



Investor Newsletter

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- Israel's economy continues to grow at a healthy rate, outpacing the OECD average each year since 2012
- 2019 budget passed with goals of increasing growth and decreasing cost-of-living and inequality
- Global growth a positive sign for Israel's exporters

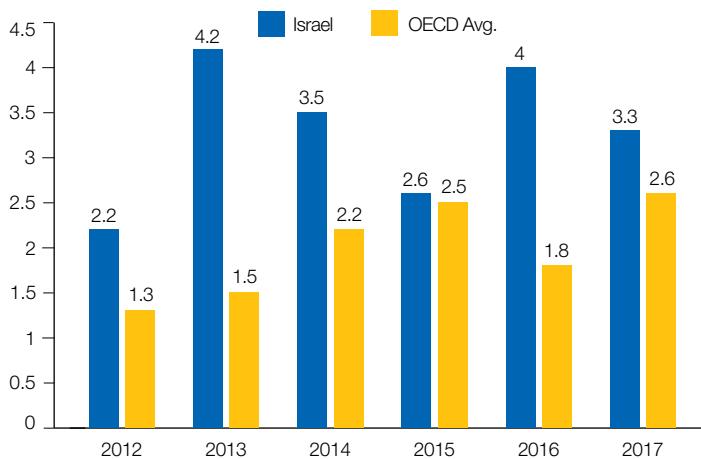
Macro

Since the establishment of the modern state of Israel, 70 years ago, its economy continues to grow at a healthy rate. During the first quarter of 2018, Israel grew 4.5 percent, on an annualized basis. This follows quarterly growth rates of 0.7 percent, 2.9 percent, 4.3 percent, and 4.5 percent annualized rates in 2017, respectively, for an annual rate of 3.3 percent. Israel's growth outpaced the OECD average each year from 2012-2017 by an average of 1.35 percent per year. The Ministry of Finance estimates 3.5 percent growth for 2018, 3.4 percent for 2019, and 3 percent for 2020. The International Monetary Fund estimates Israel to grow 3.3 percent in 2018, 3.5 percent growth in 2019, and 3 percent growth in 2020.

In 2017, Israel's population reached 8.8 million and nominal GDP reached \$351 billion. At \$40,318, Israel's per capita GDP is greater than South Korea, Japan, the United Kingdom, and France.

GDP Growth, Change in Real GDP, % per Annum

Source: Ministry of Finance, OECD Economic Outlook No. 103



During the last decade, Israel experienced a significant period of economic expansion. Indeed, the state has not experienced a single calendar quarter of negative economic growth since 2008. The last time Israel experienced two successive negative quarters was in 2001.

Israel's labor market has also been strengthening in recent years. In April 2018, the unemployment rate dropped to 3.9 percent, down from 4.2 percent at the end of 2017. Israel's labor participation rate has been higher than the OECD average for more than half a decade and, as of April 2018, stands at 63.8 percent. During the same period, wages have risen quite substantially. During the years 2015, 2016, and 2017, wages grew 2.9 percent, 2.8 percent, 2.9 percent, respectively. At the same time, the minimum wage also rose by 6.1 percent, 3.8 percent, and 6.1 percent, respectively. The minimum wage is set to increase by 5.5 percent in 2018.

The economy's output gap is very close to zero and the Chief Economist of the Israel Ministry of Finance estimates that Israel is growing at just about its estimated potential growth. The ratio of public debt-to-GDP fell to 60.9 percent at the end of 2017. This is a 12.2 percent decline from 2007, which places Israel's debt-to-GDP slightly higher than the Netherlands, and just below Finland and Germany.

Budget

In March, the Government passed the budget for calendar year 2019. Unlike recent budgets, this one is annual rather than biennial. The deficit target is set at 2.9 percent of GDP, just as it was for the budgets for 2015-2018. The main principles of the economic plan put forth in this budget seek to reduce the cost of living and inequality and increase competition and growth. For instance, the 'Net Family' plan, advanced by Finance Minister Moshe Kahlon, directly lowers prices for necessities and products for the average family.

The budget allocates NIS 55 billion for the Ministry of Defense, NIS 60 billion for the Ministry of Education (an increase of 36 percent from 2014), and NIS 39 billion for the Ministry of Health (an increase of 61.8 percent from 2014).

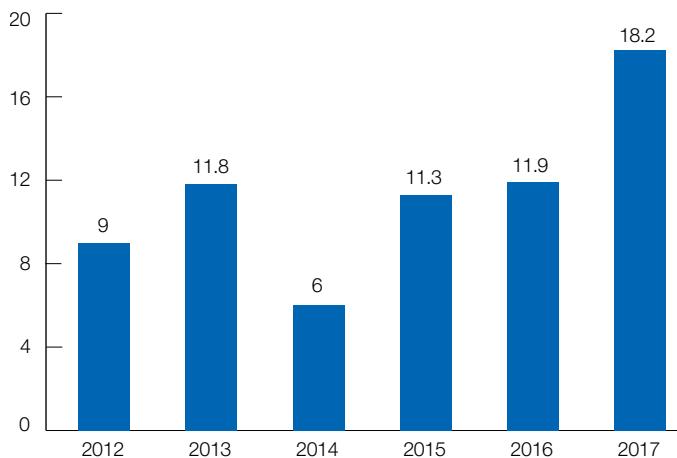
Trade

In their April 2018 World Economic Outlook, the International Monetary Fund noted a "cyclical upswing" in global growth. Projections for advanced economies to continue expanding above their potential growth rates is a positive for Israel's exporters. Exports (excluding diamonds and startups) grew by 9.5 percent in the first quarter of 2018.

When looking at global trade, Israel finds itself in a unique position. While it does not belong to any large trade pacts, such as the EU or NAFTA, Israel has significant international trade agreements around the world. This includes trade agreements with both the U.S. and the E.U., MERCOSUR, EFTA, Canada, Mexico, Turkey, India, Vietnam, and many others. Israel's advanced high-tech sector accounts for almost half of all goods exported. The rising tide of global growth also encourages increased foreign direct investment (FDI) into Israel. Over the past six years, Israel attracted an average of \$11.4 billion per year in FDI. In 2017, a record \$18.17 billion of FDI made its way into Israel.

Foreign Direct Investment, USD Billions

Source: Central Bureau of Statistics



During the recovery from the 2007-2008 financial crisis, and the subsequent global slowdown in growth, the market for Israel's exporters contracted. During the period from 2012-2017, Israel's average growth rate was 3.3 percent, but its exports averaged just 1 percent annual growth during that period. During this time, private consumption became Israel's main economic driver, averaging 4.1 percent growth per year.

Israel is a major player in the cyber security sector as well. As the world becomes connected through the internet-of-things and the increasing reach of the internet, the need to secure online infrastructure becomes ever more important. According to the Cyber Security Bureau in the Prime Minister's office, Israel attracts about 20 percent of global private cyber security investment. This is up from roughly 5 to 10 percent in 2014.

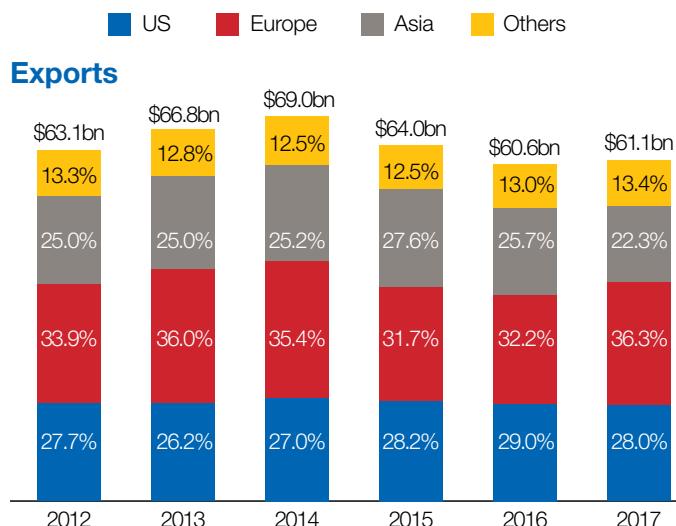
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Trade (continued)

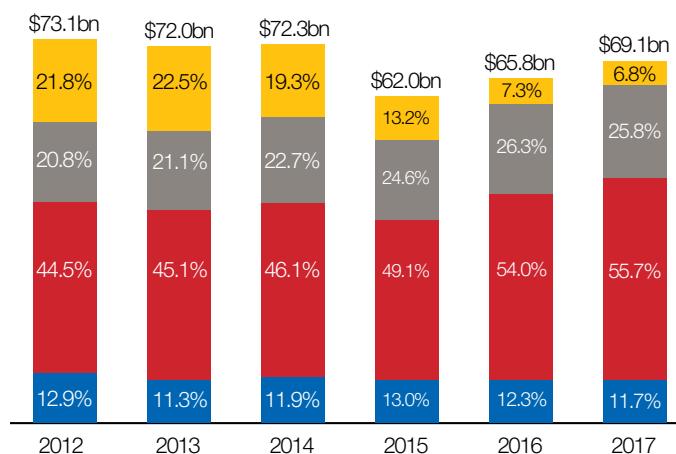
Israel's largest trading partner is the United States. Israel exported about \$17.1 billion of goods to the U.S. in 2017 and, in turn, imported close to \$8 billion. The next largest export destinations for Israel are Hong Kong, the United Kingdom, China, Belgium, and India. In 2017, Israel exported roughly 28 percent of all goods to the U.S., 36.3 percent to Europe, 22.3 percent to Asia, and about 13.4 percent elsewhere. In total, Israel exported more than \$61 billion of goods last year. Due to its geographical proximity, Israel imports mostly from Europe, which comprises 55.7 percent of imports. About 25.8 percent of Israel's imports come from Asia, 11.7 percent come from the U.S., and 6.8 percent from other countries.

Trade: Goods Exports and Imports, Value in USD Billions and Breakdown by Geography as % of Total

Source: Ministry of Finance, Central Bureau of Statistics



Imports



Monetary

The Bank of Israel's current interest rate has remained at 0.1 percent since 2015.

Israel's rolling 12-month inflation rate (April-April) is 0.4 percent, which is 0.6 percent below the Bank of Israel's target range of 1-3 percent. The Ministry of Finance estimates inflation to reach 1 percent in 2018 and 1.1 percent in 2019. The Bank of Israel approximates inflation reaching 1.1 percent in 2018 and 1.4 percent in 2019. And the International Monetary Fund estimates Israel's inflation to reach 1 percent for 2018 and 1.5 percent for 2019.

The average inflation rate from 2012 to 2017 was 0.5 percent. Israel's inflation rate was negative from 2015 until 2017.

At the end of 2017, the Bank of Israel held \$113 billion of foreign currency reserves, raising Israel's import coverage to 14 months. At the beginning of 2018, reserves increased to \$117.62 billion. The reserves have fallen in the past few months as a result of government and private sector transfers abroad as well as a revaluation. As of April 2018, the Bank of Israel holds \$115.35 billion in reserves. The \$2.35 billion increase is inclusive of \$471 million of reserves purchased under the program to offset the effect of natural gas production on Israel's currency. Relative to GDP, the exchange reserves have remained relatively stable at about 33 percent since 2010.

Other News

■ Intel to Invest \$5 Billion to Expand its Israel Operations

Intel plans to boost spending in Israel, investing \$5 billion to upgrade its manufacturing plant in Kiryat Gat. It intends to buy local companies for NIS 3 billion and employ an additional 250 people to streamline its operations.

Intel has had a long history in Israel, beginning in 1974. Today it is one of the largest employers in the country. Last year, it purchased Mobileye, the Israeli technology company that develops vision-based advanced driver-assistance systems, for a record \$15 billion.

— Bloomberg

<https://www.bloomberg.com/news/articles/2018-05-15/intel-to-invest-5-billion-to-expand-its-israel-operations>

■ International Flavors and Fragrances Acquires Frutarom for \$7.1 Billion

New York-based International Flavors and Fragrances (IFF) announced plans to acquire the Israeli flavors and natural ingredients firm Frutarom for \$7.1 billion. This deal makes IFF the second largest company in the global flavors market.

With the merger, Ori Yehudai, Frutarom's president and CEO, will remain with the company as a strategic advisor to IFF Chairman and CEO Andreas Fibig. IFF will continue to be headquartered in New York while also maintaining a presence in Israel.

— Food Business News

<https://www.foodbusinessnews.net/articles/11779-international-flavors-and-fragrances-to-acquire-frutarom>

■ Volkswagen Opens Tel Aviv Innovation Center

German carmaker Volkswagen (VW) opened a Tel Aviv innovation center to promote the development of autonomous vehicles, new mobility services, and tailor-made solutions. The VW campus will be a co-working space called Konnect, and will provide local partners and mobility-based startups direct access to the Volkswagen group for business collaborations as well as support in mentoring and consulting.

Volkswagen Group chief customer officer Peter Harris remarked, "I am a strong believer in the technological innovations being developed within the Israeli market and I am convinced that they can help us reach our goal of being one of the global market leaders in sustainable mobility. Konnect is another step in expanding our activities in Israel and will help our portfolio of brands engage with the Israeli start-up ecosystem."

— Google

<https://www.google.com/search?q=volkswagen+opens+Tel+Aviv+innovation+center>

■ BlackRock Set for Israel Expansion

During a recent visit to Israel, BlackRock president Robert Kapito described Israel as an important tech hub and announced plans to expand the company's presence in Israel. BlackRock is the world's largest asset manager.

According to Kapito, "We continue to spend a lot of time and effort building technology for the financial services industry. Israel is a great hub for creating new technologies, and it can help us build infrastructure for the future. We're here to hire people into the technology area and to develop new tools for the financial services industry." He also added that because of a plethora of technology-related companies, including startups, Israel is an interesting place for foreign investment.

— Globes

<http://www.globes.co.il/en/article-blackrock-set-for-israel-expansion-1001234111>

Other News (continued)

■ Israel to Invest \$275 Million in Digital Health Project

Israel approved a plan to invest NIS 1 billion shekels (\$275 million) to digitize the health records of its nearly nine million citizens in order to help develop new drugs. The government, in partnership with German software giant, SAP SE, will gather information from Israeli volunteers and create a database for academics and foreign health care companies to use in the development of preventive medicines and personalized care.

Israeli doctors have been documenting patient data on digital platforms for many years and can now examine clinical data on more than 98 percent of the population. The Israeli database "is a huge asset and we want to give it to researchers, developers and companies. The interest of global companies is tremendous," Prime Minister Netanyahu said in a statement.

— *Bloomberg*

<https://www.bloombergquint.com/business/2018/03/25/israel-to-invest-275-million-in-digital-health-project#gs.=351mD0>

■ Life Sciences Industry in Israel Soars

A comprehensive report by Israel Advanced Technology Industries and PwC on the life sciences industry in Israel has shown dramatic growth. The sector currently has 1,450 active companies compared to 800-900 five years ago. A record \$1.2 billion was raised in 2017 from local and foreign funds, public offerings, investments by private equity funds, and support from the Israel Innovation Authority. The capital raising was 40 percent higher than in 2016 and 400 percent more than a decade ago. According to the report, \$656 million was raised in rounds of more than \$20 million last year, compared to \$452 million in 2016. This increase was significant because larger financing rounds enable drug companies to conduct advanced clinical trials and companies with less complex medical devices to build marketing apparatuses.

— *Globes*

<http://www.globes.co.il/en/article-life-science-investment-in-israel-soars-1001236085>

Relevant Links

Israel Government Portal

<https://www.gov.il/en>

Israel's Ministry of Finance

<http://mof.gov.il/en/pages/default.aspx>

Israel's Government Debt Management Unit

<http://mof.gov.il/en/PolicyAndBudget/GovernmentDebt/Pages/default.aspx>

Bank of Israel

<http://www.boi.org.il/en/Pages/Default.aspx>

Central Bureau of Statistics

http://www.cbs.gov.il/reader/cw_usr_view_Folder?ID=141

Tel Aviv Stock Exchange

<https://www.tase.co.il/Eng/Pages/Homepage.aspx>

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