



GOVERNMENT OF ISRAEL MINISTRY OF FINANCE  
OFFICE OF THE ACCOUNTANT GENERAL

# Investor Newsletter

## Editors:

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- Fitch affirms Israel's credit rating and outlook
- Israel meets market accessibility level for inclusion in the FTSE World Government Bond Index (WGBI)
- 5.2 percent first quarter GDP growth

## Credit Rating

In March 2019, Fitch Ratings affirmed Israel's A+ credit rating and Stable outlook. Fitch has maintained this rating since it upgraded Israel in November 2016. In its report, Fitch noted, "external debt is low, at 7.7 percent of GDP in 2018, down from 20 percent of GDP in 2006. Israel benefits from high financing flexibility. It has deep and liquid local markets, good access to international capital markets, an active diaspora bond programme, and U.S. government guarantees in the event of market disruption."

Fitch also reported, "Downside risks relate to any large security incidents or further weakening of world trade." It added that while "Israel's ratings are constrained by political and security risks ... its credit profile has shown resilience to periodic conflict and political shocks over an extended timeframe."

Fitch additionally pointed to Israel's impressive macroeconomic performance, including a GDP growth stronger than rating peers over a five-year period, a current account surplus since 2003, low unemployment, human development indicators and GDP per capita well above peer medians, a net external creditor position that is "significantly stronger than the 'A' median and is also stronger than the 'AA' median."

In April 2019, Moody's Investors Service published a credit opinion on Israel. It noted, "Israel's credit profile remains very strong, exhibiting significant economic and financial resilience to shocks. The development of offshore natural gas reserves will further diversify and expand Israel's net external creditor status and help build or strengthen relationships with other countries in the region."

Among the various risks, Moody's reported that, "Israel's defense costs remain the largest line item in the budget,

although it has stabilized under a multi-year defense budget agreement in 2015 and has fallen in relative terms compared to previous years." Moody's continued by stating, "Israel has seen improvements in its security situation in recent years... security risks that do manifest have historically had limited, transient impact on the economy and the government's fiscal position."

In summary, Moody's noted that, "The credit profile of Israel reflects a resilient economy, robust external position, strong institutional framework and favorable fiscal dynamics which are balanced against longer-term demographic challenges and material geopolitical risks. The outlook horizon will allow us to assess whether Israel can sustain credit metrics more consistent with AA-rated sovereigns." Moody's currently rates Israel at A1; Positive.

Standard and Poor's current rating and outlook for Israel: AA-; Stable.

## FTSE World Government Bond Index (WGBI)

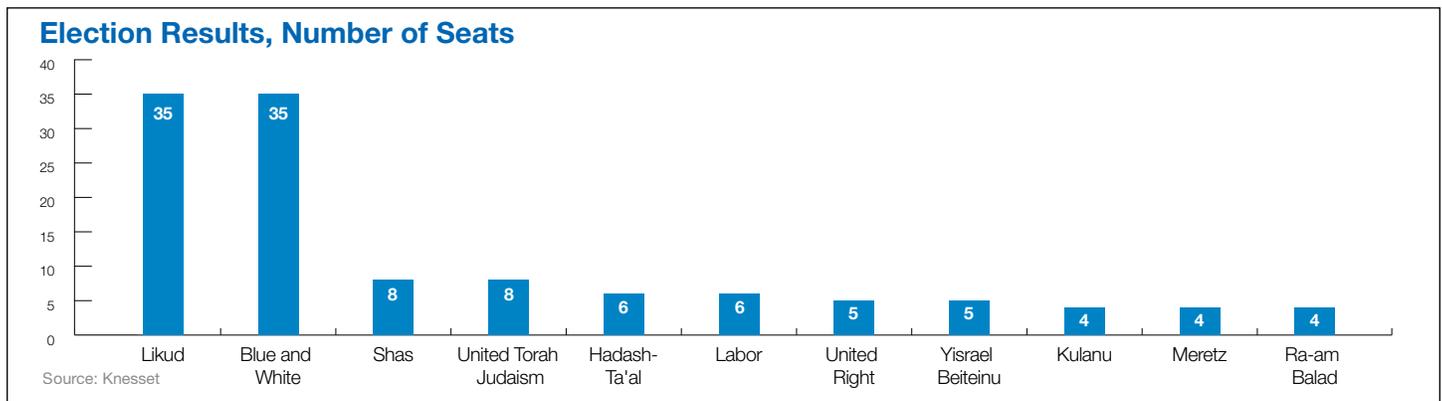
On April 15, 2019, FTSE Russell announced that Israel's local currency fixed-rate government bond, in addition to meeting the market size criteria as of March 2019, had met the minimum market accessibility level for inclusion in the WGBI. This is the first time that Israel has met the Market Accessibility criterion for inclusion in the main WGBI Index. The WGBI is a widely used benchmark for fixed-rate, local currency, investment-grade sovereign debt. The index is comprised of sovereign debt from more than 20 countries and has more than 30 years of historical data. Since December 2017, Israel has been included in the WGBI-Extended Index, which includes select countries that meet size and investment-grade credit criteria of the WGBI.

In its press release, FTSE Russell stated: “Israel now meets the minimum Market Accessibility Level for the WGBI, in addition to the objective market size and credit quality criteria. Should these criteria continue to be met for the September 2019 review, an announcement regarding a resulting index inclusion change and the timetable for implementation, which will include a minimum notice period of 6 months, will be made shortly thereafter.”

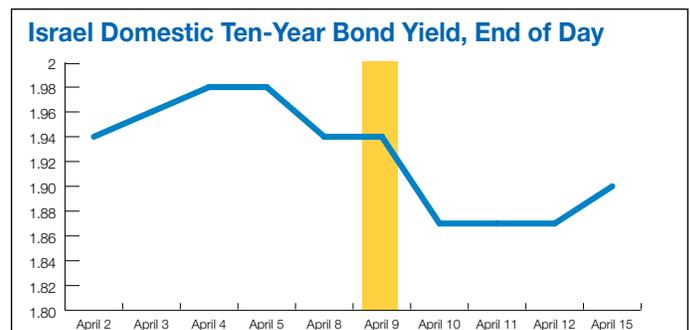
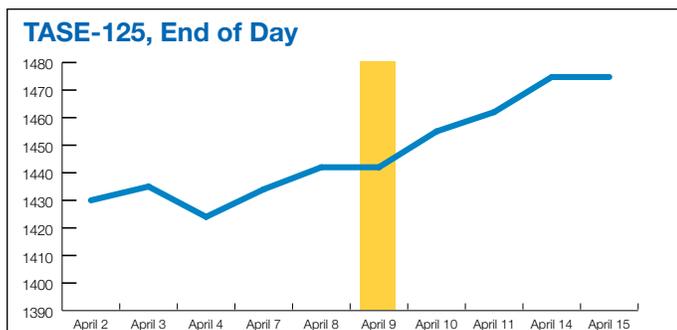
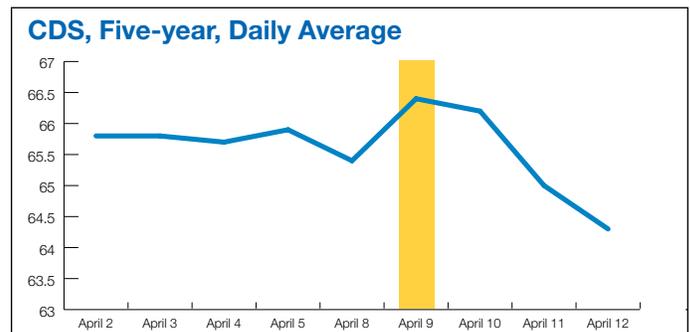
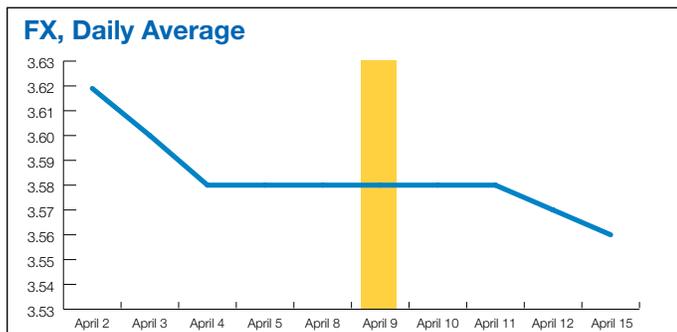
FTSE Russell’s press release can be found [here](#).<sup>1</sup>

## Election

On April 9, 2019, Israel held national elections. Israel holds closed-list proportional elections. The Knesset is comprised of 120 seats; the minimum threshold for a party to enter the Knesset is 3.25 percent of the state-wide vote. A government is formed when a majority coalition of 61-or-greater seats is achieved. Following the election, each party speaks with Israel’s President to indicate their preference of who should be the next Prime Minister. Based on this information, the President assigns the task of creating a government to the head of the party that is most likely to succeed in doing so. In this case, Likud – the party led by incumbent Prime Minister Benjamin Netanyahu – won the most seats and on April 17, it was given the mandate to form a coalition.



Gold indicates Election Day 2019



Source for Charts: Bloomberg

<sup>1</sup> [https://www.ftserussell.com/sites/default/files/15apr19\\_ftse\\_russell\\_fixed\\_income\\_country\\_classification\\_review\\_april\\_2019.pdf](https://www.ftserussell.com/sites/default/files/15apr19_ftse_russell_fixed_income_country_classification_review_april_2019.pdf)

## Macro

In Q1 2019, GDP grew at 5.2 percent, the highest quarterly growth rate since Q2 2016. Much of the growth can be attributed to private consumption, including a jump in the purchasing of cars, which has led to more revenue for the state. Other contributors to growth in the first quarter include a rise in goods and service exports and fixed-asset investments into Israel.

Israel's economy grew 3.3 percent in 2018, slower than the growth rates in 2017 and 2016 of 3.5 and 4.0 percent, respectively. The International Monetary Fund currently estimates Israel's growth for 2019 and 2020 to be 3.3 percent for both years<sup>2</sup>. The Bank of Israel projects Israel's growth for 2019 and 2020 to be 3.2 and 3.5 percent, respectively. The Ministry of Finance estimates 3.1 percent growth for both 2019 and 2020. Private consumption, boosted by historically low unemployment<sup>3</sup> along with rising wages has evolved as the key GDP growth driver in recent years.

Global growth has slowed and, in turn, has been a drag on open, export-oriented economies like Israel. However, as a high-tech exporter, Israel has been somewhat insulated from the full effects of this slowdown. Service exports have grown from 29 percent of Israel's total exports in 2007 to 42 percent in 2017. Roughly 27 percent of Israel's service exports are

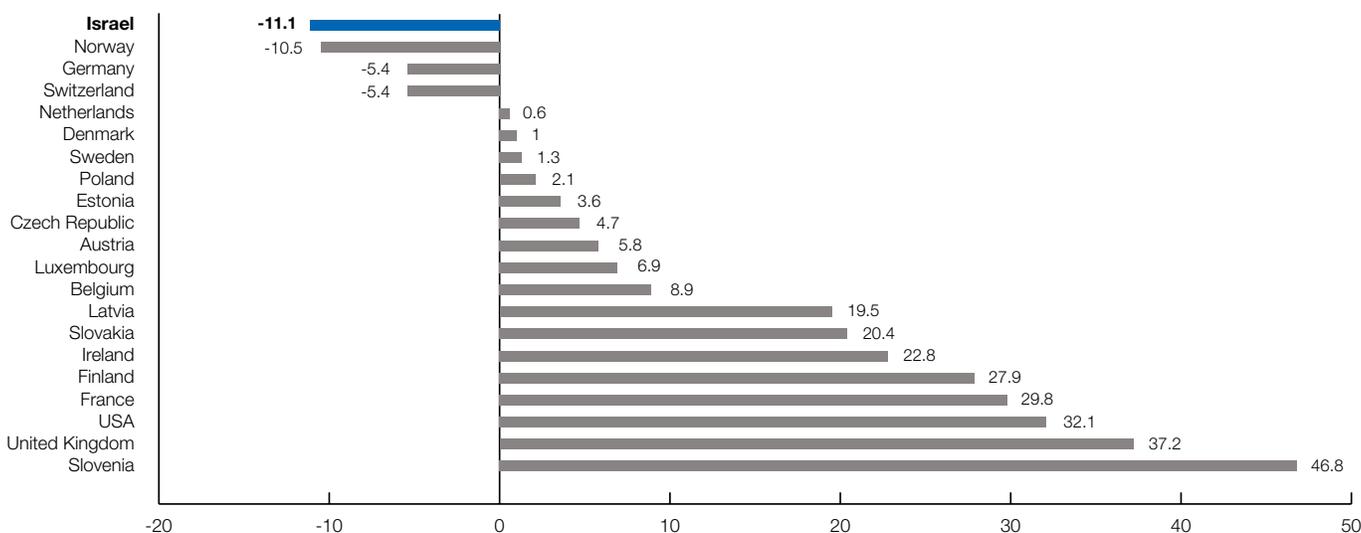
computer and related services, 16 percent deal with research and development, and 21 percent are travel- and transportation-related. In addition, goods exports are also heavily high-tech weighted and somewhat insulated from slowing global demand. Goods exports grew 2.2 percent in 2018 and rose 5.7 percent in the first two months of 2019, relative to Q4 2018. Goods export growth came mostly from medicine, chemical, and electronic equipment sectors. In four of the past six years, net exports, as a component of GDP, has been negative. During these years, however, exports have grown nominally and so this result stems from imports rising faster than exports.

In 2018, public debt rose to 61 percent of GDP, a slight increase from 60.5 percent in 2017. Government debt as a percentage of GDP also increased to 59.4 percent in 2018. While this remains below the European Union's benchmark Maastricht Treaty level (60 percent), it is still slightly higher than its 58.8 percent level in 2017. The rise in debt can be attributed to a significant weakening of the shekel against the U.S. dollar and euro, as well as high inflation relative to previous years.

So far in 2019, however, Israel's currency has been strong, returning just under 5 percent, versus the U.S. dollar, and roughly 6.5 percent return versus the euro.

### Change in General Government Debt-to-GDP

(Percentage points of GDP, 2008-2018)

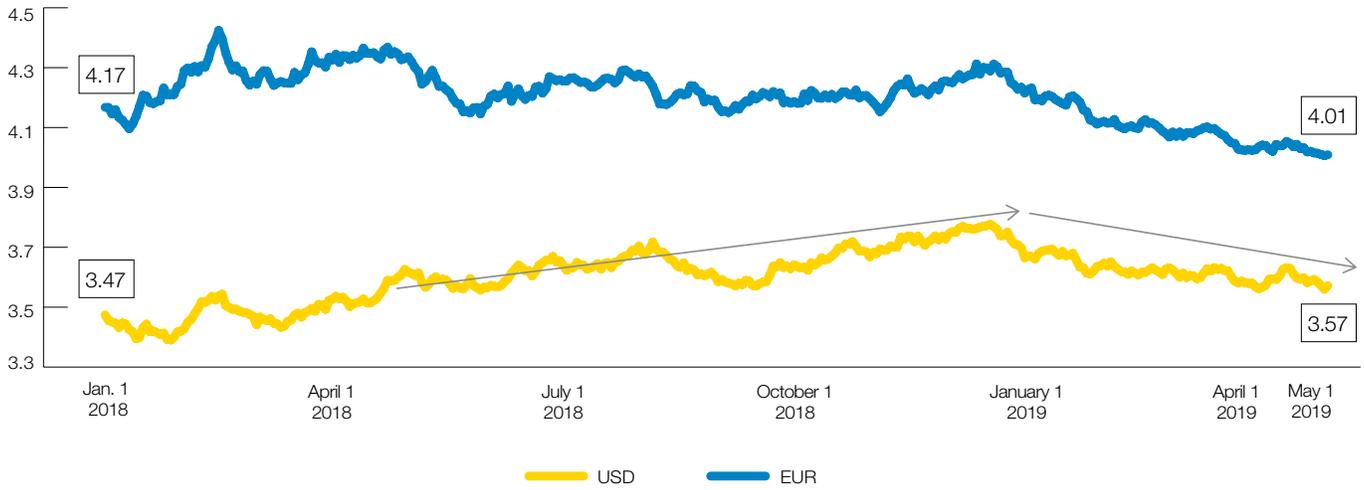


Source: MoF; IMF World Economic Outlook, April 2019

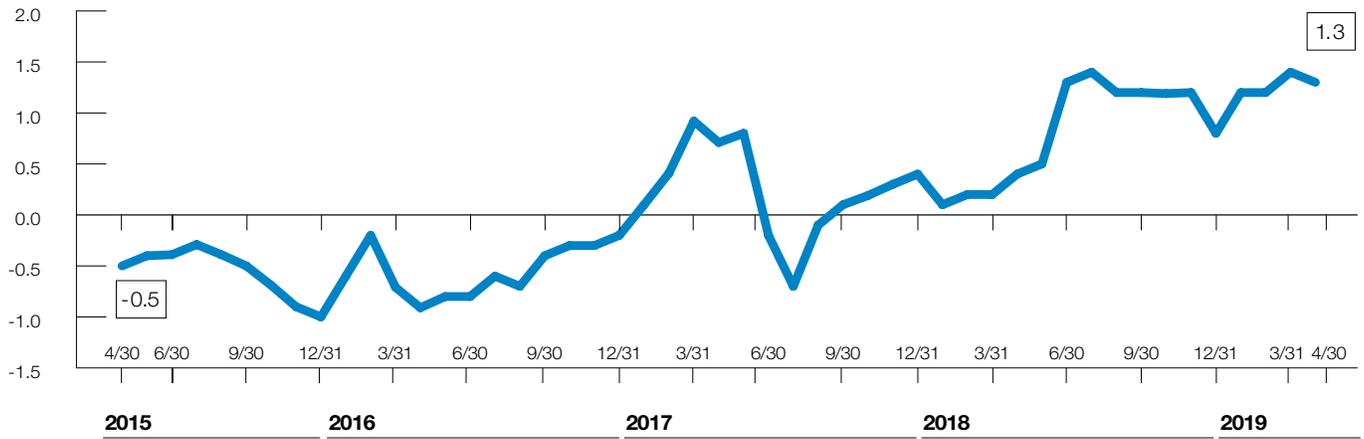
<sup>2</sup> World Economic Outlook, April 2019

<sup>3</sup> 3.9 percent as of March 2019; Central Bureau of Statistics

### Israeli Shekel FX, USD and EUR



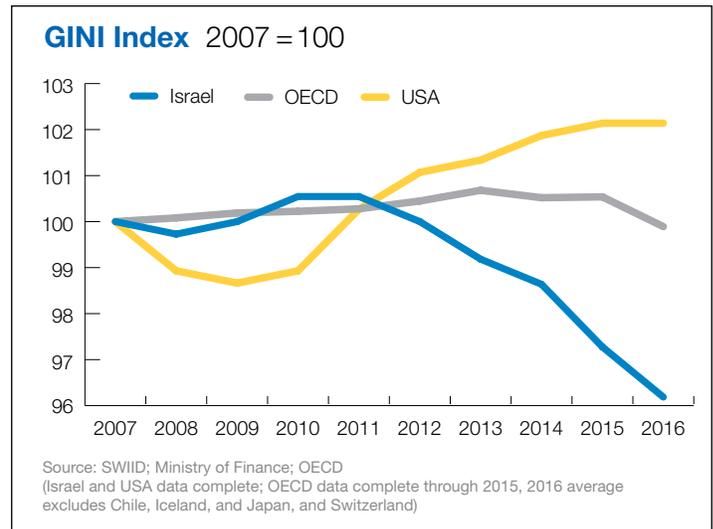
### Israel CPI YoY, Not Seasonally Adjusted



## Inequality

While high-tech is an important engine for Israel's economic growth, only 15 percent of the population is employed in the sector. Large shares of the population (for cultural reasons) have not participated in the workforce to the same degree as the rest of the population. This includes Arab women, who make up roughly 10 percent of Israel's total population; and Ultra-Orthodox men, who comprise around 6 percent of the total population. These groups have a low participation rate in the economy, do not usually serve in the military (where valuable workforce training is learned), and many live off welfare from the state. Between those working in the highly productive high-tech sector and those choosing not to work at all (or just entering the workforce in low-productivity jobs), a large productivity chasm has led to a high rate of income inequality. This disparity has also resulted in Israel showing up near the bottom of OECD poverty and standard-of-living rankings, despite a per capita GDP of more than \$40,000. With an annual population growth rate of roughly 2 percent, reducing economic inequality is a high priority for the government.

Government policies were enacted years ago and the long-term trend toward greater equality has been positive. In 2006, less than one in four Arab women participated in the workforce; today more than one out of three participate. Also in 2006, fewer than 40 percent of Ultra-Orthodox men participated in the workforce; today more than 50 percent have a job. With a greater share of these populations working, rising wages (including minimum wage), reductions in cost-of-living, and holistic government policies aimed at solving this long-term concern, Israel has been able to reduce structural economic inequality over the years. The GINI coefficient is a popular index used to gauge economic inequality. As illustrated in the graph, over the past ten years, Israel's policies have been successful in reducing economic inequality. The drop in relative inequality is most apparent after 2011's public protests against the rising cost of food. The drop in relative inequality is especially noteworthy when compared to other advanced countries. Since 2007, economic inequality in the U.S. has risen, while in OECD countries it has remained stable.



## Monetary

The Bank of Israel has maintained its central rate at 0.25 percent since November of 2018. In its May 20 interest rate announcement, the Bank of Israel noted, *"The Committee assesses that the rising path of the interest rate in the future will be gradual and cautious, in a manner that supports a process at the end of which inflation will stabilize around the midpoint of the target range, and that supports economic activity. The Bank of Israel continues to monitor developments in inflation, the real economy, fiscal policy, the financial markets, and the global economy, and will act to attain the monetary policy targets in accordance with such developments."* The full press release can be found [here](#)<sup>4</sup>. The next interest rate decision will be published on Monday, July 8, 2019.

As of April 2019, Israel's foreign currency balance rose about 3 percent, totaling \$118 billion. Bank of Israel [reports](#)<sup>5</sup> that the increase was a result of a revaluation that increased the reserves by approximately \$695 million and private sector transfers of about \$4 million. In 2018, the foreign currency balance grew roughly 2 percent from \$113 billion to \$115.3 billion. The amount on reserve is 32.2 percent of GDP. Reserves have roughly maintained this ratio since late 2009.

4. <https://www.boi.gov.il/en/NewsAndPublications/PressReleases/Pages/20-05-19.aspx>

5. <https://www.boi.gov.il/en/NewsAndPublications/PressReleases/Pages/7-05-19.aspx>

## Other News

### ■ Israeli Startups Shine in \$92 Billion Cybersecurity Market

Israeli startups received \$1.19 billion or almost 20 percent of 2018 global VC investments in cybersecurity, an increase of 47 percent from the previous year, according to a recent report from Start-Up Nation Central. In another report published by Strategic Cyber Ventures, it shows that Israel surpassed China last year as the “hottest spot for VC investments in cybersecurity companies outside the U.S.”

Start-Up Nation Central also reported the increased participation by non-Israeli investors who were involved in 65 percent of investment deals and by corporate VCs who participated in 21 percent of deals. These investors, together with local investors, helped to spur the growth of the cybersecurity sector in Israel. By the end of 2018, there were 450 local cybersecurity companies and 47 multinational corporations with cybersecurity-related operations in Israel.

— *Forbes*

<https://www.forbes.com/sites/gilpress/2019/02/26/israeli-startups-shine-in-the-92-billion-cybersecurity-market/>

### ■ Bloomberg Index Ranks Israel Fifth Most Innovative Nation

Israel moved up to fifth place in the 2019 Bloomberg Innovation Index, an annual ranking of the world's 60 most innovative countries. The index reviews dozens of criteria using seven metrics, including research and development spending, manufacturing capability and concentration of high-tech public companies.

South Korea led the index, followed by Germany, Finland and Switzerland. Israel was ranked 10th in 2018.

— *Haaretz*

<https://www.haaretz.com/israel-news/business/israel-ranked-5th-most-innovative-nation-by-bloomberg-1.6869143>

### ■ Intel Corp. Plans \$11 Billion Chip Plant Expansion in Israel

Intel Corp. will receive a grant of close to \$1 billion from the Israeli government to invest \$11 billion dollars in a new factory in Israel. Currently one of the biggest employers and exporters in Israel, Intel plans to submit a business plan for continued investment in its Kiryat Gat manufacturing site in central Israel. The expansion is expected to add 1,000 new employees to Intel's workforce in Israel, currently around 13,000.

Intel's exports from Israel rose by \$300 million in 2018 to \$4 billion, while it purchased \$1.7 billion of products from local companies. The company, along with Israel Chemicals and Teva Pharmaceutical, accounts for half of Israel's industrial exports.

— *Reuters*

<https://www.reuters.com/article/us-israel-intel-idUSKCN1PM2GT>

### ■ Israel, Egypt and Others Form New Natural Gas Group

Countries around the Eastern Mediterranean announced the creation of a forum joining Israel, Egypt, Cyprus, and other neighbors to develop their new natural gas discoveries.

The Eastern Mediterranean Gas Forum formalizes growing energy ties among recent rivals and could hopefully spur much-needed development of energy infrastructure required to tap the region's potential as a source of energy for Europe and beyond. The forum cements the growing commercial links between Israel and Egypt; Israel expects to start shipping natural gas to Egypt in the next few months as part of a landmark, \$15 billion deal between the two countries.

— *Foreign Policy*

<https://foreignpolicy.com/2019/01/15/club-med-israel-egypt-and-others-form-new-natural-gas-group/>

## Other News

### ■ **Nvidia to Buy Mellanox for \$6.9 Billion in Data Center Push**

Nvidia, a company that designs graphic-processing units for the gaming and professional markets, has agreed to buy the Israeli chipmaker company, Mellanox Technologies, for \$6.9 billion.

Mellanox Technologies makes chips used to speed the flow of information across computer servers. The purchase is reportedly viewed as an opportunity for Nvidia to push into the growing market for data center components.

— *LA Times*

<https://www.latimes.com/business/la-fi-tn-nvidia-mellanox-data-centers-20190311-story.html>

### ■ **McDonald's Purchases Israeli Tech Firm for \$300 Million**

In its largest acquisition in 20 years, McDonald's Corp., the world's biggest restaurant chain, is buying Dynamic Yield Ltd., an Israeli decision-logic technology company, for \$300 million. With the new technology, McDonald's restaurants can vary their electronic menu board's display of items, depending on factors such as weather, time of day or regional preferences.

"Technology is a critical element of our velocity growth plan," noted Steve Easterbrook, McDonald's chief executive officer.

— *Bloomberg*

<https://www.bloomberg.com/news/articles/2019-03-25/mcdonald-s-300-million-tech-deal-is-its-largest-in-20-years>

## 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 (GDMU)

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

### Israel's Annual Debt Report

<https://mof.gov.il/en/PolicyAndBudget/GovernmentDebt/GovernmentDebtIndices/Pages/AnnualDebtReport.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](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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