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SHEKEL

ECONOMIC AND FINANCIAL TRENDS IN ISRAEL

Overview

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- Israel's growth continued to outpace that of the OECD in 2015, as it has done for more than a decade.
- Israel's debt-to-GDP ratio declined from 66.9 percent in 2014 to 64.9 percent in 2015.
- The labor force participation rate in Israel in 2015 was at an all-time high of 64.5 percent; unemployment fell to 5.2 percent.
- Israel's budget deficit in 2015 was 2.15 percent, well below the limit of 2.9 percent that the government had set for itself.
- Israel has been a pioneer in the rise of Fintech companies and continues to develop into a hub for international financial institutions in search of innovative solutions.
- KamaTech discusses its strategy for integrating more ultra-Orthodox Israelis into the high tech sector, with more than 4,000 currently benefiting from its activities.
- Seeking creative and entrepreneurial talent, as well as diverse language skills, CGS turned to Israel.

Editor's Review

Jason Reinin, Senior Advisor, Israel Ministry of Finance in New York

Overview

During 2015 - a year of lackluster worldwide economic growth - the Israeli economy performed relatively well.

In terms of economic growth, Israel outpaced its peer group of advanced countries (OECD). Fiscally, it continued to reduce its debt-to-GDP ratio and remained within its targeted deficit range. In the labor market, wages rose, unemployment fell, and labor participation rates reached a record high. Of particular note, is the improvement of participation of groups that have historically been underrepresented in the workforce. And Israel's high tech sector continues to grow and mature.

The slow global recovery in 2015 forced many of the central banks around the world to adopt monetary policies that resulted in extremely low, and even negative, interest rates. These low interest rates caused the Israeli Shekel to strengthen, thus putting a strain on Israel's exporters by making them less competitive in the global marketplace.

Israel likely faces more international economic headwinds in 2016, as global growth is estimated — by the IMF — to remain moderate. However, given the current strength of Israel's economy and its appropriate fiscal and monetary policies, it is well positioned to navigate the potential choppy economic seas ahead.

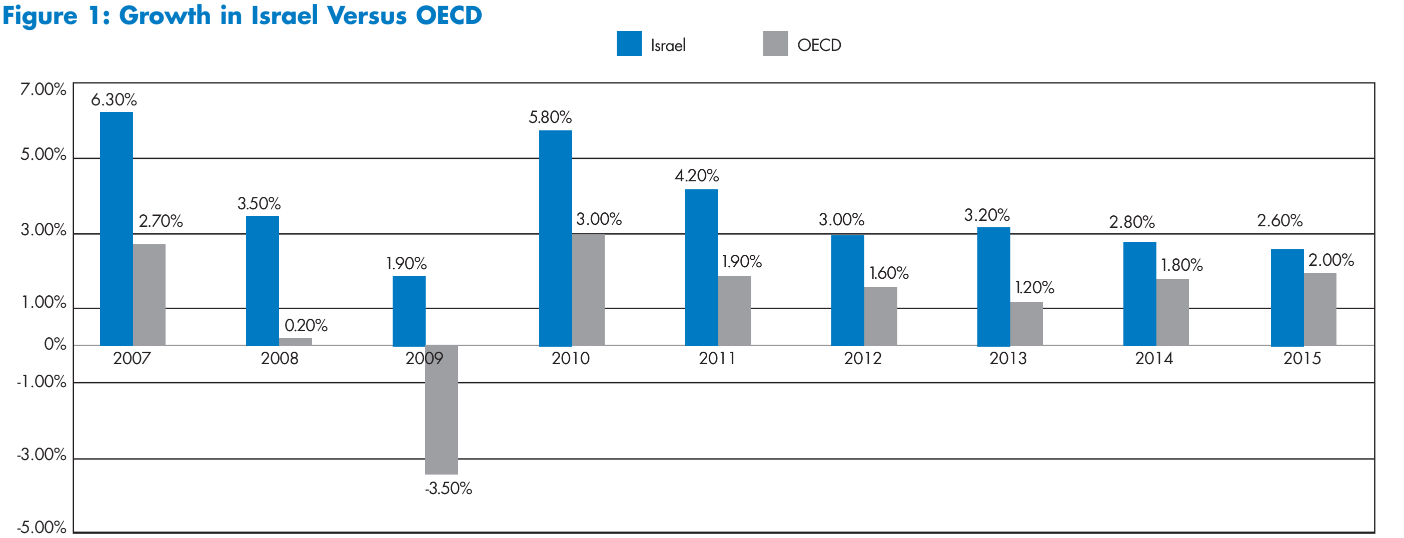
GDP

Israel's GDP grew in 2015 by 2.6 percent (initial estimate). That rate of growth continues to outpace OECD countries, estimated at 2 percent growth in 2015 (Figure 1). Recent figures, just released, show that Israel's fourth quarter GDP increased 3.3 percent on an annualized basis, compared to 2.5 percent growth in Q3 and 0.4 percent in Q2. GDP per capita also increased in 2015 with the initial estimate showing a growth of 0.6 percent. This remains in line with 2014's rate of 0.6 percent.

Clearly, Israel is not immune to the global economic slowdown, as the growth rate of its GDP has trended downward over the past few years. This being said, Israel is still in a relatively advantageous position, as it has a solid history of outpacing the OECD's growth rate and early estimates show that it is likely to outperform again in 2016. This year, Israel's GDP is forecasted to grow 3.3 percent (by the IMF) and 3.1 percent (by the OECD).

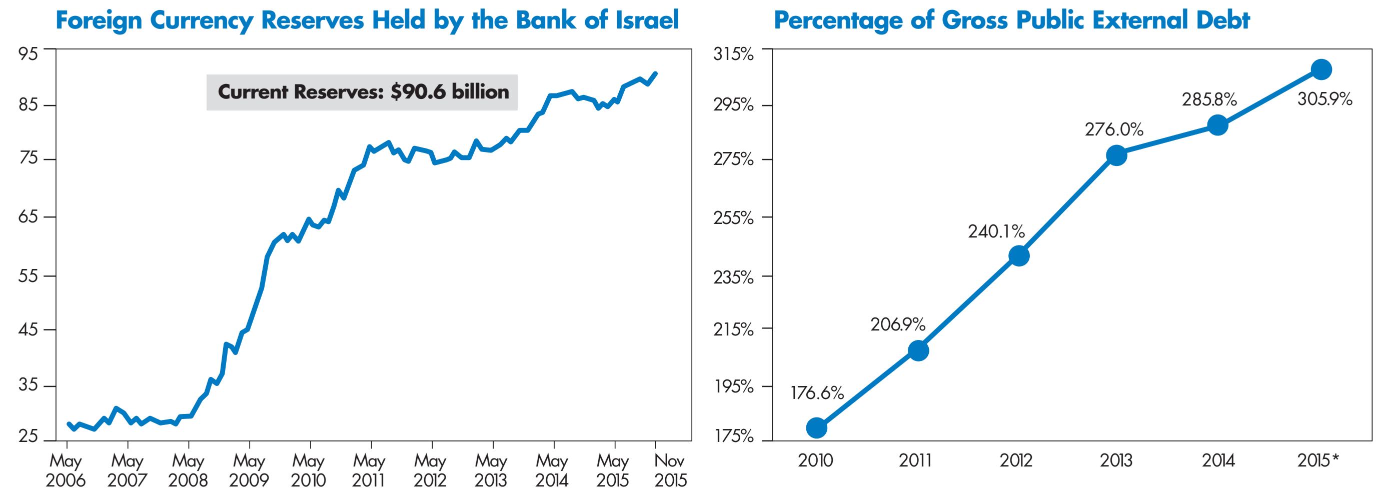
On the negative side, in 2015, Israel's economic growth has been hindered by exports. Exporters have suffered as global monetary policies remain highly accommodative, resulting in a strong Shekel. This headwind, however, has been offset by growth in consumption — both private and public — within Israel. In 2015, Israel raised the minimum wage, and overall wages increased more than 3 percent. The increase in wages was positive for the economy. With more money to spend, private consumption rose roughly 4.5 percent in 2015. The most recent figures show private consumption increased by 5.8 percent in the fourth quarter and 3 percent for the second half of the year. Additionally, public consumption grew at 2.1 percent. Recently released figures show a 14.5 percent growth in public consumption, as the newly passed budget led to a surge in government spending for the quarter. Investments in fixed assets grew by 1.1 percent in the second half of 2015, contributing $2.8 billion to GDP.

Figure 1: Growth in Israel Versus OECD



Source: Central Bureau of Statistics and OECD.

Figure 2



Source: Bank of Israel.

*As of September 2015

Foreign Trade/External Accounts

Israel's external accounts remain consistently strong. The current account (net income, net current transfers and exports minus imports) has been in surplus for more than a decade. Additionally, Israel's foreign currency reserves held at the Bank of Israel are at an all-time high of $90.6 billion (Figure 2). This amount represents more than 305 percent of gross public external debt, and, incredibly, equals more than all of the public debt in Israel (roughly $90 billion).

Israel's industrial production has grown 3.1 percent per year, on average, for the last ten years, and high tech has averaged 5.3 percent per year. High and mid-high tech comprises approximately 81 percent of Israel's exports. Foreign direct investments in Israel had a strong year in 2015, with initial estimates of $13.7 billion (data for the first three quarters, annualized). This is above the 12-year average of $8.1 billion.

Labor Market

Israel's labor market had a remarkable 2015. The labor participation rate ended at an all-time high of 64.5 percent. Unemployment at the close of 2015 was 5.2 percent (both initial estimates).

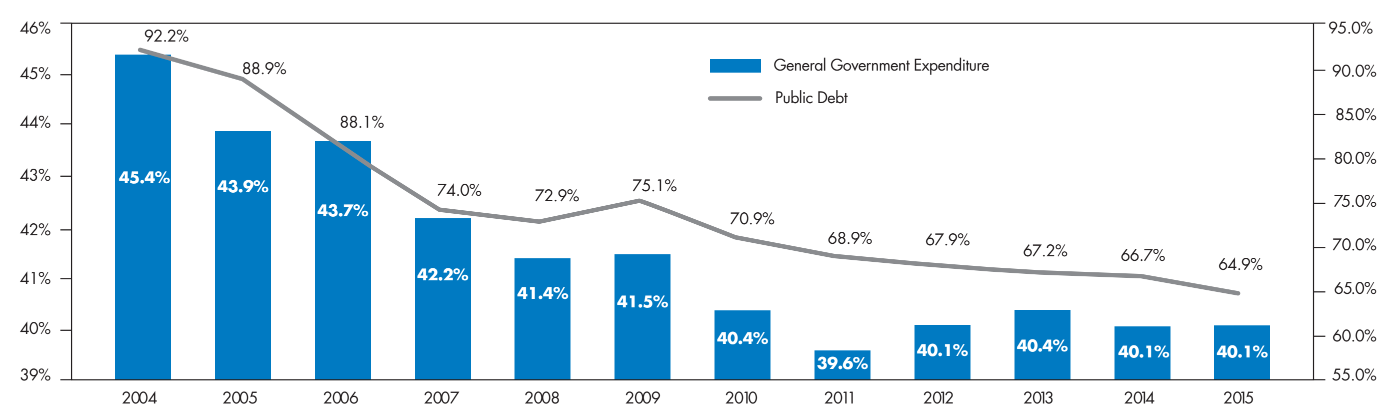
Israel continues to focus on helping to employ two groups that have historically been left out of the workforce: Ultra-Orthodox men and Arab women. Through investment in education, an increase in the minimum wage, partnerships with non-profits, and adjustments to welfare, the participation rates for both these communities rose. From 2010 to 2014, the participation rate for Ultra-Orthodox men rose 5 percent, while the rate for Arab women increased 6.3 percent. There is still work to be done on this front, but the trend has pointed in the right direction in recent years.

Fiscal Update

Israel's debt-to-GDP ratio fell once again in 2015, from 66.7 percent to 64.9 percent (Figure 3). This decline continues a longer trend of reduction in the ratio. Israel was able to accomplish this, in part, due to a firmer fiscal policy of higher revenues and constrained spending.

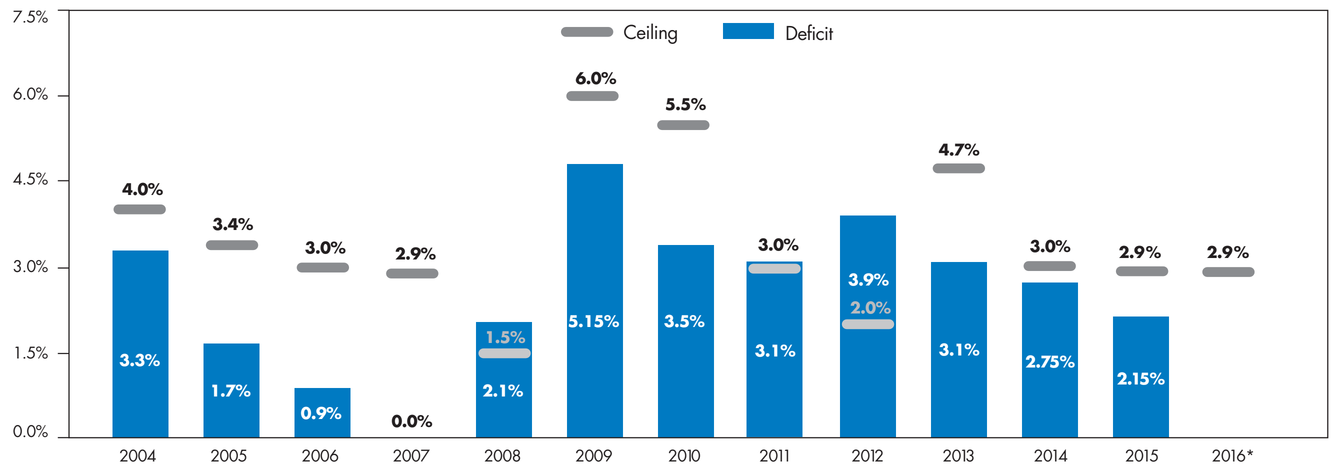
Higher revenues were derived from higher wages, including a raise in the minimum wage, more people entering the workforce, and reduced unemployment.

Figure 3: General Government Expenditure and Public Debt (as a Percentage of GDP)



Source: Central Bureau of Statistics

Figure 4: Government Deficit



Source: Central Bureau of Statistics, Ministry of Finance * Estimate

On the spending side, general government expenditure remained at 40.1 percent of GDP (the same as 2014), primarily because a formal budget had not yet been approved until November 2015. Without a budget, the government used the allotted spending from the previous year (divided by 12) to calculate the permitted monthly spending. In November, a budget was passed for the remainder of 2015 and all of 2016. Constrained spending also helped Israel keep the deficit in check at 2.15 percent of GDP. This was below the limit, of 2.9 percent, that the government had set for itself (Figure 4).

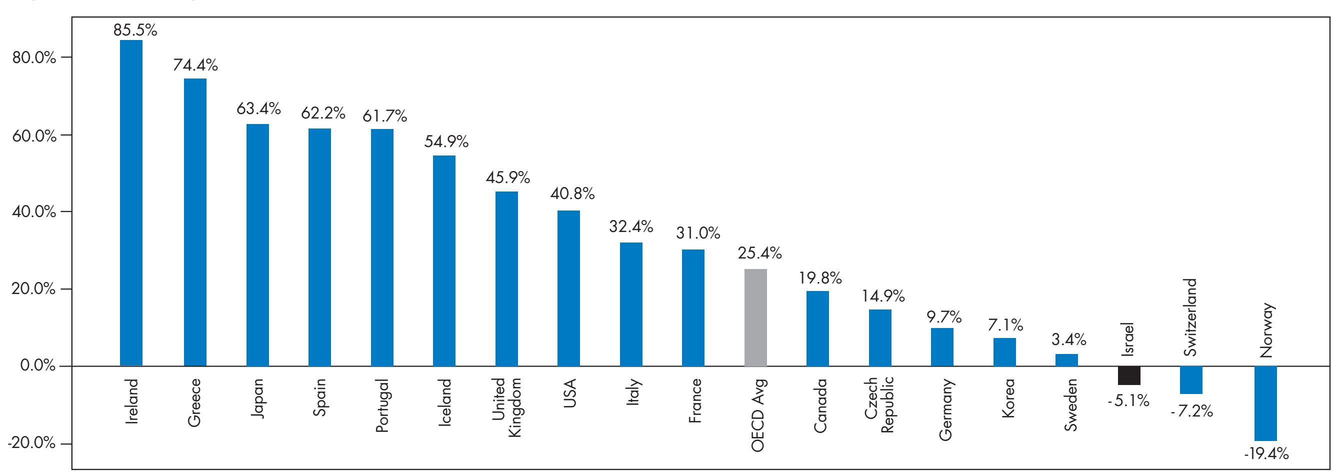
Remarkably, from 2007 to 2014, Israel reduced its total government debt by 5.1 percent. To put this into perspective, the OECD average was a *gain* in total government debt by 25.4 percent during the same period (Figure 5). Israel, along with Switzerland and Norway, were the only three member countries to post reductions.

Monetary Update

The Bank of Israel kept February's interest rate unchanged at 0.1 percent. This rate has been in place since March 2015. With the Fed rate hike in the U.S., Israel's central bank rate sits below the U.S. rate for the first time since 2008.

In 2015 (December-December), Israel's inflation rate was -1 percent. Israel's low inflation is not unique. Inflation was very low in many advanced countries, largely as a result of lower energy and commodity prices. Stripping out government price reductions and energy prices, inflation in Israel in 2015 was closer to positive 0.6 percent. Currently, the 2016 estimate for inflation in Israel is around 0.4 percent.

Figure 5: Change in Government Debt-to-GDP (2007 – 2014)



Source: IMF, Ministry of Finance

The "Year of Fintech"

Yifat Oron, CEO, LeumiTech

It is an interesting time for banks.

For the first time in history, small technology companies are launching financially oriented services, once solely maintained by banks.

The disintermediation of the banks, the rising relative costs of human capital (both major parts of the banks' cost structure), as well as shrinking margins due to low interest rates, are some of the factors encouraging banks to re-think their business models.

Today, banks and financial institutions are redesigning some of their activities, and focusing more on investing resources aimed at innovation and technology. As financial institutions witness mammoth changes in other large industries, such as transportation and housing, they have concluded that they must re-think their identities.

Banks are seeing their clients express growing needs for more sophisticated banking services. Accordingly, many have adopted peer-to-peer (P2P) lending, and robo-advisors, among other innovations.

Traditionally, banks have invested tremendously in infrastructure with extensive reach and access to markets. The banking system is required to perform and deliver ROE under heavily regulated regimes. Such platforms are key to utilizing banks' positive returns to scale (up to a point). The question is whether the better utilization of such platforms would benefit the banks over the next 10-20 years and keep them relevant players in the global marketplace.

In the last ten years, we have seen a rise in the establishment of Fintech companies. In 2015, there was approximately $20 billion invested in Fintech versus $12 billion in 2014, up from only $4 billion in 2012.

Areas of investment focus were seen in digital and mobile payments, biometrics, cloud computing, big data and analytics, as well as block chain.

Anticipating this growing demand and investment, Israel has long been a pioneer in establishing Fintech companies. Israeli companies include Actimize (sold to Nice), Triana, Check, Trusteer, and Fundtech, founded in the late 1990s.

Recently, we have witnessed the establishment of many new Fintech-related companies. Today, there are approximately 400 Fintech startups in Israel. Examples include Payoneer, eToro, FundBox, Behalf, BlueVine, TradAir, Blender, and EZBob.

Photo: Yoram Reshef

Yifat Oron

Israel continues to develop into a global Fintech innovation hub for international financial institutions, as well as large technology corporations.

Utilizing new Fintech technology, more banks are becoming better positioned to offer more services, thereby becoming a one-stop-shop for all financial needs. Down the road, banks will be challenged with integrating all these inventive solutions and choosing which new technologies they will need to keep up with competition. In order to address this, they will need to predict which Fintech companies will come up with the next "big thing."

The answer lies in each bank's approach to open innovation. Rather than viewing start-ups and technology companies as vendors, banks are now turning to them as partners.

The banks are able to access the start-up market through various models of innovation programs, investment vehicles, acceleration programs, and other forms of partnerships. Our bank, Bank Leumi, has been doing all these things for a few years now.

Bank Leumi, through its CIO office, large IT department, and Digital division has been developing structured processes of working with startups and incorporating their solutions in the overall offering — both front-end applications as well as on the infrastructure side.

In addition, we have strategically decided that in order to allow a continuous open exchange with start-ups, we need to re-think our banking services model vis-a-vis these companies.

For example, technology companies, often characterized by lack of capital, negative cash flow, and high growth, may find it hard to find a bank that understands their banking needs.

In order to service this industry's particular needs, Leumi has launched LeumiTech, Leumi's technology banking arm. This division allows the banks to service tech companies with a unique set of products and a tailor made service model for early stage companies, as well as for later stage technology companies.

The Leumi Group has built a relationship with many of the technology companies in Israel, including the Fintech sector and others. Such relationships allow the bank to identify nascent companies, help it stay on the cutting edge of technology, and embark on a mutual value proposition.

KamaTech – Integration of Haredim Into the High Tech Sector

Moshe Friedman, Co-Founder and CEO, KamaTech

Moshe Friedman

Israel is known globally as the Start-Up Nation, but in actuality, the Start-Up Nation comprises only a sliver of Israel's population. Many talented Israelis are lacking exposure to the opportunities found in the high tech industries in Israel.

The Haredi (ultra-Orthodox) community represents about 1 million people, 12 percent of the total population. However, they are growing at four times the rate of non-Haredi people in Israel, as the number of children per Haredi family is 6.7 (versus 3 for the average Israeli family). As a result, the share of Haredi among those under the age of 20 is more than 18 percent of the total population. While Haredi employment is on the rise, recent figures from the Central Bureau of Statistics show employment rates for Haredi women at 69.3 percent compared to 71 percent for the women's national figure, while just 44.5 percent of Haredi men are employed, far below the 81.5 percent national rate for male employment. The Haredi are generally employed in low paying sectors. As a result, poverty rates are around 60 percent for the Haredi population.

In recent years, more younger Haredi men and women are willing to participate in the Israeli workforce. Many have turned to universities and colleges as well as various tracks of vocational courses, and their numbers are growing rapidly every year. However there are still many obstacles and challenges they face, especially in the high tech industries, the jewel in the crown of the Israeli economy.

In the high tech sector, the number of Haredim remains low, as the industry can seem inaccessible to them. This is due to a lack of proper education, inadequate connections and understanding of the eco-system, a dearth of role models, and institutional discrimination.

KamaTech was established to meet these challenges. Zika Absuk, a secular Senior Business Development Manager with Cisco, and I, a Haredi serial entrepreneur, teamed up with Dr. Yossi Vardi, one of the founding fathers of the Start-Up Nation, to help Haredim who are interested in working in the technology fields.

KamaTech is a nonprofit initiative, supported by some of the largest tech companies operating in Israel, including Cisco, Microsoft and Google, as well as the UJA Federation of New York, the Maimonides Fund, Matanel Fund, The Kemach Foundation, the U.S. State Department's MEPI Fund, Israel's Ministry of Economy and others. Its strength is a unique coalition of large high tech companies, VC funds, high level managers and investors as well as successful entrepreneurs, all working together with KamaTech on this mission.

To achieve its goals, KamaTech formed three different tracks of operation. KamaTech established a coalition comprised of 50 of the largest high tech companies operating in Israel. Coalition members, including Cisco, Google, Microsoft, IBM, Facebook, SAP, Citibank, and others, have been working together toward promoting the employment of Haredi men and women in major high tech companies. To date, more than 4,000 Haredi high tech professionals were influenced by KamaTech. Hundreds of them have found work in leading high tech companies, thanks to KamaTech's training, workshops, and professional placement services.

The second track is TicTech, an accelerated line of courses developed by KamaTech together with leading high tech companies such as Google, Cisco, eBay, WIX and others. This track is geared toward training Haredi men and women, in less than one year, in technologies in the most demanding professions. More than 400 Haredi men and women have participated in these courses and more than 90 percent found jobs after graduating.

The third track is the KamaTech accelerator, a program for Haredi entrepreneurs. It provides access to knowledge, tools and connections, and hence promotes the development of Haredi high tech enterprises. The core of the program format is an innovative model: Adoption of Haredi innovators by prominent, successful, secular start-ups. This enables Haredi entrepreneurs to connect to the high tech and start-up ecosystem, undergo apprenticeship in leading its companies and enjoy the supervision of senior experts. KamaTech accelerator recently celebrated its first "graduation" with demo days in Tel Aviv, London and New York.

When KamaTech announced the opening of its accelerator, 224 companies applied and eight companies were accepted into the program. Sixteen founders started the accelerator, and today, their companies employ 44 people. When these eight companies entered the accelerator, they had no outside funding. Today they have already received $3.5 million in investments, and additional investors are in advanced negotiations with a few of these start-ups.

Recently, the Israeli high tech magazine, *GeekTime*, selected the KamaTech accelerator as one of the best five accelerators in Israel – out of a list of more than 200. This achievement shows that the Haredi community has the talent and the ability to integrate successfully into the high tech industry given the right support and tools, and become a leading contributor in the workforce.

KamaTech is accelerating the shift of the Haredi community toward productivity. Regardless of the isolation of the Haredi community, and massive educational and cultural gaps, we have shown that with appropriate training and support, graduates of yeshiva are likely to become excellent employees and successful entrepreneurs. Their outstanding learning capabilities, analytic skills, fresh perspectives, and experiences in group work will create new jobs and business opportunities for others in the Haredi community , and will help many Haredi families rise out of poverty, creating a more just and cohesive society in Israel.

Talent, Creativity and Culture – Why We Chose Israel

Phil Friedman, President and CEO, CGS

When a long-term global customer comes to you requiring new thinking and added service, you not only listen, you act. For us, this wasn't an ordinary or off-the-shelf request, this idea meant bringing our existing service offering to a new region.

Nearly a year ago, a valued client in the technology sector asked us to help with providing services in a new part of the world as the company's needs had progressed. CGS is known as a global provider of business applications, enterprise learning and outsourcing services and had been working with this tech company for more than 11 years. Our partnership has only grown stronger in the last year. One of our premier services that this company has engaged us in providing is business process outsourcing, which includes supporting customer service through our contact centers. On average, CGS handles more than 3.75 million customer interactions per month in more than 20 languages, many of which this global company utilizes.

Yet, having thousands of CGS agents throughout North America, South America and Europe, the company wanted us to add languages that had not previously been offered by CGS outsourcing, specifically Hebrew, Russian and Arabic. As we looked to expand our services, CGS sought a location that offered long-term economic promise, creative and entrepreneurial talent and diverse language skills. Our search led us to Israel.

In November 2015, we opened a location in Netanya, providing CGS with an exceptional opportunity to tap into a market equipped to answer the growing demand for linguistic and creative skills across a range of sectors, including that of our technology customer's requirements.

As our own business has expanded globally, we've navigated specialized talent niches throughout the world, and we've never been more excited about the pool of talent we find today in Israel, and in particular, Netanya. We've seen first hand that talent is the key determinant of future success when any organization is looking to grow, especially in the market of customer management.

Israel is rich with creative, competitive and entrepreneurial people. It is a populace with a tremendous amount of talent, fueled by a community of support from top universities, armed services experience and government programs. This community of support has created leader-ready talent and the appetite for engaging careers.

For us, the key to choosing geographies for expanding business process outsourcing locations, or any line of business, is avoiding a one-size-fits-all approach. Instead, we identify the specific needs of current customers, talent opportunities created by each geography's educational focus and the business opportunities created by geopolitical boundaries. Over the last several years, our business process outsourcing group has maintained and opened new offices in North America, Romania, India and Chile, and has continually looked to new global horizons. In each instance, we sought a group of talented and educated individuals that could aid our growing global business and language needs while supporting and attracting prospective customers.

Phil Friedman

Companies often find software development talent in the former Soviet Union, project management skills in Eastern Europe, and for us, in Israel (a preponderance of polyglots), language skills that offer real business advantage in a global economy.

So why did CGS consider and ultimately choose to expand its presence to Israel? Because of the pool of talented, knowledgeable and creative team members that not only met our current customer needs but also created the foundation for a successful part of our company as well as its promise for current and future economic growth. We're preparing to take our business process outsourcing offerings to new heights and in this short time since we opened our office in Israel, we have seen great interest from our global customers as well as from regional prospects.

Our talent along with well-resourced and nurtured customer relationships have been the core components in building our global business. As we strive to address customer needs and market trends, attract the most talented team members and grow in the world's most advanced marketplace, we knew that Israel would "fit the bill."

From our more than 30 years of serving some of the world's leading brands, including IT, telecommunications, global retailers, hospitality and healthcare providers, we are able to immediately recognize the entrepreneurial and competitive spirit of Israel's population. Over the next several years, we expect that our Israel office will continue to grow, offering the outstanding service and knowledgeable team member expertise to our long-term and future customer relationships.

In the first year of operations in Israel we will have upwards of 100 employees and within 24 months we expect to add approximately 300 full-time employees. We envision an office where we will have Israelis – both Jews and Arabs – working together to support some of the most innovative companies in the world.

In the customer management domain, it is imperative to meet and grow responsively and in line with customers' needs. Over the last several years at CGS, our global customer base of business process outsourcing clients has continued to flourish, and we have enhanced our global footprint in direct response to that success. We could not be prouder to be a part of our customers' and Israel's future growth.

Macroeconomic Figures

Compared to the Previous Period, Annual and Quarterly Changes

	2014	2015	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3
Real GDP Growth Rate	2.6%	2.3%	1.1%	5.6%	2.3%	0.4%	2.5%
Business GDP	2.6%	2.4%*	-1.4%	7.6%	2.1%	-0.8%	2.4%
GDP Per Capita Growth Rate	0.6%	0.3%	-1.0%	3.3%	0.4%	-1.6%	-0.1
Unemployment	5.9%	5.2%	6.2%	5.6%	5.4%	5.1%	5.2%
Goods and Services Exports (% of GDP)	32.3%	31.3%	30.6%	33.4%	33.3%	31.4%	29.0%
Goods and Services Imports (% of GDP)	30.6%	28.2%	31.4%	30.9%	29.5%	28.0%	27.9%

Macro Info	2007	2008	2009	2010	2011	2012	2013	2014	2015
Debt to GDP	74%	72.9%	75.1%	70.9%	68.9%	67.9%	67.2%	66.1%	64.9%
General Government Expenditure	41.6%	41.4%	41.5%	40.4%	39.6%	40.1%	40.4%	40.1%	40.1%
Current Account Surplus	4.3%	1.4%	3.9%	3.5%	2.6%	1.6%	2.9%	3.7%	4.2%*

Source: Central Bureau of Statistics, Ministry of Finance *Latest Available Data/Est.

Web Sites of Interest

Israel Ministry of Finance:
http://www.mof.gov.il

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

State of Israel Bonds Organization:
http://www.israelbonds.com

Investment Promotion Center:
http://www.investinisrael.gov.il

Israel Government Portal:
http://www.israel.gov.il/firstgov/english

Israel Ministry of Foreign Affairs:
www.mfa.gov.il/mfa

Israel Ministry of Economy:
www.economy.gov.il

Israel Ministry of Tourism:
http://www.goisrael.com

Israel Venture Capital Research Center:
http://www.ivc-online.com

MATIMOP: Israeli Industry Center for R&D:
http://www.matimop.org.il

Tel Aviv Stock Exchange:
http://www.tase.co.il/taseeng/homepage.htm

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