Israel

SEB GROUP – COUNTRY RISK ANALYSIS **March 29, 2019**

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Israel continues steady economic development since many years with solid annual growth, reasonable external and internal balances and low inflation despite record low unemployment. The country's long track record in quickly clamping down on terror attacks from the Palestinian territories is evidence of growing resilience to never ending security threats.

Country Risk Analysis

Solid and steady growth: For several years Israel has been able to maintain healthy annual growth rates in the range of 3-4% without any signs of stress, placing the country in the league of best performers among advanced developed countries. Last year's economic expansion reached 3.7%, slightly up from the year before, an achievement to be continued into the current year based on healthy growth in consumer demand, buoyed by rising real household income, and the expected commissioning of several major investment projects, including a large-scale gas project, the off-shore Leviathan field, and a new Intel manufacturing plant, coming on stream in the second half of the 2019, they will boost exports and increase government revenues.

Strong job creation but still low inflation: As a result of economic expansion the labor market has remained strong and unemployment has declined to record lows below 5% of the total labor force. That has spurred wage increases of more than 3% a year but so far without major repercussions on prices. In 2018 the CPI (Consumer price index) rose from 0.2% to 0,8% growth, 8%. That was below the central bank's annual target of 1-3%, and for the current year estimates are for price pressure to increase only slightly to 1%. However, with the output gap about to close the annual inflation rate is now likely to normalize around 1.5% at least in a short to medium term projection.

External balances to stay on a healthy path : For several years the current account balance has remained in surplus of almost 3% of GDP. That trend is set to continue in 2019 and going forward supported by new exports of electronics and now also natural gas while imports keep growing in line with domestic demand. Also services are now contributing strongly to foreign earnings along with a surge in inbound tourism apparently regardless of the ups and downs in Israel's never-ending security problems with its Palestinian neighbors..

The basic balance improving fast: Together with rapid net inflows of FDI (foreign direct investments) this has created a sharp rise in the basic balance surplus which again has caused large unscheduled net capital outflows of some $16bn. in 2018 as the central bank refused to by the basic surplus but rather stood by observing markets finding the equilibrium in the foreign exchange market on their own. As a result reserves remained overall steady at a solid $113bn equivalent to 18 months of import cover. That level of reserves is also enough to cover the gross external debt of some 20%/GDP twice.

Fiscal policies: For the current year the government budget will see expenditure rising reflecting higher outlays on defense, in part one-off spending, and higher social security spending not entirely unexpected in view of upcoming elections. That is estimated to raise the budget deficit by some 0,7 percentage points (pp) to 3.6%/GDP. However, as in previous years, the government has consistently underestimated revenues. As those are set to rise with the completion of several investment projects bound to benefit the government tax takes in coming years, most observers project a new boost to revenues with the effect to cut the deficit back to less than 3%/GDP already next year and into the next decade. That will keep the government debt/GDP ratio relatively stable at some 60%/GDP, a far cry from the worryingly high levels it had reached at the beginning of the present decade. As such, previous alarms about government finances have now mainly gone quiet.

Monetary policies on a steady path: The Bank of Israel (BoI) – central bank – is expected to follow its mission to keep inflation pressure at bay with an eye on the exchange rate and overall financial condition. It has raised the policy rate by a few tenths of a percent since 2017 and could follow thru with another minor hike towards the end of the current year then reaching 0.5%pa. Scandals in some major Israeli banks seem now as a thing of the past.

Structural policies: With well diversified, steady and balanced economic growth at full employment calls for major structural reform policies have subsided. However as a small country local monopolies can be hard to avoid and maintaining a competitive environment is a continuous challenge for the government as do the battle against sleaze and corruption not least in political circles.

Politics: As local media are eager to expose mischief among high profile representatives of business and politics Israel may often unfairly be associated with and unhealthy ethical environment. The recent allegations against the sitting PM is a case in point. So far these suspicions have not been confirmed in court but the apparent attempt of the PM to use his positions to manage the news flow in this matter represents an unexpected, if not entirely unprecedented attempts at obstructing justice.

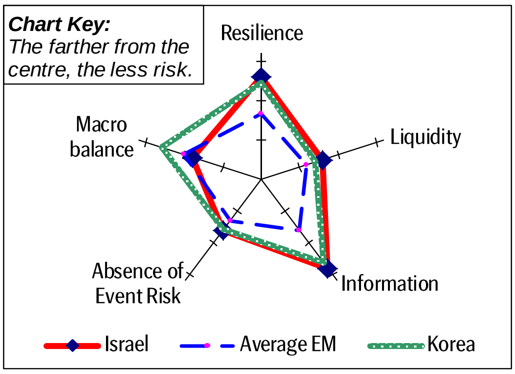
External security: Otherwise, Israel's long-standing weak performance on political stability according to surveys mainly reflects the conflict with the Palestinian neighbors. While seemingly never-ending, the intensity appears to have subsided in recent years probably reflecting the apparent lack of success for the instigators. Periodic skirmishes are still to be expected, however, as seen in the recent rocket attacks from the Palestinian territories. A new major war, by contrast, with Syria and Iran as often warned against by the present Israeli government and the White house, is often shrugged off as mostly rhetoric by observers.

Outlook: With the country's finances and economy in good shape for the current year and at least well in to the next decade, Israel is likely to see continued prosperity for the country's population which will continue to experience rapidly rising income per capita. That is also supported by strong demographics being supported by immigration of often well-educated people from the diaspora in the US and Europe. These people are highly motivated to contribute to the development of Israel despite the potential although fading risks of security threats. Over the last decades Israel has proved clearly more resilient to protect its citizens and this issue combined with the much stronger economy can no longer be counted as major credit risk.

Ratings: The rating agencies have recently not indicated any downward rating actions.

Israel: Risk Profile

Key ratios	2019
Population (mil)	8,58
GDP/capita (US$)	27023
GDP (% change)	3,2%
Inflation (%)	1,0%
Curr.Acc. Balance (% of GDP)	2,8%
Reserves/imports (months)	11,8
Budget balance (% of GDP)	-3,6%
Government debt (% of GDP)	61%



External ratings:
Fitch: A / Stable
Moody's: A1 / Stable
S&P: A+ / Stable

Peers:
Czech Rep.
South Korea
Chile

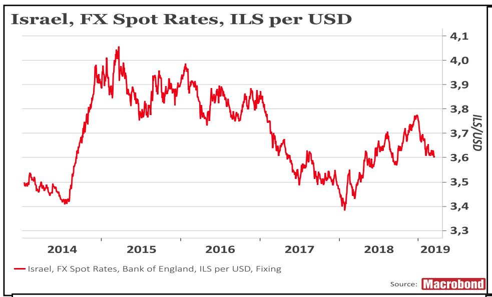
Graph: The pentagon shows the creditworthiness of Israel as strong on information, liquidity and resilience (long-term economic, socio-political factors) but weak on macroeconomic balance reflecting high government debt.

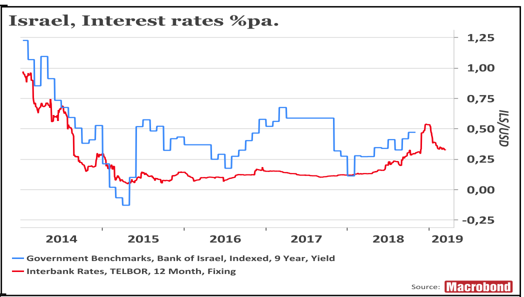
Key data:	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**
GDP (bill. US$)	310	301	319	353	369	392	413	436
GDP/capita (US$)	24517	21715	25422	27442	26431	27173	27023	27018
GDP (change)	3,9%	2,5%	4,0%	3,4%	3,3%	3,2%	3,6%	3,7%
Investments/GDP	19%	19%	21%	20%	20%	20%	20%	20%
Budget balance/GDP*	-2,7%	-2,1%	-2,1%	-2,0%	-2,9%	-3,6%	-2,8%	-2,4%
Govt debt/GDP**	66%	64%	62%	60%	61%	61%	61%	58%
CPI inflation (%)	0,5%	-0,6%	-0,5%	0,2%	0,8%	1,0%	1,3%	1,8%
Money demand (%)	7,8%	13,2%	10,3%	8,4%	4,6%	6,1%	5,8%	5,9%
Stock prices	1265	1385	1256	1287	1397			
Interest rates	0,5%	0,1%	0,1%	0,1%	0,1%	0,6%	1,3%	1,8%
Exch. Rate ($)	3,58	3,88	3,84	3,60	3,60	3,59	3,61	3,62
Trade/GDP (%)	63%	59%	58%	57%	59%	59%	59%	60%
Oil price (Brent)	$52	$44	$54	$71	$61	$66	$67	$69
billions US $								
Export of goods	100,5	94,1	95,6	103,3	110,8	117,0	124,5	132,8
Imports of goods	94,7	84,5	89,7	97,4	107,8	114,0	120,8	128,2
Other:	7,9	6,4	6,3	4,2	8,2	8,1	8,1	8,1
Current account	**13,7**	**16,1**	**12,3**	**10,1**	**11,1**	**11,1**	**11,8**	**12,7**
(% of GDP)	4,4	5,3	3,8	2,9	3,0	2,8	2,9	2,9
FDI	1,5	0,4	-2,6	12,0	12,6	13,3	14,0	14,8
Loan repayments	-5,1	-5,6	-5,6	-4,5	-4,7	-4,4	-4,7	-5,0
Net other capital flows	-5,8	-6,4	3,8	-3,1	-16,7	-16,8	-14,3	-14,6
Balance of payments	**4,3**	**4,5**	**7,9**	**14,6**	**2,3**	**3,2**	**6,9**	**8,0**
Reserves	86,1	90,6	98,4	113,0	115,3	118,5	125,4	133,4
Total debt	86,0	87,0	89,0	88,0	87,0	86,0	84,0	83,0
o/w short term debt	27,9	28,2	28,6	28,2	27,9	27,6	27,0	26,6

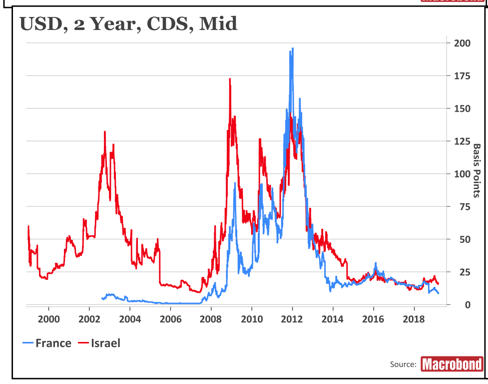
Sources: Oxford Economics and SEB estimates.

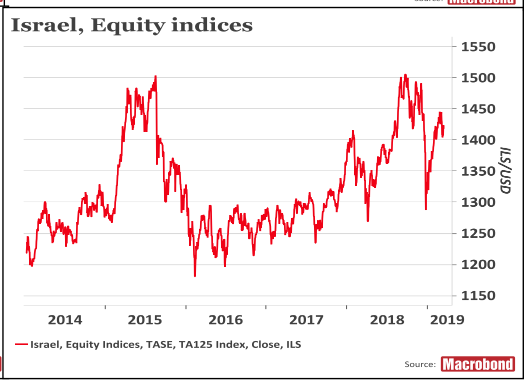
Rating history					
Fitch (eoy)	A	A	A+	A+	A+
Moody's	A1	A1	A1	A1	A1

Type of government:	Parliamentary Democracy
Next elections	2023 (legislative)
Other:	
Latest PC deal	None
Latest IMF arrangements	None









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