

## Overview

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- Israel's GDP grew by 2.8 percent in 2014, once again exceeding OECD growth. The fourth quarter growth rate of 7 percent made up for GDP declines earlier in the year.
- Israel's debt-to-GDP ratio declined to 67.1 percent. This is the fifth straight year of decline and a positive trend for Israel.
- In May 2015, Fitch affirmed its A rating for Israel. Earlier this year, Moody's affirmed its Stable outlook for Israel's banking system.
- Israel's Current Account remained in surplus for a tenth straight year. Although Israel is a net creditor, foreign investment has remained strong with \$9.5 billion in 2014.
- Israel's unemployment rate continued to decline in 2015. As of March, unemployment stands at 5.3 percent, a positive indicator for Israel.
- Israel's GDP per capita in 2014 was \$37,092, placing it among higher-rated sovereigns.
- The Bank of Israel increased its foreign currency reserves in 2014. As of April 2015 they stand at \$85.9 billion.
- The Tel Aviv Stock Exchange (TASE) has implemented numerous changes over the past year, with the purpose of conforming to the trade standards of other exchanges around the world. The TASE continues to evolve, offering real solutions for Israeli and international investors.
- Takwin is the first private venture capital fund and incubator making return-driven investments in ventures created by Israeli Arab entrepreneurs. Its aim is to launch successful Arab high tech companies in Israel.
- The new Minister of Finance is slated to be MK Moshe Kahlon, a former Minister of Communications, Minister of Welfare and Social Services, and current head of the Kulanu Party.

# Economic Overview – Spring 2015

Jason Reinin, Israel Ministry of Finance in New York

The 2014 economic figures for Israel describe an economy that has found its groove. Half a decade removed from the global financial crisis, Israel finds itself growing steadily while many other developed countries are still struggling to regain their footing. Of course, Israel continues to face formidable challenges such as pressure on exports, due to a strong shekel relative to the euro. However, the overall picture is that of a country that has navigated the choppiest of global economic waters and is now reaping the benefits of long-practiced fiscal discipline, as much of the rest of the world gradually recovers. In May 2015, Fitch affirmed their A rating for Israel.

## GDP

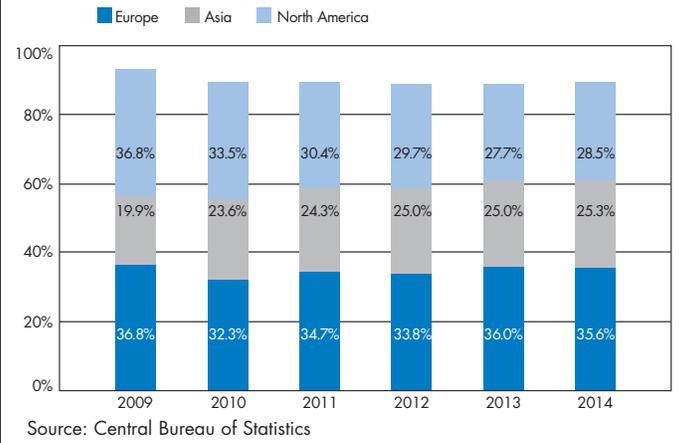
From 2009 to 2013, Israel's GDP experienced strong growth averaging just over 4 percent growth per year. The first three quarters of 2014 resulted in a decline in GDP. This can be partially attributed to the weakening in economies of some of Israel's trading partners still recovering from the global financial crisis. Although the trend in the first three quarters showed a decline, a growth of 7 percent in the fourth quarter brought the annual GDP to a positive 2.8 percent. Likewise, business GDP averaged slightly more than 4.33 percent from 2009 to 2013. It too had three quarters of decline in 2014 (including a -0.7 percent third quarter). However an 8.1 percent surge in the fourth quarter brought the growth rate to 2.7 percent for the year (Figure 1).

Just as it has over the last decade, Israel's GDP growth exceeded the average rate for advanced economies in 2014. GDP experienced growth in public consumption (4.2 percent), private consumption (4 percent), and exports of goods and services (1.3 percent). However, investments in fixed assets dropped 2.5 percent.

## Foreign Trade/Balance of Payments

In recent years, Asia has become an increasingly important market for Israel's exports. In 2014, Asia accounted for 25.3 percent of Israel's exports, compared to only 19.3 percent in 2006. In contrast,

**Figure 2: Export of Goods-Destinations**  
(as a Share of Total Exports of Goods)



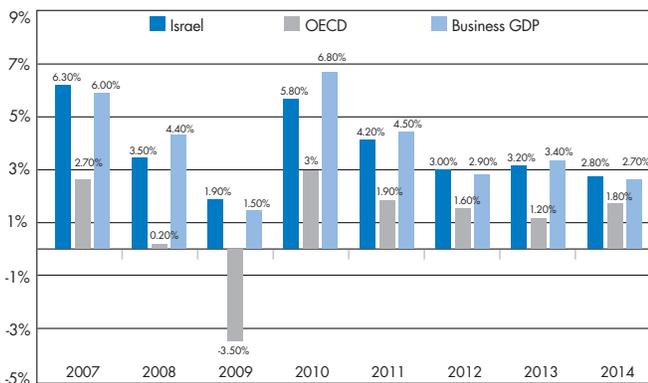
exports to North America fell from 36.8 percent in 2006, to 28.5 percent in 2014 (Figure 2). The United States is still far and away the top export destination for Israel with \$18.6 billion exported in 2014. China was the second biggest destination with \$8.9 billion. The United States is also the number one importing country to Israel with \$8.9 billion (China, again second, with \$8.1 billion).

For the past ten years, Israel has retained a surplus in its current account and, as such, has kept its position as a net creditor. In 2014, its current account surplus (as a percent of GDP) was 3 percent. Although Israel is a net creditor, foreign investment has remained strong with \$9.5 billion in 2014.

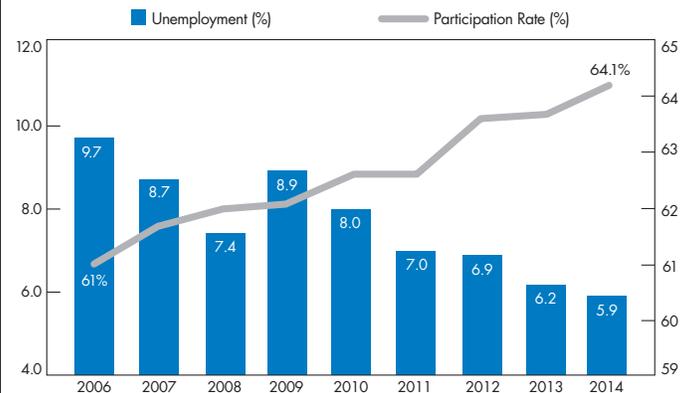
## Labor Market

Israel ended 2014 with an unemployment rate of 5.9 percent, one of the lowest with respect to other advanced countries (the OECD average unemployment rate was 7.3 percent in 2014). Early 2015 data show that this positive employment trend is continuing into this year (5.3 percent unemployment rate as of March 2015).

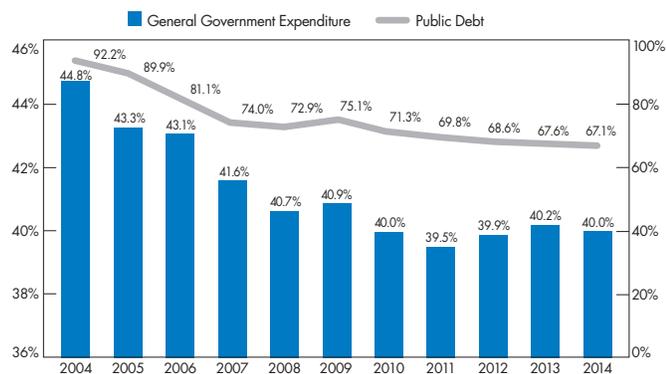
**Figure 1: GDP Growth** (% per annum)



**Figure 3: Unemployment and Participation Rate**



**Figure 4: General Government Expenditure and Public Debt** (as percentage of GDP)



Source: Central Bureau of Statistics

Indeed, Israel's unemployment rate is falling as its participation rate is rising. The rate of unemployment is trending lower while at the same time more workers are entering the labor market. Rising participation and a declining unemployment rate are indicative of a strengthening labor market (Figure 3).

### Fiscal Update

Ten years ago, Israel's public debt-to-GDP ratio was quite high at 92.2 percent. Since then, it has dropped to 67.1 percent in 2014 (Figure 4). The declining debt-to-GDP is a very positive indicator for Israel's macroeconomic health. Israel has improved this ratio over the years when compared to advanced economies. The OECD's average debt-to-GDP in 2007 was 73.3 percent, while Israel's was 73.9 percent. In 2013, the ratio ballooned to 110.9 percent in the OECD while Israel's debt-to-GDP was 67.6 percent. Much of this can be attributed to governments increasing their borrowing in response to the financial crisis.

Israel was somewhat protected from this effect, because it did not

**Figure 5: Israel's CPI Year-Over-Year**



Source: Bank of Israel

suffer an internal financial crisis. Further, it maneuvered quickly to weather the external crisis, and maintained fiscal discipline in the years leading up to the crisis. Israel has stayed the course until today.

### Monetary Update

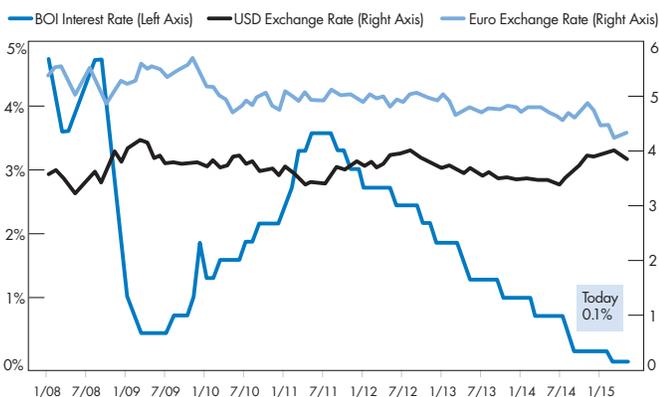
The Bank of Israel's inflation target is between 1 and 3 percent. 2014 ended with the inflation rate within the target band at 1.83 percent. So far in 2015, the CPI stands at -1 percent (Figure 5).

Recently the Bank of Israel lowered its interest rate to 0.1 percent, and, while the shekel has become slightly weaker against the dollar, it has strengthened versus the euro (Figure 6).

In early 2015, Moody's affirmed a stable outlook for the Israeli banking system, noting expectations of robust economic growth, strong liquidity, and increased capital reserve ratio requirements.

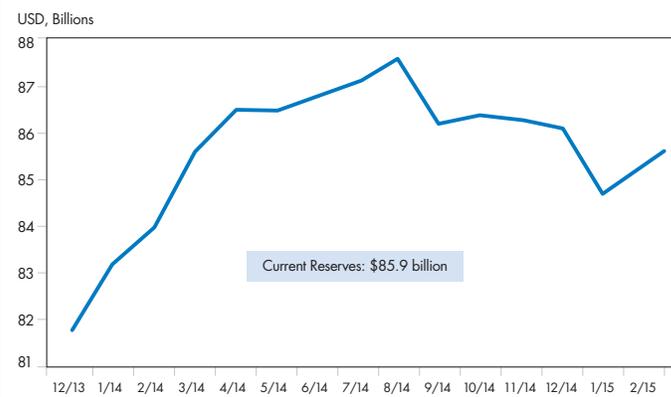
The Bank of Israel maintains a reserve of foreign currency. Currently the Bank of Israel holds \$85.9 billion in reserve, down from a high of more than \$87 billion in 2014 (Figure 7).

**Figure 6: Interest Rate and Exchange Rates**



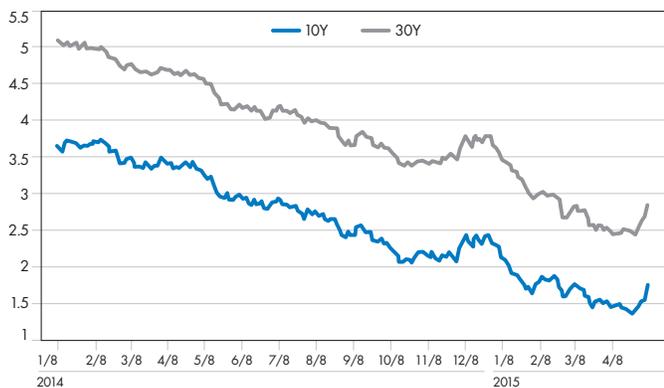
Source: Bank of Israel, Ministry of Finance

**Figure 7: Bank of Israel Foreign Exchange Reserves**



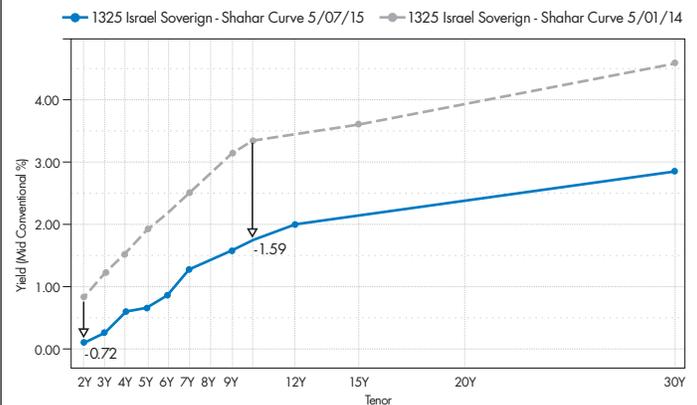
Source: Bank of Israel

**Figure 8: Israel's 10- and 30-Year Bond Yields**



Source: Ministry of Finance

**Figure 9: 2014 Yield Curve Compared to 2015**



Source: Bloomberg

### Yield Curves in Israel's Domestic Market

The yields on Israel's domestic bonds have risen recently (Figure 8), following the global trend.

This being said, they have come down from where they were at this point last year. Bond prices had risen in 2014, rewarding investors in the 30-year bond with approximately a 30 percent return.

The yield curve has flattened substantially from where it was last year (Figure 9). The spread between the 2-year bond and the 10-year bond declined from 250 basis points to 160 basis points.

Currently the yield on Israel's domestic 10-year bond is 1.74 percent while the 30-year stands at 2.85 percent. The spread between the two (110 basis points) is still high, but has decreased significantly from 140 basis points last year, which at the time represented one of the steepest yield curves in the world.

### Election

Earlier this year, Prime Minister Netanyahu dissolved the government and called for a new election. The election resulted in the Prime Minister's party (Likud) grabbing the most seats in the new Knesset. President Rivlin then tasked the Prime Minister with creating a new majority coalition in order to form a government. On May 6, 2015, Prime Minister Benjamin Netanyahu reported that he has enough seats in his coalition to form a government.

There was no major disruption to the economy due to the election. Additionally, the election did not cause any shock to Israel's markets as elections in Israel are a more regular occurrence than in many other countries (no government in the past 30 years has completed a full term). Moody's stated, following the announcement of the election, that the "government's fiscal rules should contain spending growth and keep credit metrics for Israel on their well-established improving trend, a credit positive." Currently Moody's credit rating for Israel is A1, Stable.

The new Minister of Finance is slated to be MK Moshe Kahlon, a former Minister of Communications, Minister of Welfare and Social Services, and current head of the Kulanu Party (Kulanu won ten seats in the new government).

### Moshe Kahlon, New Minister of Finance for Israel

Moshe Kahlon is set to become the next Minister of Finance for Israel. He will be following Minister Yair Lapid, who served in the post from 2013-2014. Kahlon previously served as the Minister of Communications from 2009-2013, as well as Minister of Welfare and Social Services from 2011-2013. As Minister of Communications, Kahlon was credited with breaking up Israel's cellular monopoly by removing roadblocks for new cellular communication companies to enter the market.

Kahlon first entered national Israeli politics in 2003 where he was appointed Deputy Speaker of the Knesset and also served on several committees, including chairing the Knesset Economic Affairs Committee. In 2013, Kahlon split from the Likud Party and founded a new party that he named Kulanu (all of us).

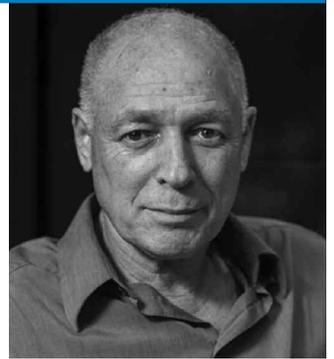
Kahlon served in the IDF from 1978-1986, received a BA in Political Science and General Studies from the University of Haifa, a Bachelor of Laws from the Netanya Academic College, and has completed studies at Harvard University's advanced management program.

## The Tel Aviv Stock Exchange: Sound and Attractive to International Investors

In an interview with *Shekel*, Amnon Neubach, Chairman of the Tel Aviv Stock Exchange (TASE), speaks of the important strategic plan he has promoted in cooperation with the TASE board of directors and its CEO, Yossi Beinart.

“The Tel Aviv Stock Exchange has implemented numerous changes over the past year, with the purpose of conforming to the trade standards practiced in other exchanges around the world. The combination of the strong and resilient Israeli economy, fertile technology and startup environment in Israel, as well as the new energy resources and the responsible economic policy, create an appealing ecosystem that is beneficial to international investors.”

Another initiative led by Neubach is the demutualization of the TASE. “In recent years, most stock exchanges in the West have become public, and when the process was concluded, we saw that performance was improved, as was service to investors. We are hoping to complete the demutualization process of the TASE in the course of the next two years, and subsequently it will possibly also be listed,” he said.



Amnon Neubach  
Chairman of the TASE

### National Mission

Neubach, who was a director and financial consultant in recent years, spent five years as Israel's Minister for Economic Affairs in Washington, D.C., and also served in the 1980s as the economic adviser to then Prime Minister Shimon Peres. Even with his vast experience, Neubach said that he considers his position at the TASE a challenge, and a mission of national importance.

“The economy in Israel is strong, and needs a stock exchange that offers a real solution for Israeli and international companies alike, as well as to its investors,” Neubach noted. “In the context of preparing the strategic plan, we analyzed the developments in the Israeli capital market following a decade of highly significant regulatory changes throughout the world. Among other things, it emerged from the analysis that, although Israel is renowned as a startup nation and is abundant in growth companies (there are some 5,000 of these in Israel at any given time), due to the absence of solutions in the domestic stock exchange, many such companies are exiting overseas.

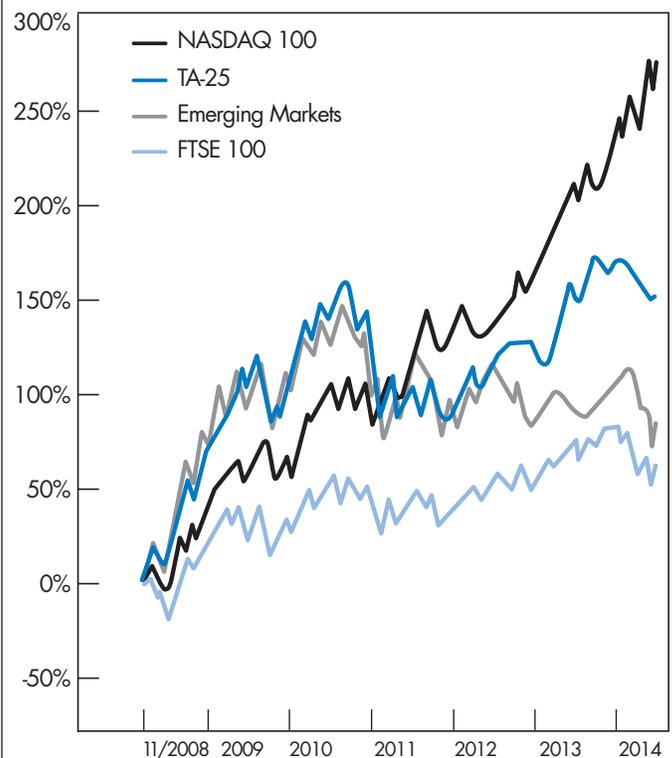
### New Initiatives for Global Investors

The Israeli economy is globally considered a growing, dynamic, and promising environment. Neubach noted that the TASE sees great importance in being accessible to international investors, and has taken significant measures in this respect over the past year.

For example, June 2014 saw the commencement of trading in futures based on the TA-25 Index at the Eurex Exchange. This new product has created opportunities for foreign investors who had not been previously active in Israel. Furthermore, the TASE has been lobbying for the adoption of international risk management standards (a process which is presently in progress), and has joined the Federation of European Securities Exchanges (FESE).

2015 is expected to introduce further significant changes. These include, among other things, opening an account with the European clearinghouse Euroclear Bank SA/NV, with the purpose of transferring the securities of companies traded in both Israel and Europe between these two markets. This account serves a purpose similar to the account opened by the TASE Clearinghouse with the Depository Trust Company (DTC) in the United States, which is used for the transfer of securities between Israel and the United States.

### TA-25 and International Indices, 11/2008 - 2014 (US\$)



“We would like to give these companies another option to raise capital through the TASE, and this is, without a doubt, one of our central goals,” he added. “We are in the midst of a legislative change, with the purpose of encouraging issues by research and development companies, through relaxations both to the companies and to their investors. We are also acting to promote and strengthen this sector in a variety of additional ways, such as through the analysis of technology companies in English, and the launch of international indices based on Israeli high-tech companies.”

### Financial Ties with the U.S.

Undoubtedly, the Israeli stock exchange also holds great importance in the context of the relationship between Israel and the United States. An indication of this may be found in the message posted by Dan Shapiro, the Ambassador of the United States to Israel, on his Facebook page, following his visit to the new and modern building of the TASE this past February: “A fascinating visit to the Tel Aviv Stock Exchange, whose success is a sign of Israel’s impressive economic growth. Many companies at TASE are cross-listed on Nasdaq and the New York Stock Exchange in another example of close economic ties between Israel and the United States.”

The connection between the Tel Aviv Stock Exchange and the American economy was also reflected recently in the issues of bonds of American real estate companies at the TASE. This reflects how foreign companies are giving the TASE and Israel their votes of confidence.

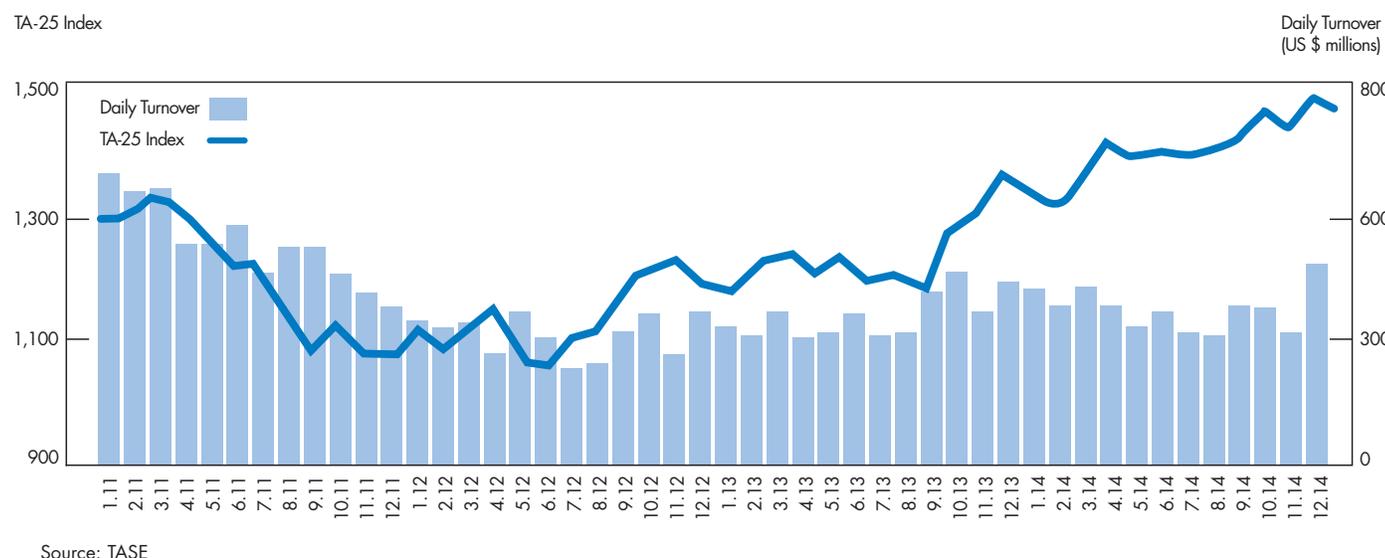
### Israel’s Stability

“Israel’s stability is manifested in various ways. For instance, while the debt burden has increased in economies around the world, Israel is able to proudly note that its own debt burden has decreased. When banks around the world collapsed in 2008, Israeli banks held their ground thanks to the strict regulation that had been implemented in Israel for many years. Israelis invest abroad and the world invests in Israel. The reason for this is that Israel is a society with a responsible economic policy, including effective deficit control. All of this stems from June 1985, when the Israeli government made the dramatic decision to take on an economic stabilization plan. Shimon Peres was the Prime Minister at the time, and I was a party to the plan in my capacity as his economic adviser. The plan set forth a completely different set of rules for the Israeli economy, and the economy has since enjoyed remarkable stability. It is more affected by the global economic situation than its geopolitical situation,” Neubach noted.

### TASE in the Future

“We are doing a great deal to help the TASE double its daily trading volume, offer investors a variety of interesting investment instruments and provide a real solution for companies that wish to go public in Israel. I hope that in three to four years we will be looking to go public ourselves. That is what we are aiming for, and, judging by the scope and nature of activity in the past few months, we are very optimistic with respect to the implementation of this plan,” Neubach concluded.

The Equity Market Prices and Turnover, 2011-2014



Source: TASE

## Takwin: Paving the Way for Israeli Arab Entrepreneurship

Itzik Fried, Managing Partner, Takwin

Israel's continued economic growth depends both on the ongoing productivity and expansion of its advanced industries, and the successful integration of its underperforming populations into these fields. As recently as February 2015, the OECD cited better economic integration of Arab citizens, who make up 21 percent of the population, among the top four priorities for Israel's economic future.

Arab citizens have higher poverty rates, lower labor participation rates, and are less represented in professional fields—often despite having qualifications. As a result, government estimates show that, though they make up one-fifth of the population, Arab citizens contribute only 8 percent to the GDP at estimated losses of NIS 31 (app. \$8.5) billion annually.

Numerous initiatives have been backed by the government in recent years that aim to boost Arab economic development, most of which focus on employment. Among these efforts, high-tech integration stands as the pinnacle of opportunity: high quality employment for Arab citizens on the one hand, and a source of professional talent domestically for an industry that cannot keep up with the demand for a qualified workforce.

Changes are beginning to be seen. Today, Arab citizens comprise approximately 2 percent of over 200,000 professionals in Israel's high tech industry, up from less than 1 percent only a couple of years ago. Moreover, we see more Arabs aspiring beyond high-tech employment to become innovators in the start-up nation and launch their own companies. Arabs are attending and graduating from the best technology departments in Israel, and more are studying computer science, which until recently was not considered a legitimate professional course for young Arab talent. Some of those graduates are continuing on to work for large high-tech companies, mostly in the north of Israel. These are promising signs, but statistically they are still outliers. However you look at the data, Arabs are nearly totally outside of the flourishing scene that earned Israel the name, "The Startup Nation."

At the Israel Dealmakers Summit in New York in March and at events with the Ministry of Economy, Takwin Labs shared how the right kind of investment in Arab-led startups can expand Israel's high tech into the rapidly growing Arabic-language markets, tap into the creative potential of Israel's Arab society, and take Arab economic integration to another level. Takwin is the first private venture capital fund and incubator making return-driven investments in ventures created by Israeli Arab entrepreneurs. Our aim is to launch successful Arab high-tech companies in Israel that will foster entrepreneurial culture in Israel's Arab society, encourage stronger Jewish-Arab relations through collaboration, and boost growth in Israel.

Takwin was founded in partnership by three major leaders in Israel's venture capital and industry arenas. The first two, Chemi Peres, Founder and Managing Partner of Pitango and MK Erel Margalit (prior to joining politics), Founder of JVP – Jerusalem Venture Partners, represent the first partnership formed between Israel's two largest high-tech investment funds. After Erel Margalit's transition to

politics, his partner, Uri Adoni joined Takwin's management team. Takwin's third founder is Imad Telhami, the renowned industrialist, former COO of Delta Textile and founder of Babcom Centers. Imad Telhami serves as Takwin's Chairman with Chemi Peres as Head of its Investment Committee. As the fourth partner, I serve as the Managing Partner. Previously I was the CEO of Playscape, Managing Director of Argoquest Holdings, Vice President of Business Affairs at AOL, and Senior Adviser to the Minister of Finance.



Itzik Fried,  
Managing Partner, Takwin

The partners believe that fostering successful Arab role models for high-tech entrepreneurship would have a big impact on not only the number of Arab citizens looking to enter these fields, but the level of achievement to which they will aspire and commit.

There is an incredible pool of talent in Arab society that is untapped and unconnected to the vast array of resources that give most Israeli start-ups a leg up. For those who have advanced degrees, overcome the fear of risk, and develop an entrepreneurial dream, it is still harder to access seed funding and proper guidance than it is for Jewish start-ups who probably know someone who knows someone who can guide them into the right door. Not that it is ever easy, but a Jewish company can much more easily avoid mistakes and develop direction than an Arab company without these connections.

Takwin also recognizes the exciting business opportunity in the rapidly growing Arabic speaking online market. While Arabic speaking users make up the fourth largest group using the Internet, no Arabic speaking countries have anywhere near the capabilities to generate content and online infrastructure to meet the growing number of users (only 1 percent of internet content is in Arabic, or about 323,000 sites for 350 million people). Arab citizens, with better access to Israel's start-up ecosystem and a wide range of cultural fluency, could serve as an important economic bridge and expand Israel's industry into this territory.

Takwin Labs takes a proactive approach. To date, we have met with more than 100 applicants, invested in one company, and have three deals pending. We scrutinize a pipeline of potential investment deals, we identify the best and brightest individuals fit for high-tech entrepreneurship, and we work with them closely for many months, in some cases on their products and ideas. In other cases we match them with initiatives that need improved leadership.

In this first phase, Takwin invests in and incubates these companies from our offices in downtown Haifa. From this home base, we plan to expand to the Middle East and North Africa in the future and support high-tech entrepreneurship in the Palestinian Authority. It represents an exciting business opportunity, combining creativity and equal opportunity and leveraging the Israeli high tech experience, connections, and accomplishments.

Takwin raises funding from a range of investors. So far, we have raised \$5.5 million from Israeli Jews and Arabs, Palestinians, and U.S. high-tech entrepreneurs, and hope to complete a total of \$20 million.

## Macroeconomic Figures

Compared to the Previous Period, Annual and Quarterly Changes

	2013	2014	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014
Real GDP Growth Rate	3.2%	2.8%	2.8%	3%	1.5%	0.4%	7%
Business GDP	3.4%	2.7%	2.5%	2.7%	2.1%	-0.7%	8.1%
GDP Per Capita	1.3%	0.8%	0.7%	1.1%	-0.3%	-1.6%	4.7%
Unemployment	6.2%	5.9%	5.8%	5.9%	6.1%	6.2%	5.7%
Goods and Services Exports	32.9%	31.8%	33.6%	33.2%	30.9%	29.9%	33.2%
Goods and Services Imports	31.6%	30.5%	30.8%	29.9%	29.7%	31.5%	30.9%

	2007	2008	2009	2010	2011	2012	2013	2014
Debt to GDP	74%	72.9%	75.1%	71.3%	69.8%	68.6%	67.6%	67.1%
General Government Expenditure	41.6%	40.7%	40.9%	40%	39.5%	39.9%	40.2%	40%
Current Account Surplus	3.1%	1.5%	3.8%	3.4%	1.5%	0.8%	2.4%	3%

Source: Central Bureau of Statistics, Ministry of Finance

## Web Sites of Interest

Israel Ministry of Finance:

[http://www.mof.gov.il/mainpage\\_eng.asp](http://www.mof.gov.il/mainpage_eng.asp)

Government Debt Management Unit

<http://ozar.mof.gov.il/debt/gen/mainpage.asp>

Bank of Israel:

<http://www.bankisrael.gov.il/firsteng.htm>

Central Bureau of Statistics:

<http://www.cbs.gov.il/engindex.htm>

Dun & Bradstreet's Israel:

<http://www.dunandb.co.il/english/index.asp>

Equities Israel:

<http://www.equities.co.il>

Investment Promotion Center:

<http://www.investinisrael.gov.il>

Israel Economic Mission:

<http://www.israeconomicsmission.com>

Israel Government Portal:

<http://www.israel.gov.il/firstgov/english>

Israel Ministry of Foreign Affairs:

[www.mfa.gov.il/mfa](http://www.mfa.gov.il/mfa)

Israel Ministry of Economy:

[www.economy.gov.il](http://www.economy.gov.il)

Israel Ministry of Tourism:

<http://www.goisrael.com>

Israel Science and Technology Home Page:

<http://www.science.co.il>

Israel Venture Association:

<http://www.iva.co.il>

Israel Venture Capital Research Center:

<http://www.iva-online.com>

MATIMOP: Israeli Industry Center for R&D:

<http://www.matimop.org.il>

State of Israel Bonds Organization:

<http://www.israelbonds.com>

Tel Aviv Stock Exchange:

<http://www.tase.co.il/taseeng/homepage.htm>

# SHEKEL



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