying notes are an integral part of these Financial Statements.

Condensed Consolidated Statement of Changes in Shareholders' Equity
For the Periods Ended 30 June 2006
Reported Amounts

	For the Three Months Ended 30 June					
	2006			2005		
	(Unaudited)					
	Capital and reserves	Retained earnings	Total shareholders' equity	Capital and reserves	Retained earnings	Total shareholders' equity
	(NIS millions)			(NIS millions)		
Balance at the beginning of the period	7,010	10,273	17,283	7,010	8,451	15,461
Net profit for the period	-	378	378	-	578	578
Benefit in respect of share options and shares to employees	-	219	219	-	-	-
Adjustments in respect of presentation of securities available for sale at fair value	-	(134)	(134)	-	79	79
Related tax effect	-	58	58	-	(30)	(30)
Translation adjustments for companies included on the equity basis	-	13	13	-	(2)	(2)
Loans to employees for purchase of Bank's shares	-	(466)	(466)	-	-	-
Balance at the end of the period	7,010	(a) 10,341	17,351	7,010	(a) 9,076	16,086

	For the six Months Ended 30 June					
	2006			2005		
	(Unaudited)					
	Capital and reserves	Retained earnings	Total shareholders' equity	Capital and reserves	Retained earnings	Total shareholders' equity
	(NIS millions)			(NIS millions)		
Balance at the beginning of the period	7,010	8,990	16,000	7,010	7,976	14,986
Net profit for the period	-	1,490	1,490	-	1,106	1,106
Benefit in respect of share options and shares to employees	-	252	252	-	-	-
Adjustments in respect of presentation of securities available for sale at fair value	-	111	111	-	7	7
Related tax effect	-	(42)	(42)	-	(7)	(7)
Translation adjustments for companies included on the equity basis	-	1	1	-	(10)	(10)
Loans to employees for purchase of Bank's shares	-	(461)	(461)	-	4	4
Balance at the end of the period	7,010	(a) 10,341	17,351	7,010	(a) 9,076	16,086

	For the Year Ended 31 December 2005 (Audited)		
	Capital and capital reserves	Retained earnings	Total shareholders' equity
	(NIS millions)		
Balance as at 1 January 2005	7,010	7,976	14,986
Net profit for the year	-	2,136	2,136
Proposed dividend	-	(1,103)	(1,103)
Adjustments in respect of presentation of securities available for sale at fair value	-	(83)	(83)
Related tax effect	-	35	35
Translation adjustments for companies included on the equity basis	-	25	25
Loans to employees for purchase of Bank's shares	-	4	4
Balance as at 31 December 2005	7,010	(a) 8,990	16,000

(a) The retained earnings at the end of the period include:

- Adjustments from translation of the financial statements of autonomous foreign investees in the amount of NIS (341) million (NIS (377) million as at 30 June 2005 and NIS (342) million as at 31 December 2005).
- Adjustments in respect of presentation of securities available for sale at fair value, less related taxation, in the amount of NIS 115 million (NIS 94 million as at 30 June 2005 and NIS 46 million as at 31 December 2005).

The accompanying notes are an integral part of these Financial Statements.

NOTES

1. The Condensed Consolidated Interim Financial Statements to 30 June 2006 have been prepared in accordance with accounting principles adopted for the preparation of interim reports. The accounting principles used in preparing the interim report are consistent with those applied in the audited Financial Statements as at 31 December 2005, save as set forth in Note 2 below. These Statements should be read in conjunction with the Annual Financial Statements as at 31 December 2005 and for the year ended on that date, and their accompanying Notes.

2. **A. First Application of New Accounting Standards:**

1. **Accounting Standard No. 20 (Amended) – "Accounting Treatment of Goodwill and Intangible Assets on Acquisition of Investee Companies"**

As from 1 January 2006, the Bank has been applying Accounting Standard No. 20 (Amended) - "Accounting Treatment of Goodwill and Intangible Assets on Acquisition of Investee Companies" ("Standard No. 20") of the Israel Accounting Standards Board.

Standard No. 20 prescribes the accounting treatment of goodwill and intangible assets on the acquisition of a subsidiary and an investee company that is not a subsidiary, including a company under joint control.

According to Standard No. 20, the excess of the cost of acquisition of an investment in an investee company over the part of the holding company in the fair value of its identifiable assets (including intangible assets) less the fair value of its identifiable liabilities (after relevant tax attribution) constitutes goodwill. The excess of the cost of acquisition of an intangible asset acquired will be attributed only in the event of fulfilment of the definition of intangible asset in accordance with the criteria fixed in Standard No. 20. According to Standard No. 20, in the event that negative goodwill (excess of fair value over acquisition cost) is derived as of acquisition, such negative goodwill will be recognized immediately as of acquisition date as a gain in the profit and loss statement and will not be amortized methodically. Positive goodwill and intangible assets with undefined lives will not be amortized, as opposed to the rules in effect until the starting date of the Standard, according to which goodwill and intangible assets are amortized over their useful lives, up to a maximum of 20 years for goodwill.

The Bank is adopting the provisions of Standard No. 20, save for discontinuation of amortizing goodwill and save for charging negative goodwill that is created at the time of acquiring businesses to profit and loss. Pursuant to the Supervisor of Banks' directives, goodwill will continue to be amortized over a period of 10 years unless the Supervisor of Banks shall otherwise permit.

The first application of Standard 20 did not have an effect on the Bank's Financial Statements.

2. **Accounting Standard No. 21 - "Earnings per Share"**

As from 1 January 2006 the Bank has been applying Accounting Standard No. 21, "Earnings per Share" ("Standard No. 21") of the Israel Accounting Standards Board. Standard No. 21 prescribes the principles for the computation and presentation of earnings (loss) per share in the financial statements and supersedes Opinion No. 55 of the Institute of Certified Public Accountants in Israel on the matter.

According to Standard No. 21, earnings per share are to be computed based on the number of ordinary shares (and not per NIS 1 par value of the shares as computed until the commencement date). Basic earnings per share are to include only the weighted average of the number of shares which are outstanding during the period whereas convertible securities (such

as convertible debentures and options) are to be included only in the computation of diluted earnings per share, in contrast to the principles applied until the commencement date of the Standard, according to which in cases where a convertible security is likely to be converted, it is included in the computation of basic earnings per share. In addition, convertible securities which had been converted during the period are to be included in diluted earnings per share only up to the date of conversion and are to be included in basic earnings per share from that date. Pursuant to Standard No. 21, options will be included in diluted earnings when their exercise results in the issuance of shares for a consideration which is less than the market price of the shares. The amount of dilution is the market price of the shares minus the amount that would have been received as a result of the conversion of all the options into shares. This is in contrast to the method of computation prescribed by Opinion No. 55 of the Institute of Certified Public Accountants in Israel, which also includes adjustments to profits.

According to Standard No. 21, the provisions of the Standard should be implemented regarding comparative earnings per share data relating to previous periods.

The first application of Standard 21 did not have an effect on the comparative figures of earnings per share.

3. **Accounting Standard No. 22 - "Financial Instruments – Disclosure and Presentation"**

As from 1 January 2006 the Bank has been applying Accounting Standard No. 22 – "Financial Instruments – Disclosure and Presentation" ("Standard No. 22") of the Israel Accounting Standards Board.

Standard 22 prescribes principles regarding the presentation of financial instruments and details the proper disclosure required in respect thereof in the financial statements. In addition, Standard 22 lays down principles for the classification of a financial instrument, or its constituent parts, upon its initial recognition as a financial liability, financial asset or equity instrument, and the classification of transaction costs (net of any related tax benefit) arising from the financial instrument as a profit and loss item or capital item accordingly, and the conditions upon which a financial asset will be offset against a financial liability.

Adoption of the Standard is implemented according to the "from here onward" method. In certain matters relating to the presentation of financial instruments, the rules determined in the directives of the Supervisor of Banks apply to the Bank.

The time application of Standard 22 did not have an effect on the Bank's Financial Statements.

4. **Accounting Standard No. 24 - "Share-Based Payment"**

As from 1 January 2006 the Bank has been applying Accounting Standard No. 24 - "Share-Based Payment" ("Standard 24") of the Israel Accounting Standards Board.

Standard 24 requires the recognition of share-based payment transactions in the financial statements. Such transactions include transactions with employees or other parties that are to be settled in the company's equity instruments or in cash, as well as transactions that provide the company or the supplier of the service or goods with a choice of settling in cash or in equity instruments. Concurrently with the recognition of the goods or services received, it is necessary to recognize an increase in shareholders' equity in the financial statements when the share-based payment transaction is settled in equity instruments, and the incurrence of a liability when this transaction is settled in cash.

Standard 24 prescribes the principles for the recognition, measurement and disclosure of the fair value of the goods or services provided in exchange for the equity instrument granted. In

particular, measurement principles are prescribed with respect to transactions with employees and others providing similar services, transactions with parties who are not employees and transactions that are measured by reference to the fair value of the equity instruments granted. In addition, requirements are prescribed for situations in which modifications are made to the conditions on which the equity instrument was granted.

The first application of Standard 24 did not have an effect on the Bank's Financial Statements. See Note 10 with regard to the grant of options and the sale of shares to the Bank's employees in 2006.

B. First Application of the Provisions of Proper Banking Management Directives relating to Provision for Doubtful Debts in respect of Housing Credit at Leumi Mortgage Bank

As from 1 January 2006 Leumi Mortgage Bank has been implementing the Bank of Israel's circular dealing with all matters relating to the manner of the calculation of the provision for doubtful debts regarding housing credit. The circular determines, *inter alia*, that a bank that elected to calculate the provisions in respect of loans in accordance with the depth of arrears method, even if it was not required to do so under the directives, is not entitled to reduce the provisions by means of a decision to make specific provisions. In addition, clarifications were given as to the manner of the calculation of the depth of arrears, directives as to the manner of the calculation of the provision in respect of arrangements and the re-organization of loans and also the manner of the calculation of the provision in respect of loans in which the principal is repaid in one payment. Further, the circular relates to the clearance of a debt in arrears after the balance sheet date and does not allow the reduction of the provision even if cash is received in respect of the arrears after the balance sheet date, including cash in respect of the sale of an apartment before the balance sheet date.

The effect of applying the circular to the provisions for doubtful debts at Leumi Mortgage Bank is a one-time addition in the amount of NIS 63.7 million, in respect of adjusting the opening balance for 2006.

In addition, it is stated in the instructions that the definition of housing credit for the purposes of financial reporting will also include loans granted "for any purpose" against the pledging of a residential apartment. The effect of this instruction on Leumi Mortgage Bank is in the classification of provisions for doubtful debts.

3. In the regular course of business, legal claims were filed against the Bank and certain consolidated companies, including applications for approval of class actions.

In the opinion of the Management of the Bank and the managements of the consolidated companies, based on legal opinions regarding the chances of the claims succeeding, including the applications for approval of class actions, appropriate provisions were recorded in the Financial Statements, insofar as required, to cover damages resulting from the said claims.

In the opinion of the Management of the Bank and the managements of the consolidated companies, the total additional exposure arising from legal claims filed against the Bank and against the consolidated companies as mentioned above on various subjects, the amount of each of which exceeds NIS 2 million, and where the chances of such claims succeeding are not remote, amounts to some NIS 99 million.

Following are details of claims in material amounts.

A. On 24 August 1997 an application to approve the filing of a class action against the Bank and against Israel Credit Cards Ltd. ("ICC") was filed in the Tel Aviv-Jaffa District Court in connection with collection of fees for limitation of credit card holders' liability. The application is for approval of a monetary class action in the amount of some NIS 105 million as of the date of filing the claim and also for additional remedies. The application is in the preparation of written summaries stage.

- B. In September 1997 a foreign company in the process of liquidation filed a claim against the Bank, a subsidiary of the Bank (Bartrade International Trade and Financing (83) Ltd.) and certain of their employees in the amount of some NIS 153 million as of the date of filing the claim. The claim relates to transfer of US\$ 43.4 million by the foreign company to an account with the Bank in the name of a manager of the foreign company. The liquidator of the foreign company claims, *inter alia*, that the defendants acted in such a way that enabled the manager of the foreign company to steal the said amount from it.
- C. On 15 June 2000 a claim was filed against the Bank in the Tel Aviv-Jaffa District Court, together with an application to approve the claim as a class action in the amount of NIS 1 billion.

The plaintiff alleges that the Bank, in its various publications, promised to depositors of shekel deposits made by self service through direct banking channels, a preferred annual interest rate of 1% over the accepted rate, and that the various publications and the information provided to the depositors at the time of the original deposit mislead the depositors to think that the 1% additional interest is granted also in respect of the periods in which the deposit is automatically renewed and not only in respect of the original deposit period, as is the actual case.

Accordingly, the plaintiff is requesting that the Bank pay to it and all the relevant depositors being represented, the preferred interest also in respect of the periods in which the deposits were automatically renewed. In December 2003 the Court approved the claim as a class action. The Bank submitted an appeal on the decision to the Supreme Court, which has not yet rendered a ruling on the matter.

- D. On 19 June 2002 an application for approval of a class action was filed by the Ramle Municipality against the following respondents: the Bank, the Bank Clearing Center Ltd, Bank Hapoalim B.M., Israel Discount Bank Ltd., The First International Bank of Israel Ltd., United Mizrahi Bank Ltd. and Mercantile Discount Bank Ltd. The applicant asserts that the respondent banks entered into a restrictive arrangement with regard to commissions they charge their customers that receive standing order clearing services and that, as a result of the restrictive arrangement to which the respondents are parties, the applicant, and all recipients of standing order clearing services, pay unfair and unreasonable amounts for these services. The class action was filed in the amount of NIS 967.5 million. On 11 December 2003 the application for approval of the class action was summarily dismissed. On 18 February 2004 the Ramle Municipality appealed the dismissal. On 28 November 2005 the Supreme Court dismissed the appeal. The Municipality submitted an application to the Supreme Court for an additional hearing on the decision and an application for exemption from deposit of a guarantee. The Supreme Court dismissed the application for exemption from deposit of a guarantee and the Municipality has filed an application to strike out its application for a further hearing, which was struck out on 11 April 2006.
- E. On 14 October 2004 an application to approve a claim as a class action in the amount of some NIS 2 billion was filed with the Tel Aviv-Jaffa District Court against the Bank on the basis of the Banking (Service to Customer) Law, 1981 and Regulation 29 of the Civil Procedure Regulations, 1984.

The subject of the claim was originally the allegations of the applicant that he and all other customers of the Bank were charged fixed management fees, credit provision fees and securities deposit management fees illegally and contrary to the exemptions indicated beside the fees on the Bank's price list. The applicant maintains that the Bank misled its customers and breached the disclosure duties owed to them, and breached contractual obligations to them by charging them the fees, despite the fact that according to the Bank's price list they were entitled to exemptions from the payment of such fees. The applicant is also claiming that as such the Bank was unlawfully enriched.

On 19 December 2004 the Bank submitted to the Court its response to the application to approve the claim as a class action, and on 24 February 2005 the applicant's reply to the Bank's response to the application for approval of a class action was filed. On 20 September 2005 an application was filed with the Court to amend the statement of claim, pursuant to which the applicant requested to strike out all that part of the claim relating to commissions on securities deposit management fees. The Court approved the request for such amendment and the amount of the claim was reduced to some NIS 1.12 billion. As a result of the amendment, on 19 December 2005 the Bank submitted an amended response to the amended application for approval of the claim as a class action. On 20 March 2006 an amended reply of the applicant was filed.

- F. In June 2005, an application for the approval of the filing of a class action was filed in the Tel Aviv-Jaffa District Court against the Bank in the amount of NIS 576 million.

The applicant claims that the Bank did not stand by promises advertised on its internet site during the years 2002 to 2004 (inclusive), regarding interest benefits on certain deposits made through the internet. The applicant is demanding that the Bank pay him and all depositors through the internet who did not receive the promised benefits as advertised, the damages that they suffered as a result of non-receipt of such promised benefits.

On 3 October 2005 the Bank filed a response to the application to approve the claim as a class action, and on 20 November 2005 the applicant's reply to the Bank's response was filed. A date for the hearing of the application has not yet been fixed.

- G. On 7 August 2005 a claim was filed in the Tel Aviv-Jaffa District Court to approve a claim as a class action against the Bank, based on the assertion that until January 2003 the Bank did not credit its customers with a proportionate part of the amounts of the commission that they paid for bank guarantees that were issued at their request and the amount whereof was reduced prior to the end of the guarantee period.

The Plaintiffs assert that the amount of the claim exceeds NIS 2.5 million.

4. In addition, there are legal claims pending against the Bank, including applications for approval of class actions, as detailed below. In the opinion of the Management of the Bank, based on legal opinions with regard to the chances of the claims, it is not possible at this stage to estimate the chances of the claims and therefore no provision was recorded in respect thereof.

Following are the details of the legal claims:

- A. In February 2006 an application for the approval of filing a class action was filed by a customer of the Bank in the Tel Aviv-Jaffa District Court against the Bank, in an amount estimated by the applicant at some NIS 300 million.

According to the applicant, in the framework of the sale of "structured products" to Bank customers, the Bank does not disclose the full pricing and charges a hidden "commission" that is expressed in a financial margin which enures to the benefit of the Bank in the transaction, which in the applicant's view contradicts the requirement for disclosure imposed upon the Bank in accordance with the law.

The group to which the requested class action relates, according to the claim, is all Bank customers that invested in various "structured products" marketed by the Bank, from January 1999 until January 2006, where the Bank did not disclose to them what allegedly should have been disclosed.

The Bank has not yet submitted a response.

According to the Management of the Bank, based on the opinion of its legal advisers, the chances of the claim cannot be estimated at this time.

- B. On 23 April 2006 an application was filed in the Jerusalem District Court to approve a class action against the Bank on the assertion that in consequence of a change in the classification of accounts that were managed at the Bank as “debitory current accounts” to “private commercial debitory current accounts”, on 25 April 1999 or thereabouts, according to the applicant’s assertion, without due disclosure to customers and in breach of the provisions of the account management terms and conditions agreement and the legal provisions in such regard, the Bank changed the interest rate (the risk supplement component) and additional costs relating to the management of the account.

The amount of the class action has been estimated by the applicant in an amount of some NIS 45 million.

A response on behalf of the Bank has not yet been filed.

In the opinion of the Management of the Bank, based on the opinion of its legal advisers, the chances of the application cannot be estimated at this time.

5. Following are details of requests for approval of class actions in material amounts that were submitted against Leumi Mortgage Bank Ltd. ("Leumi Mortgage Bank"). In the opinion of the Management of the Bank, based on the opinion of the Management of Leumi Mortgage Bank, which is based on the opinion of Leumi Mortgage Bank's legal advisers as to the chances of these proceedings, appropriate provisions have been included in the Financial Statements, insofar as required, to cover damages resulting from such claims:

- A. On 21 June 2000 an application for approval of a class action was filed in the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank based on the Banking (Service to Customer) Law, 1981, Regulation 29 of the Civil Procedure Regulations, 1984, and the Supervision of Insurance Practices Law, 1981. The amount of the claim, whose approval as a class action was requested, is estimated by the applicants at some NIS 100 million.

The applicants who took out loans from Leumi Mortgage Bank, are making claims regarding the value of buildings for purposes of property insurance in the framework of loans taken out from Leumi Mortgage Bank. According to the applicants, Leumi Mortgage Bank or its representative prepared an excessive valuation of the buildings, resulting in overpayment of premiums by Leumi Mortgage Bank customers. The applicants contend that this was also done in their case. In accordance with the decision of the District Court, the hearing on the claim was stayed until the appeals reviewed in paragraph 6A below are decided.

- B. On 3 July 2001 an application was filed in the Tel Aviv-Jaffa District Court for approval of a class action based on the Banking (Service to Customer) Law, 1981, the Restrictive Trade Practices Law, 1988, and Regulation 29 of the Civil Procedure Regulations, 1984.

The amount of the class action whose approval is requested is estimated by the applicant at some NIS 180 million as of the date of submission of the claim.

The subject of the claim is claims of alleged overcharging by Leumi Mortgage Bank of borrowers of Leumi Mortgage Bank who took out loans at variable interest. The applicant took out a loan from Leumi Mortgage Bank at variable interest. The applicant is claiming that the interest according to which Leumi Mortgage Bank updates loans at variable interest is excessive and collected illegally, due to it being based on misleading information which misled borrowers, the existence of a syndicate between the mortgage banks which caused a limitation in the supply of loans at variable interest and their quality and diversity, and a series of other claims.

In addition to the monetary relief, additional relief was requested including declarative relief and determination of various rights for borrowers in accordance with the loan agreement.

On 3 June 2003 the Court dismissed the application for approval of the claim as a class action. On 23 September 2003 the applicant appealed the said decision to the Supreme Court. On 30 June 2004 the Supreme Court decided to stay the continuation of the hearing of the appeal in order to await a decision in the additional hearing regarding Regulation 29 of the Civil Procedure Regulations, 1984 (file no. 5161/03) that was meanwhile handed down on 1 September 2005. In short, the ruling states that although interpretive means may be utilized to convert Regulation 29 to an instrument for submission of class actions, such utilization is not appropriate as at this time, taking into consideration legislative procedures underway in the field of class actions. Accordingly, the parties agreed that the matter of Regulation 29 would be struck off from the appeal and a date for hearing of the appeal was fixed for 4 May 2006.

On 12 March 2006 the Class Actions Law, 2006 (the "Class Actions Law") was published. The object of the Law is to regulate uniform rules relating to the filing and conduct of class actions.

The Law provides that a class action shall not be filed, other than as a claim detailed in the schedule to the Law or pursuant to an express statutory provision. The matters in respect whereof a class action may be filed on the basis of the Law include "a claim against a banking corporation in connection with a matter between it and a customer, irrespective of whether they entered into a transaction or not". The Law provides that in principle its provisions shall also apply to applications to approve a class action and to class actions that were pending before a court on the day the Law was published. At the same time, the Law repeals the provisions in the Banking Law (as well as in the Restrictive Trade Practices Law and in additional laws) that enable the filing of class actions. The Class Actions Law also prescribes provisions as to the prescription of causes of action that had not been established in specific arrangements that enabled the filing of a class action prior to its enactment (such as arrangements pursuant to the Banking Law or the Restrictive Trade Practices Law) and that were included in applications to approve class actions that were submitted prior to the publication of the Law. On 24 April 2006 the Supreme Court ruled that the parties should submit their summations as to the applicability of the Class Actions Law to the proceeding before it, and if the Law in fact applies - what the implications of its application are. At the same time, the Court cancelled the date of the hearing that had been fixed for 4 May 2006 and fixed it for 15 January 2007.

- C. On 7 July 2003 an application for approval of a class action was filed in the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank and against the Director of Stamp Duty based on the Banking (Service to Customer) Law, 1981, and Regulation 29 of the Civil Procedure Regulations, 1984.

The applicant is claiming as follows: he received a loan from Leumi Mortgage Bank; according to the Law, Leumi Mortgage Bank was required to stamp the loan documents; Leumi Mortgage Bank charged the applicant a higher amount than the legally required stamp duty, which was calculated according to the total amount of the loan repayments, including interest in respect thereof, over the entire loan period; the correct amount of stamp duty should be calculated according to the amount of the loan, without taking into account interest; Leumi Mortgage Bank presented misleading documents to the applicant, according to which the stamp duty that was required was the legally required amount.

The relief requested is for the refund by Leumi Mortgage Bank and the Director of Stamp Duty to the group of applicants of the difference between the actual stamp duty and the amount claimed by the applicants.

The amount of the class action whose approval is requested is estimated by the applicant at some NIS 100 million.

6. In addition, the applications for approval of class actions set out below are pending against Leumi Mortgage Bank. In the opinion of the Management of the Bank, based on the opinion of management of Leumi Mortgage Bank, which is based on the opinion of the legal advisors of Leumi Mortgage Bank with regard to the chances of these legal proceedings, it is not possible at this stage to estimate their chances and therefore no provision was recorded. Following are details of the legal proceedings:

A. On 17 July 1997 an application for approval of a class action in an amount exceeding NIS 1 billion was filed with the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank and against other mortgage banks in connection with collection of borrowers' life insurance and property insurance commissions. Each of the applicants took out a loan from one of the respondent mortgage banks. According to the applicants, in the framework of taking out the loan, the respondent banks included them in life insurance or property insurance policies taken out through the banks and, according to their assertions, part of the insurance premiums illegally reached the respondent banks.

On 17 November 1997 the Court ruled that the claim could not be heard as a class action according to the Banking (Service to Customer) Law, 1981, and the Restrictive Trade Practices Law, 1988. Accordingly, the Court struck off the monetary claim.

Nevertheless, the Court decided that the claim could be heard in the framework of Regulation 29 of the Civil Procedure Regulations, 1984, only with regard to the claim for declaratory relief relating to causes of action that had arisen before 10 May 1996. The Court ruled that the causes of action that could be heard in this framework related to the "restrictive arrangement and various insurance issues".

Appeals to the Supreme Court submitted against this decision by Leumi Mortgage Bank, all the other respondent mortgage banks and the applicants are pending. Pursuant to the decision of the Supreme Court, the District Court's decision was stayed. Accordingly, the claim will not be determined until the Supreme Court rules with regard to all of the appeals.

On 1 September 2005 the Supreme Court handed down a judgement in which it was determined, in short, that although it was possible to utilize interpretive means to convert Regulation 29 to an instrument for submission of class actions, such utilization is not appropriate at this time, taking into consideration legislative procedures underway in the field of class actions. On 12 March 2006 the Class Actions Law was published. For details of the Law, see Note 5B above.

In the opinion of the Management of the Bank, based on the opinion of management of Leumi Mortgage Bank, which is based on the opinion of its legal advisors, at this stage it is not possible to estimate the chances of the appeals.

B. On 10 June 2003 an additional application for approval of a class action was filed in the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank regarding alleged over-collection from borrowers who took out loans at variable interest. Although the application and the claim are stated unclearly, it appears that (at least partial) overlapping exists with the basic arguments raised in paragraph 5B above, the requested relief and the group of applicants.

The amount of the class action requested is estimated by the applicants at some NIS 90 million.

In light of the (at least partial) overlapping between the application for approval of the class action reviewed here and the application for approval of the class action reviewed in paragraph 5B above, it was agreed between the parties to stay the proceedings in the claim until after clarification of the appeal submitted in connection with paragraph 5B above. The Court was informed of this agreement and, accordingly, a response has not yet been submitted to the application for approval of a class action.

In the opinion of the Management of the Bank, based on the opinion of management of Leumi Mortgage Bank, which is based on the opinion of its legal advisors, in light of the preliminary stage of the process, the chances of the claim cannot be estimated at this time.

- C. On 27 March 2006 an application was filed in the Tel Aviv-Jaffa District Court against Leumi Mortgage Bank to approve a class action with regard to an alleged overcharging of stamp duty.

The estimated amount of the class action against Leumi Mortgage Bank is asserted in the application to be NIS 22 million.

The application was filed by a person who took a loan from Leumi Mortgage Bank and who contends that Leumi Mortgage Bank charged customers who had taken loans from it, stamp duty in respect of the amount of the interest that is added to the loans. As is asserted in the application, the claim involves overcharging since Leumi Mortgage Bank should have only charged stamp duty in respect of the amount of the loan principal.

It should be noted that an application is pending against Leumi Mortgage Bank to approve a class action in an asserted amount of some NIS 100 million, that was filed against it and against the stamp duty authorities on 7 July 2003, in which overcharging of stamp duty is also asserted, which it is contended was effected by charging stamp duty in respect of the interest component of the loan (see Note 5C above for an expansion of the matter). It is contended in the present application that it relates to a charge period that is different from that asserted in the application to approve a class action with regard to stamp duty that is already pending against Leumi Mortgage Bank. Leumi Mortgage Bank has not yet filed a response to the application for the approval.

7. Sale of Two Non-banking Holding Corporations

The Bank of Israel advised the Bank that it is required to sell its holdings in two conglomerates (Africa Israel and/or Migdal Insurance Holdings and/or The Israel Corporation) as soon as possible and no later than 30 September 2006. Should one of the two corporations being sold be Migdal Insurance Holdings, the Bank would be entitled to sell its holdings in Migdal Insurance Holdings in stages by 31 March 2008 as follows: by 31 March 2007 the holdings of the Bank in Migdal Insurance Holdings would not exceed 10%, and by 31 March 2008, the Bank would be required to sell the balance of its holdings in Migdal Insurance Holdings (if until such time the Banking Law is not amended so that insurance companies are explicitly excepted from the provisions of Section 24 of the Banking Law).

On 18 January 2006 the Bank notified the Bank of Israel of its intention to sell its holdings in Africa Israel and in Migdal Insurance Holdings.

On 1 February 2006, the Board of Directors approved entering into a transaction for the sale of the Bank's entire holdings in Africa Israel to Mr. Lev Leviev (the controlling shareholder of Africa Israel) or a company controlled by him, at a price of NIS 150 per share, reflecting a company value of NIS 7,075 million. On 13 February 2006 an agreement was signed for the sale. The transaction was completed on 27 March 2006. The total consideration to the Bank for the transaction was some NIS 1,131 million. The net profit from the transaction is some NIS 480 million.

On 5 March 2006 an agreement was signed between the Bank and Leumi Real Holdings Ltd., a wholly owned subsidiary of the Bank ("Leumi Holdings") and Participatie Maatschappij Graafschap Holland N.V. (the "Purchaser"), a wholly owned subsidiary of Assicurazioni Generali S.p.A., for the sale of shares in Migdal Insurance Holdings constituting 10% of the issued and fully paid share capital of the company owned by the Bank and Leumi Holdings for a total consideration of some US\$ 142 million.

After receipt of the approval of the Supervisor of Insurance, the transaction was completed on 15 March 2006. The net profit from the transaction is some NIS 237 million.

Following the completion of the transaction, 9.98% of the issued and fully paid share capital of Migdal Insurance Holdings remains in the hands of the Bank, and is presented in the securities available for sale item.

8. Capital Market Reform Legislation

On 9 November 2004 the team which was appointed by the Minister of Finance for the purpose of examining and recommending the steps required in order to intensify competition in the Israeli capital market, published its recommendations. The team's recommendations were approved by the government.

Following the team's recommendations, on 10 August 2005 three laws implementing a substantial reform of the capital market were published.

The laws that were published were:

The Intensification of Competition and Reduction of Concentration and Conflicts of Interest in the Israeli Capital Market (Legislative Amendments) Law, 2005;

The Financial Services (Control) (Engagement in Pension Counseling and Pension Marketing) Law, 2005;

The Financial Services (Control) (Provident Funds) Law, 2005.

In February 2006 the Joint Investment Trusts (Distribution Commissions) Regulations, 2006 and the Financial Services (Control) (Provident Funds) (Distribution Commissions) Regulations, 2006, that regulate the payment of distribution commissions for the distribution of mutual funds and provident funds, were published. Furthermore, the Commissioner of the Capital Market, Insurance and Savings has issued a draft circular, which is intended to regulate the operating agreements between a pension counselor and institutional entities and the payment of a commission to a banking corporation in respect of service to members, by a purchaser of provident funds from such banking corporation.

Further details of the legislation that regulates the capital market reform is given in the 2005 Annual Report, in the Directors' Report and Note 31 to the Financial Statements.

The said legislation has material effects on the Bank, as set forth below.

Actions taken by the Bank following the Legislation

Following the legislation, the Bank has taken the following actions:

- On 15 September 2005 it was decided to sell the holdings in Leumi-Pia at a price of some NIS 535 million to Harel Insurance Investments Ltd., subject to the signing of an agreement between the parties and regulatory approvals. As part of the negotiations for the signing of an agreement between the parties, an understanding exists between the parties whereby the assets and activities of the company will be sold at prices that reflect the structure of the planned transaction.
- On 19 October 2005 the Bank sold its holdings in Direct Insurance – Financial Investments Ltd. to Tzur Shamir Holdings Ltd. at a price of some NIS 116 million.
- On 26 November 2005, the Bank decided to enter into agreements, together with Leumi Gemel Ltd., for the sale of the goodwill, activities, assets and liabilities relating to the provident funds managed by Leumi Gemel Ltd.

A group of five provident funds, the largest of which are the Otzma, Taoz and Rimon provident funds and the investment activities of these provident funds, were sold to Harel Insurance Investments Ltd. at a price of NIS 675 million. The completion of the transaction is conditional upon

the receipt of regulatory approvals and the signature of distribution and operating agreements. A group of provident funds, the largest of which are Sion, the Central Severance Pay Fund, Tzur and Sagi were sold to Prizma Investment House Ltd, formerly A. Solomon Investments Ltd. (or a company under its control), at a price of some NIS 473 million. The completion of the transaction is conditional upon the receipt of regulatory approvals. The Leumi Group will continue to provide operating services in relation to all the provident funds that were sold, subject to the signing of operating agreements.

- On 28 November 2005, the Bank, together with Psagot Ofek Investment House Ltd. and its subsidiaries, including Psagot Managers of Mutual Funds - Leumi Ltd. (the "Psagot Ofek Group"), decided to enter into a binding agreement of principles for the sale of the goodwill, activities, assets and liabilities relating to all the assets of the Psagot Ofek Group, with York Capital Management ("York") on behalf of entities managed by it, at the price of NIS 1,350 million. In addition, the Bank received an option to purchase from York half the means of control of the company that will manage the portfolio management activities. On 23 June 2006 the signing of a detailed agreement between the parties was completed, that is based on the binding agreement of principles and includes a mechanism for adjustment of the consideration, in accordance with the volume of assets to be managed by the Psagot Ofek Group's mutual funds close to the date of the completion of the transaction, and in accordance with the Psagot Ofek Group's financial statements as at the date of the completion of the transaction. According to the mechanism for adjustment of the price pursuant to the volume of assets, as at 24 August 2006 the consideration will be reduced by some NIS 50 million. The agreement also includes various detailed terms with regard to the transaction and its execution, as well as the relations between the Bank, the Psagot Ofek Group and York after the completion of the transaction. In addition, the Bank waived the said option. The completion of the transaction is conditional upon the fulfilment of conditions precedent, and the receipt of regulatory approvals, including receipt of approvals from the Israel Securities Authority. On 2 July 2006 the signing of an additional agreement was completed, pursuant to which the date for the fulfilment of the pre-conditions for completion of the purchase was extended to 28 September 2006. Following the said extension, it was agreed that amounts that accrued in the Psagot Ofek Group, amounting to NIS 20 million, would be transferred to York with the activities and assets purchased at the time of the completion of the transaction. York deposited an advance in the sum of NIS 200 million on account of the consideration.
- Pursuant to the legislation, in March 2006 the Bank gave notice of a new commission to be charged in respect of holdings of customers in mutual funds, such being where there is no distribution agreement between the Bank and a fund manager, or where the customer does not agree to the Bank receiving distribution commission from the fund manager. With regard to managers of funds that were controlled by the Bank at the time of publication of the laws, the commission will be charged as of the date when such fund managers are no longer controlled by the Bank. The Bank has signed distribution agreements with the majority of the fund managers.
- On 26 May 2006, an agreement was signed between the Bank, Israel Discount Bank Ltd., Kahal Employees Supplementary Training Fund Ltd. ("Kahal"), Kahal Management of Study Funds (1996) Ltd. ("Kahal Management"), and between Migdal Capital Markets (1965) Ltd. on behalf of a company under its control and Migdal Insurance and Financial Holdings Ltd. on behalf of a company under its control (the "Purchaser"), for the sale of the goodwill, management rights, additional rights and means of control of the banks in Kahal, and for the sale of the goodwill, activities, assets and liabilities relating to the supplementary training funds managed by Kahal Management, for a consideration of NIS 260 million. Such amount will be adjusted in accordance with the volume of the supplementary training fund assets being sold as at the date of completion. The Bank's share of the consideration amount is NIS 149.5 million.

It has been agreed that the Bank will enter into an agreement with Kahal and with the Purchaser for the provision of operating services by the Bank to the funds sold, and also a distribution agreement, under which the Bank will distribute the funds.

Completion of the transaction is subject to the fulfilment of certain conditions and receipt of regulatory approvals.

- The Bank is conducting talks with the authorities and is also, together with the employees' representatives, examining the preparations required for complying with the provisions of the permit given to the Bank under the legislation, for the engagement in management of provident funds, all the members of which are employees of the Bank or employees of a corporation controlled by it.
- The Bank has received approval from the Capital Market Department of the Ministry of Finance to establish central compensation funds for its employees and employees of additional companies in the Group.
- The Bank is engaged in preparations to enter the pension counseling field. These preparations involve the development of mechanized tools and training and recruiting of staff.
- The Bank is examining the implications of the freedom of choice granted to the employees with regard to provident funds, including freedom of movement from fund to fund, on its obligations towards its employees at the time of retirement.

Effect of the Reform on the Bank and the Group

The reform has a material effect on the Group's activities in the capital market. The Group has until now engaged both in managing assets on the capital market for the public, and in counseling, distribution and provision of additional capital market services. Following the reform, the Group's activities in Israel will focus mainly on the provision of investment counseling, the provision of pension counseling (when the Bank receives a license to engage in such activities), the provision of operating services to entities active in the capital market, and additional activities.

The restrictions in the legislation, under which a banking corporation may not carry out marketing activities but only counseling (while other entities will be able to carry out marketing), the prohibition on holding material holdings in corporations which manage investment portfolios for institutional entities and the restrictions on carrying on pension counseling activities, will, in Management's estimation, lessen the ability of the Bank to compete in the most effective manner in the financial and pension markets.

Further, the disposal by the Bank of its holdings in mutual fund, provident fund and supplementary training fund management companies will cause a reduction in the Bank's current income from these activity fields. On the other hand, the legislation allows, as mentioned above, the receipt of distribution commission from institutional entities, and the receipt of commission in respect of operating services to institutional entities, and these commissions will, to a partial extent, reduce the expected adverse effect.

The following table sets out details of the Group's income from management fees from mutual funds and provident funds, including supplementary training funds (in NIS millions):

	First Half		Year
	2006	2005	2005
From mutual funds	234	201	427
From provident funds	110	100	201
From supplementary training funds	14	15	32
Total	358	316	660

In the estimation of the Management of the Bank, based on the data and assumptions detailed below, in lieu of the income of the Bank and the Group arising from management fees as detailed above, which as of the completion of the disposal transactions will no longer arise, in 2006 the Bank may receive management fees, distribution commissions and commissions in respect of services to members. In consequence, the pre-tax profit is expected to decline by some NIS 82 million.

The decrease in the amount as compared with the estimate given in the Financial Statements for the first quarter derives from the fact that the sale transactions of the various companies had not been concluded at the end of the first half of 2006.

The data and assumptions upon which the estimation is made are:

With regard to the first half of 2006, the actual income from mutual and provident funds, including supplementary training funds, was taken into account.

With regard to the third quarter, an estimate was made of income from management fees in accordance with the value of the assets being managed as at the end of the first half of 2006, this being since the sale had not been completed, save in relation to one company in respect whereof only distribution commissions were taken into account.

With regard to the fourth quarter, an estimate was made of income from management fees or distribution commissions or commission in respect of service to members, on the assumption that some of the sales transactions will be closed at the end of the third quarter and some during the course of the fourth quarter of 2006.

The calculation of the management fees and distribution commissions for mutual funds is based upon balances of holdings of customers of the Bank or the Group, as the case may be, as they were on 30 June 2006. Furthermore, the calculation of the distribution commissions is also based on the weighted rate of the commissions, according to the spread of the total assets of the funds managed by Leumi Pia and Psagot on 30 June 2006, without assuming changes in the holdings, that are likely to affect the amount of the commissions that the Bank will receive, in consequence of changes in the classification of the funds and also in consequence of changes in the volume and mix of the customers' holdings.

The calculation of the distribution commission is based on the maximum rates determined in the regulations.

The calculation of the distribution commission in respect of provident funds also includes commission in respect of services to members that are usually part of the service provided by a pension counselor, for as long as pension counseling is not provided. The calculation is also based on the balances of the holdings of members of provident funds managed by the Group, as they were as of 30 June 2006, assuming that the commissions will be paid on these total balances. It is clarified that if this assumption does not materialize in respect of the provident funds (save for supplementary training funds), the decrease in pre-tax profit as detailed above will increase by up to some NIS 10 million. In addition, this calculation was made without any assumption as to changes in members' holdings, which might affect the amount of commissions that the Bank will receive.

Operating commission that the Bank may receive from operating services was not taken into account in the calculation, on the assumption that the expenses involved in providing these services will be covered by the operating commissions.

In the above amounts, the use that the Bank is likely to make of the consideration of the sales of holdings carried out in consequence of the legislation was not taken into account.

The transactions carried out by the Bank (with the exception of the sale of Direct Insurance which was completed in 2005) are expected to be completed during 2006, and consequently the Bank anticipates capital gains of some NIS 2.0 billion in 2006.

In the Bank's assessment, in addition to the estimated decrease in income given above, the implementation of the provisions of the legislation in their entirety is likely to have additional negative affects on the Group's business, the scope of which cannot at this stage be accurately evaluated, in light of the uncertainties which still exist with regard to various matters.

9. Employee Rights

A. Changes in Mortality Tables

In November 2005 the Supervisor of Banks announced that he was adopting the letter of the Chief Actuary of the Capital Market, Insurance and Savings Department of the Ministry of Finance to the insurance companies, pursuant where to as from the first quarter of 2006 an insurer must assess the reserves for life insurance policies on the basis of the mortality tables as presented in the position paper sent by the Commissioner of Insurance for the observations of the insurance and pension fund companies in April 2005.

In accordance with the estimation of the Bank's actuary, based on the revision of the mortality assumptions in accordance with the said position paper, for the purpose of assessing the actuarial liabilities, the Bank recorded an additional provision of NIS 136 million before taxes (some NIS 86 million after taxes) in the first quarter of 2006 to revise the pension and jubilee reserves.

B. Benefits to "Leumi Alumni"

"Leumi alumni" are entitled, in addition to pension and/or severance payments, (as each chooses) to additional benefits, principally gifts on religious festivals and participation in the cost of additional welfare and social activities.

"Leumi alumni" – whoever ended their employment with the Bank, at any age, following completion of 25 years' employment with the Bank, or ended their employment at the age of 65 or more, following completion of at least 15 years' employment.

In the second quarter of 2006, the expected costs in respect of the above entitlements for the period following the period of employment were recorded pursuant to an actuarial calculation, as accrued as at 30 June 2006. The amount accrued as at this date amounted to some NIS 80 million, after the effect of taxes.

The Bank recorded the cost of the entire accumulated amount in salary expenses in the second quarter of 2006, and not by way of re-statement, pursuant to the American Interim Financial Report APB28 standard. According to the standard, in the determination of materiality for the purposes of financial reporting for the interim period, with regard to the effect of accounting changes or correction of errors, these should be related to the amount of the expected annual profit, and the effect on the profitability trend. Pursuant to the standard, separate disclosure should be made in the interim financial statements with regard to corrections that are material in relation to the interim period, even though they are not material in relation to the expected annual profit and profitability trend.

10. A. Issue of Options to Employees

On 2 February 2006, the Bank's General Meeting approved a plan for the issue of options to entitled employees, as determined in the outline published by the Bank on 24 January 2006 (the "Outline"). In accordance with this program, on 14 February 2006, 84,853,960 options, exercisable into 84,853,960 ordinary shares of the Bank, were allotted (of which 122,644 options were allotted to the Chairman of the Board of Directors and 156,659 options were allotted to the Chief Executive Officer). The said options are subject to all the terms of the Outline, including:

1. The options will be exercisable in two equal tranches, the first tranche at the end of two years from the date of the allotment of the options and the second tranche as from the end of the second year from the date of the allotment of the options and up to the end of the third year from the date of the allotment of the options.
2. The options were issued to the employees free of consideration.

3. The exercise price per share will be NIS 13.465 and will be linked to the CPI (commencing from September 2005). The price will be adjusted for the distribution of dividends (whose amounts will be linked to the CPI), bonus shares and the bonus element of rights issues, if such issues take place. This price was determined in coordination with the Ministry of Finance.

In respect of the issue of the said options, the Bank will record salary expenses in accordance with the fair value of the options with the addition of salaries tax and national insurance contributions. This expense will be recorded in the Bank's financial statements over a period of two years from the date of allotment.

The estimate of the fair value of the options, as of the date of allotment, which was prepared by an external valuer in accordance with the Black & Scholes model, was some NIS 422 million. The calculation of the value was based upon the following principal criteria:

- standard deviation of the annual yield: 25%.
- risk free linked interest rate: 3.5%.
- price per share – the closing rate of NIS 17.30 per share on 14 February 2006.
- dividend distribution policy: 50% of the net profit.
- rate at which employees leave during the vesting period of the options: 2%.

The Bank received approval from the Tax Authority for the operation of the plan as a "plan for the allotment of shares by means of a trustee" within the context of section 102 of the Income Tax Ordinance, on the capital gains taxation path. The profit benefit portion (which will be considered to be income from work in the hands of the employees) at the time of the granting of the options was some NIS 368 million. In respect of this portion, the Bank will pay salary tax and national insurance contributions in the amount of some NIS 44 million, and as against this the Bank will save companies tax and profits tax in the amount of some NIS 91 million. This saving will be recorded in the Bank's books over the period of two years from the date of the allotment, in parallel with the recording of the expense. The amount of the expense in respect of the fair value will be recorded against capital account. In the first half of the year, the Bank recorded some NIS 88 million as salary expenses in the statement of profit and loss (second quarter – NIS 48 million).

B. Sale of Shares to Employees

On 14 June 2006, employees of the Bank purchased 2.8478% of the capital of the Bank (40,274,560 ordinary shares, of these, 75,532 were purchased by the Chief Executive Officer), in accordance with an outline published on 9 May 2006 (and amended on 10 and 25 May 2006). On 3 July 2006, the General Meeting approved the purchase of 59,131 ordinary shares by the Chairman of the Board of Directors of the Bank, which purchase was carried out on 5 July 2006.

The purchase of the shares was carried out in accordance with an agreement of March 2006 with the Accountant-General regarding the offer of ordinary shares of the Bank by the State to the employees of the Bank, in accordance with the agreements in respect of the privatization of the Bank and decisions of the Finance Committee of the Knesset. According to the above agreement, the shares would be offered to the employees in two stages, the first of which, an offer of 2.873% of the share capital, has been carried out, as mentioned above. The second stage, in which a further 1% of the share capital of the Bank will be offered to the employees, will be carried out after completion of the privatization process. The base purchase price was set at NIS 16.10 per share (as agreed by the Ministry of Finance and matching the average price of the sale to Barnea). The shares were offered to the employees at a discount of 25% below the base price, the price being linked to the CPI for September 2005 up to the date of exercise of the offer with the addition of interest of 2% per annum

from 24 November 2005 (the "Exercise Price"). The Exercise Price was adjusted for the dividend distribution on 28 February 2006 (NIS 0.78 per share).

The benefit granted to the employees and the Chairman of the Board of Directors in respect of the said purchase, which was evaluated by an external valuer, included a number of components and totaled some NIS 191 million (including salary tax and national insurance).

This amount was recorded in the second quarter of the year as a salary expense, of which an amount of NIS 157 million was against the capital account.

Set out below are the parameters according to which the calculation was made:

- calculation of the fair value was made according to the price of the Bank's shares at the time of granting, which is the average price of the Bank's shares in the period during which the employees subscribed for the shares. The period was 31 May 2006 to 11 June 2006, and the average price of the shares during this period was NIS 16.71.
- the calculation of the fair value takes into account the "flaws" in the offered shares (locked-up for 4 years and regular tax payment in respect of the benefit component) as compared with regular shares.
- the shares are locked-up for 4 years. In respect of this "flaw" of lack of marketability, 15% was reduced from the value of the shares at the time of granting.
- an annual dividend payment of 50% of net profit was assumed.
- the financing of the purchase of the employees' shares was through CPI-linked, interest free loans granted by the Bank.
- the interest rate for the calculation of the value of the benefit embodied in the loans was 4% per annum linked to the CPI.
- the Bank received an approval from the Tax Authority under which the provisions of section 102 of the Income Tax Ordinance will apply to the program.

The following table sets out details of the calculation:

	NIS thousands
Fair value of the shares net of lack of marketability	102,911
Cost of financing loans	54,543
Salary tax and national insurance	33,982
Total salary expense	191,436
Tax shelter to Bank in profit and loss	(48,514)
Total net cost in profit and loss	142,922
Amount recorded in capital account	178,414

In order to finance the purchase of the shares, the employees were granted loans, which will be repayable at the end of the 4 years' lock-up period of the shares. The loans are linked to the CPI, do not bear interest and are not on non-recourse conditions. The granting of the loans was approved by the Supervisor of Banks, who noted in his approval that when determining the repayment terms, the Bank was requested to take into account the fact that approval would not be given for the extension of the repayment period of the loans beyond the end of the lock-up period. The total of the loans granted to the employees (including to the Chairman) was some NIS 466 million which amount was deducted from the Bank's capital.

11. Acquisition of Eurom Bank S.A. (Romania)

On 23 October 2005 the Bank and Kolal B.V. ("Kolal"), the controlling shareholder of Eurom Bank S.A., signed an agreement according to which the Bank would acquire control of Eurom Bank from Kolal.

On 4 August 2006 the transaction between the Bank and Kolal was completed, pursuant to which the Bank acquired from Kolal over 99% of the issued and paid up share capital of Eurom Bank, for a

consideration of some US\$ 46 million. An advance and amounts paid to cover loans and expenses in the amount of US\$ 12 million were offset from this amount.

The following are principal data of Eurom Bank as at 30 June 2006:

total assets – US\$ 159 million.

total credit to the public – US\$ 72 million.

total deposits of the public - US\$ 136 million.

shareholders' equity – US\$ 20 million.

The Bank intends to increase the shareholders' equity of Eurom Bank by a further US\$ 20 million.

Eurom Bank will change its name to Bank Leumi Romania.

12. **Change of Salary Tax and Profit Tax**

On 27 June 2006 the Value Added Tax (Rate of Tax on Non-Profit Organizations and Financial Institutions) Order, 2006 was published in the Government Gazette (the "Amendment").

In consequence of the Amendment, salary tax and profit tax applicable to financial institutions will be reduced from 17% to 15.5%. The Amendment came into force on 1 July 2006.

The provision for taxes on the Bank's income includes profit tax pursuant to the Value Added Tax Law that is levied on income. In light thereof, the statutory tax rate that includes profit tax that shall apply to the Bank in 2006 is 40.65%, 38.53% in 2007, 36.80% in 2008, 35.93% in 2009 and from 2010 and thereafter the tax rate will be 35.06%.

In calculating the current taxes and deferred taxes balances as at 30 June 2006, the new profit tax rate as determined in the Order was taken into account. The effect of the change on the consolidated Financial Statements for the second quarter of 2006 is an increase in net income in an amount of NIS 20 million.

13. **Future Application of Accounting Standards**

Accounting Standard No. 29 - "Adoption of International Financing Reporting Standards (IFRS)"

In July 2006 the Israel Accounting Standards Board published Accounting Standard No. 29 - "Adoption of International Financing Reporting Standards (IFRS)" (the "Standard"). The Standard prescribes that entities that are subject to the Securities Law, 1968, and are obliged to report in accordance with the regulations of the said Law, shall prepare their financial statements in accordance with IFRS for the periods commencing 1 January 2008. The Standard permits early adoption as from the financial statements to be published after 31 July 2006. The aforementioned does not apply to entities to which the Securities (Periodic and Intermediate Reports of a Foreign Corporation) Regulations, 2000 apply and whose financial statements are prepared other than in accordance with generally accepted accounting principles in Israel. Furthermore, the Standard prescribes that entities that are not subject to the Securities Law, 1968 and are not obliged to report in accordance with the regulations of the said law, may also prepare their financial statements according to IFRS as from the financial statements to be published after 31 July 2006.

The first adoption of the IFRS standards will be by way of implementing the provisions of IFRS 1, First Adoption of IFRS Standards, for the purpose of the transition.

As at the publication of the Financial Statements, the Supervisor of Banks' directives with regard to the manner of the implementation of the Standard by the banks, if at all, have not yet been published.

**Net Interest Income Before Provision for Doubtful Debts (on a Consolidated Basis)
Reported amounts (Unaudited)**

	For the three months ended 30 June		For the six months ended 30 June	
	2006	2005	2006	2005
	(NIS millions)		(NIS millions)	
A. Income on assets (a)				
Credit to the public	1,200	4,805	5,020	7,157
Credit to governments	(26)	53	(2)	73
Deposits with Bank of Israel and cash	(39)	62	(5)	85
Deposits with banks	(760)	865	(25)	1,029
Debentures	(529)	1,476	506	2,055
Total income on assets	(154)	7,261	5,494	10,399
B. Expenses on liabilities (a)				
Deposits of the public	1,659	(4,773)	(2,157)	(6,154)
Deposits from governments	-	(92)	(32)	(127)
Deposits from Bank of Israel	(2)	(2)	(13)	(4)
Deposits from banks	-	(142)	(101)	(160)
Debentures, bonds and subordinated notes	(150)	(386)	(422)	(542)
Total expenses on liabilities	1,507	(5,395)	(2,725)	(6,987)
C. From derivative instruments and hedging activities				
Ineffective portion of hedge relationships (b)	6	4	(2)	(3)
Net income (expenses) from ALM derivative instruments (c)	301	(496)	378	(643)
Net income from other derivative instruments	1	3	2	11
Total income from financial derivative instruments and hedging activities	308	(489)	378	(635)
D. Other income and expenses				
Financing commissions	66	62	135	123
Profits from sale of debentures available for sale, net	2	12	5	29
Profits (losses) realized and not yet realized in respect of fair value adjustments of trading debentures, net	(16)	41	(32)	60
Other financing income	32	151	163	240
Other financing expenses	51	(38)	23	(32)
Total other income and expenses	135	228	294	420
Total net interest income before provision for doubtful debts	1,796	1,605	3,441	3,197
E. Detail of net effect of hedging derivative instruments on net interest income				
Financing income (expenses) on assets	(14)	(10)	4	10
Financing income (expenses) on liabilities	40	38	12	4
Of which: net exchange rate linkage differences	-	(26)	3	(38)

- (a) Including effective portion of hedge relationships.
- (b) Excluding effective portion of hedge relationships.
- (c) Derivative instruments that are included in the Bank's asset and liability management system which are not designated for hedging relationships.

Provision for Doubtful Debts (on a Consolidated Basis)
Reported amounts (Unaudited)

	For the three months ended 30 June					
	2006			2005		
	Specific Provision (a)	Supplementary Provision (b)	Total	Specific Provision (a)	Supplementary Provision (b)	Total
(NIS millions)			(NIS millions)			
Balance of the provision at the beginning of the period	8,337	1,074	9,411	7,504	1,054	8,558
Provisions during the period	413	-	413	537	16	553
Decrease in provisions	(210)	1	(209)	(51)	1	(50)
Collection of past years' write-offs	(19)	-	(19)	(9)	-	(9)
Net amount charged to statement of profit and loss	184	1	185	477	17	494
Write-offs	(61)	-	(61)	(102)	-	(102)
Balance of provision at end of period	(c) 8,460	1,075	9,535	(c) 7,879	1,071	8,950
Including balance of provision not deducted from credit to the public	35	132	167	33	132	165

	For the six months ended 30 June					
	2006			2005		
	Specific Provision (a)	Supplementary Provision (b)	Total	Specific Provision (a)	Supplementary Provision (b)	Total
(NIS millions)			(NIS millions)			
Balance of the provision at the beginning of the period	8,212	1,040	9,252	7,275	1,041	8,316
Provisions during the period	829	36	865	1,201	36	1,237
Decrease in provisions	(445)	(1)	(446)	(274)	(6)	(280)
Collection of past years' write-offs	(33)	-	(33)	(18)	-	(18)
Net amount charged to statement of profit and loss	351	35	386	909	30	939
Write-offs	(103)	-	(103)	(305)	-	(305)
Balance of provision at end of period	(c) 8,460	1,075	9,535	(c) 7,879	1,071	8,950
Including balance of provision not deducted from credit to the public	35	132	167	33	132	165

- (a) Not including provision for interest in respect of the period after the loans were determined to be doubtful. With respect to loans in arrears for which a provision was established to the extent of the arrears, no accrual for interest was recorded thereon.
- (b) Including the general and special provision for doubtful debts.
- (c) The specific provisions according to the period of arrears are NIS 453 million on a consolidated basis (30 June 2005 – NIS 372 million). With regard to the first time implementation of the Proper Banking Management Directives regarding provisions for doubtful debts in respect of housing loans at Leumi Mortgage Bank, see note 2B above.

**Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis)
as at 30 June 2006 (Unaudited)
Reported amounts**

	Israeli currency		Foreign currency (a)			Non-monetary items (c)	Total
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
(NIS millions)							
Assets							
Cash and deposits with banks	3,469	467	21,794	4,511	4,094	-	34,335
Securities	13,457	3,988	20,797	6,092	722	3,231	47,787
Credit to the public (b)	65,286	52,857	42,349	5,916	11,521	45	177,974
Credit to governments	-	24	667	-	-	-	691
Investments in affiliated companies	9	-	-	-	-	1,215	1,224
Buildings and equipment	-	-	-	-	-	2,951	2,951
Other assets	1,925	22	2,261	559	1,338	1,321	7,426
Total assets	84,146	57,358	87,368	17,078	17,675	8,763	272,388
Liabilities							
Deposits of the public	79,235	33,029	77,387	18,192	11,216	313	219,372
Deposits from banks	2,319	1,009	1,579	483	868	-	6,258
Deposits from governments	454	993	339	9	1	-	1,796
Debentures, bonds and subordinated notes	776	12,169	3,905	172	-	-	17,022
Other liabilities	2,444	2,652	1,711	489	1,480	1,659	10,435
Total liabilities	85,228	49,852	84,921	19,345	13,565	1,972	254,883
Difference	(1,082)	7,506	2,447	(2,267)	4,110	6,791	17,505
Effect of hedging derivative instruments:							
Derivative instruments (excluding options)	-	-	59	(25)	(34)	-	-
Effect of derivative instruments that are not hedging derivatives:							
Derivative instruments (excluding options)	7,944	(3,667)	(2,249)	1,676	(3,704)	-	-
Options in the money, net (in terms of underlying asset)	(636)	-	679	(3)	(40)	-	-
Options out of the money, net (in terms of underlying asset)	584	(1)	(773)	218	(28)	-	-
Total	6,810	3,838	163	(401)	304	6,791	17,505
Effect of derivative instruments that are not hedging derivatives:							
Options in the money, net (discounted par value)	(780)	-	700	122	(42)	-	-
Options out of the money, net (discounted par value)	2,607	(9)	(2,518)	(8)	(72)	-	-

(a) Including linked to foreign currency.

(b) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.

(c) Including derivative instruments that their basis is applicable for a non-monetary item.

Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis) (cont'd)
as at 30 June 2005 (Unaudited)
Reported amounts

	Israeli currency		Foreign currency (a)			Non-monetary items (c)	Total
	Unlinked	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
			(NIS millions)				
Assets							
Cash and deposits with banks	5,885	535	19,100	6,053	3,830	-	35,403
Securities	14,267	3,320	22,571	3,294	778	1,850	46,080
Credit to the public (b)	56,918	51,561	46,212	4,395	10,368	220	169,674
Credit to governments	-	55	872	2	-	-	929
Investments in affiliated companies	-	-	-	-	-	1,825	1,825
Buildings and equipment	-	-	-	-	-	2,773	2,773
Other assets	1,828	9	2,695	398	976	1,008	6,914
Total assets	78,898	55,480	91,450	14,142	15,952	7,676	263,598
Liabilities							
Deposits of the public	80,629	35,151	(d) 73,604	(d) 15,985	(d) 10,689	365	216,423
Deposits from banks	882	2,078	(d) 1,403	441	(d) 735	-	5,539
Deposits from governments	619	1,105	851	12	1	-	2,588
Debentures, bonds and subordinated notes	115	9,175	3,915	141	-	-	13,346
Other liabilities	1,907	2,222	2,391	435	1,082	1,330	9,367
Total liabilities	84,152	49,731	82,164	17,014	12,507	1,695	247,263
Difference	(5,254)	5,749	9,286	(2,872)	3,445	5,981	16,335
Effect of hedging derivative instruments:							
Derivative instruments (excluding options)	-	-	78	(46)	(32)	-	-
Effect of derivative instruments that are not hedging derivatives:							
Derivative instruments (excluding options)	12,492	(2,483)	(9,470)	2,753	(3,292)	-	-
Options in the money, net (in terms of underlying asset)	255	-	(630)	209	166	-	-
Options out of the money, net (in terms of underlying asset)	(125)	-	93	(12)	44	-	-
Total	7,368	3,266	(643)	32	331	5,981	16,335
Effect of derivative instruments that are not hedging derivatives:							
Options in the money, net (discounted par value)	287	-	(818)	212	319	-	-
Options out of the money, net (discounted par value)	(154)	-	387	(164)	(69)	-	-

(a) Including linked to foreign currency.

(b) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.

(c) Including derivative instruments that their basis is applicable for a non-monetary item.

(d) Reclassified.

Assets and Liabilities Classified According to Linkage Basis (on a Consolidated Basis) (cont'd)
as at 31 December 2005 (Audited)
Reported amounts

	Israeli currency		Foreign currency (a)			Non-monetary items (c)	Total
	Unlinked (NIS millions)	Linked to the CPI	In U.S. dollars	In Euro	In other currencies		
Assets							
Cash and deposits with banks	5,863	507	19,331	5,559	4,121	-	35,381
Securities	15,440	1,842	22,423	5,332	828	1,960	47,825
Credit to the public (b)	62,289	52,569	47,550	4,663	10,110	74	177,255
Credit to governments	-	42	806	-	-	-	848
Investments in affiliated companies	9	-	-	-	-	2,055	2,064
Buildings and equipment	-	-	-	-	-	2,843	2,843
Other assets	1,537	9	2,511	401	1,140	1,010	6,608
Total assets	85,138	54,969	92,621	15,955	16,199	7,942	272,824
Liabilities							
Deposits of the public	81,777	33,783	78,376	16,603	10,991	298	221,828
Deposits from banks	517	1,345	1,356	452	677	-	4,347
Deposits from governments	430	1,062	721	11	1	-	2,225
Debentures, bonds and subordinated notes	762	11,720	4,606	165	-	-	17,253
Other liabilities	3,349	2,435	2,034	445	1,334	1,369	10,966
Total liabilities	86,835	50,345	87,093	17,676	13,003	1,667	256,619
Difference	(1,697)	4,624	5,528	(1,721)	3,196	6,275	16,205
Effect of hedging derivative instruments:							
Derivative instruments (excluding options)	-	-	86	(50)	(36)	-	-
Effect of derivative instruments that are not hedging derivatives:							
Derivative instruments (excluding options)	10,711	(3,453)	(5,990)	1,872	(3,140)	-	-
Options in the money, net (in terms of underlying asset)	(560)	265	152	(56)	199	-	-
Options out of the money, net (in terms of underlying asset)	(65)	(174)	209	56	(26)	-	-
Total	8,389	1,262	(15)	101	193	6,275	16,205
Effect of derivative instruments that are not hedging derivatives:							
Options in the money, net (discounted par value)	(1,033)	518	269	(47)	293	-	-
Options out of the money, net (discounted par value)	(146)	(526)	398	370	(96)	-	-

(a) Including linked to foreign currency.

(b) The general and supplementary provisions for doubtful debts have been deducted proportionately from the different linkage bases.

(c) Including derivative instruments that their basis is applicable for a non-monetary item.

**Information on activity by banking segments
Reported amounts**

Statement of profit and loss for the Three Months Ended 30 June 2006 (Unaudited)									
	Small					Total consolidated			
	Household banking	Private banking	Small business banking	Commercial banking	Corporate banking		Construction and real estate	Financial management	Other
Net interest income before provision for doubtful debts	548	81	215	291	361	156	139	5	1,796
Operating and other income:									
From outside entities -	311	94	116	105	141	15	16	217	1,015
Intercompany operations -	88	5	(4)	(4)	(27)	-	-	(58)	-
Total	399	99	112	101	114	15	16	159	1,015
Total income	947	180	327	392	475	171	155	164	2,811
Provision for doubtful debts	39	-	22	40	82	24	(22)	-	185
Net profit (loss)	62	13	26	91	135	73	(12)	(10)	378

Statement of profit and loss for the Three Months Ended 30 June 2005 (Unaudited) (a)									
	Small					Total consolidated			
	Household banking	Private banking	Small business banking	Commercial banking	Corporate banking		Construction and real estate	Financial management	Other
Net interest income before provision for doubtful debts	444	72	194	254	354	168	101	18	1,605
Operating and other income:									
From outside entities -	286	84	118	91	78	9	30	210	906
Intercompany operations -	130	6	(8)	(6)	(14)	-	-	(108)	-
Total	416	90	110	85	64	9	30	102	906
Total income	860	162	304	339	418	177	131	120	2,511
Provision for doubtful debts	22	1	26	35	391	6	13	-	494
Net profit (loss)	134	5	44	96	(69)	85	196	87	578

(a) Reclassified.

Information on activity by banking segments (cont'd)
Reported amounts

Statement of profit and loss for the six Months Ended 30 June 2006 (Unaudited)									
	Small						Other	Total consolidated	
	Household banking	Private banking	Small business banking	Commercial banking	Corporate banking	Construction and real estate			Financial management
Net interest income before provision for doubtful debts	1,067	173	424	570	751	323	123	10	3,441
Operating and other income:									
From outside entities -	619	188	232	206	232	29	22	427	1,955
Intercompany operations -	221	13	(7)	(4)	(47)	-	-	(176)	-
Total	840	201	225	202	185	29	22	251	1,955
Total income	1,907	374	649	772	936	352	145	261	5,396
Provision for doubtful debts	140	-	31	69	90	75	(19)	-	386
Net profit (loss)	150	17	78	204	304	135	646	(44)	1,490

Statement of profit and loss for the six Months Ended 30 June 2005 (Unaudited) (a)									
	Small						Other	Total consolidated	
	Household banking	Private banking	Small business banking	Commercial banking	Corporate banking	Construction and real estate			Financial management
Net interest income before provision for doubtful debts	897	142	381	504	692	318	240	23	3,197
Operating and other income:									
From outside entities -	582	174	234	173	148	21	41	420	1,793
Intercompany operations -	245	13	(13)	(2)	(24)	-	-	(219)	-
Total	827	187	221	171	124	21	41	201	1,793
Total income	1,724	329	602	675	816	339	281	224	4,990
Provision for doubtful debts	59	1	32	95	632	108	12	-	939
Net profit (loss)	252	18	98	163	(59)	107	386	141	1,106

(a) Reclassified.

Information on activity by banking segments (cont'd)
Reported amounts

	Statement of profit and loss for the Year Ended 31 December 2005 (Audited) (a)							Total consolidated	
	Household banking	Private banking	Small business banking	Commercial banking	Corporate banking	Construction and real estate	Financial management		
Net interest income before provision for doubtful debts	1,877	317	779	1,036	1,569	650	349	51	6,628
Operating and other income:									
From outside entities -	1,221	355	473	340	286	38	174	831	3,718
Intercompany operations -	504	29	(24)	14	(53)	-	-	(470)	-
Total	1,725	384	449	354	233	38	174	361	3,718
Total income	3,602	701	1,228	1,390	1,802	688	523	412	10,346
Provision for doubtful debts	172	2	75	188	818	157	14	-	1,426
Net profit	466	28	172	330	226	251	540	123	2,136

(a) Reclassified.