Strengths and Challenges of the Israeli Economy

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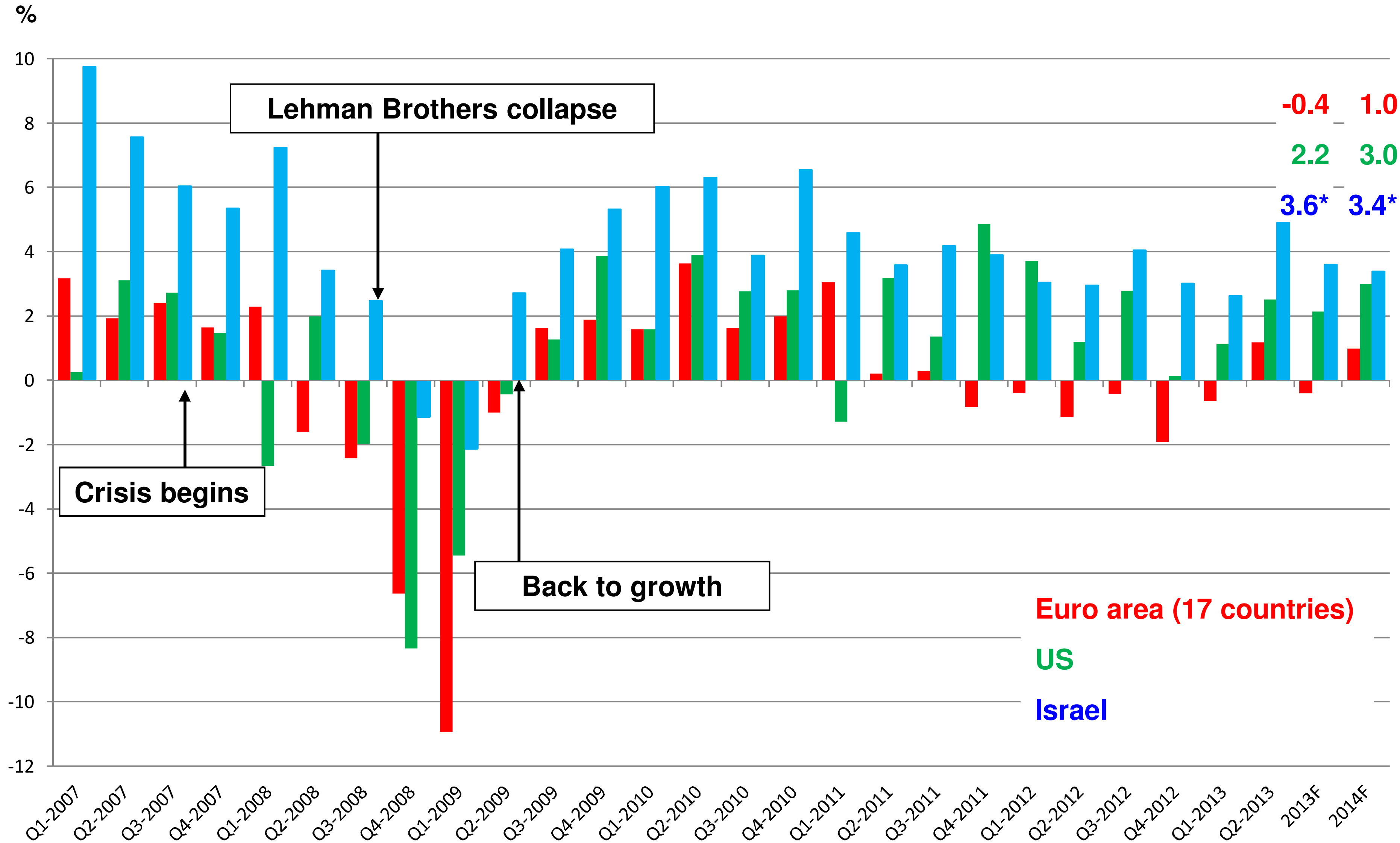
Topics

- The Macro Picture
- Monetary Policy
- Challenges

The Macro Picture

$ 2012	Israel	France	Euro 17
GDP ($bil)	242	2,611	12,183
GDP Per Capita	30,494	39,907	36,577

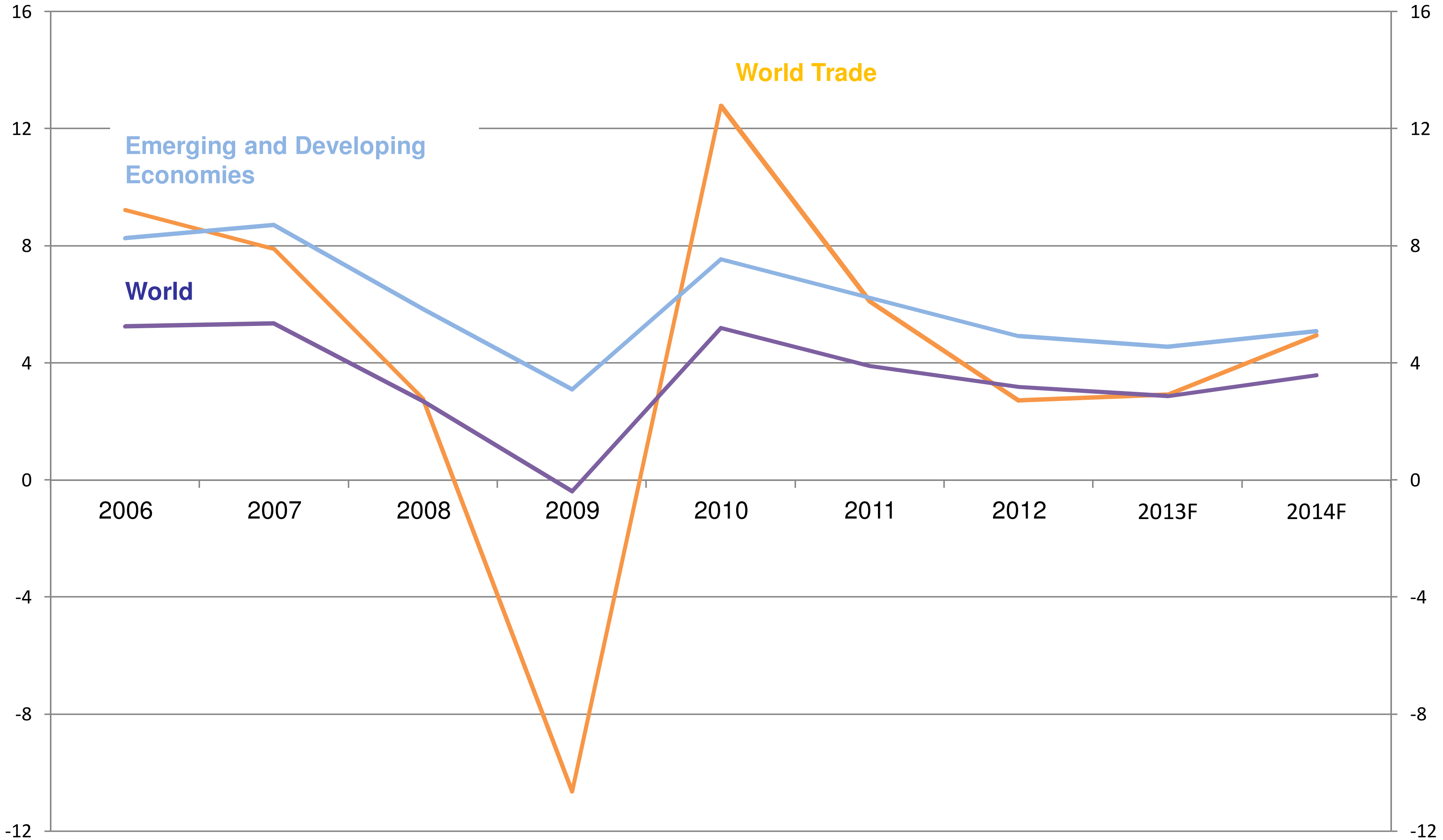
Growth Rates - Israel, US and Europe



Quarterly rates in annual terms. * excluding “TAMAR” gas, growth is 2.6 in 2013 and 2.7 in 2014.

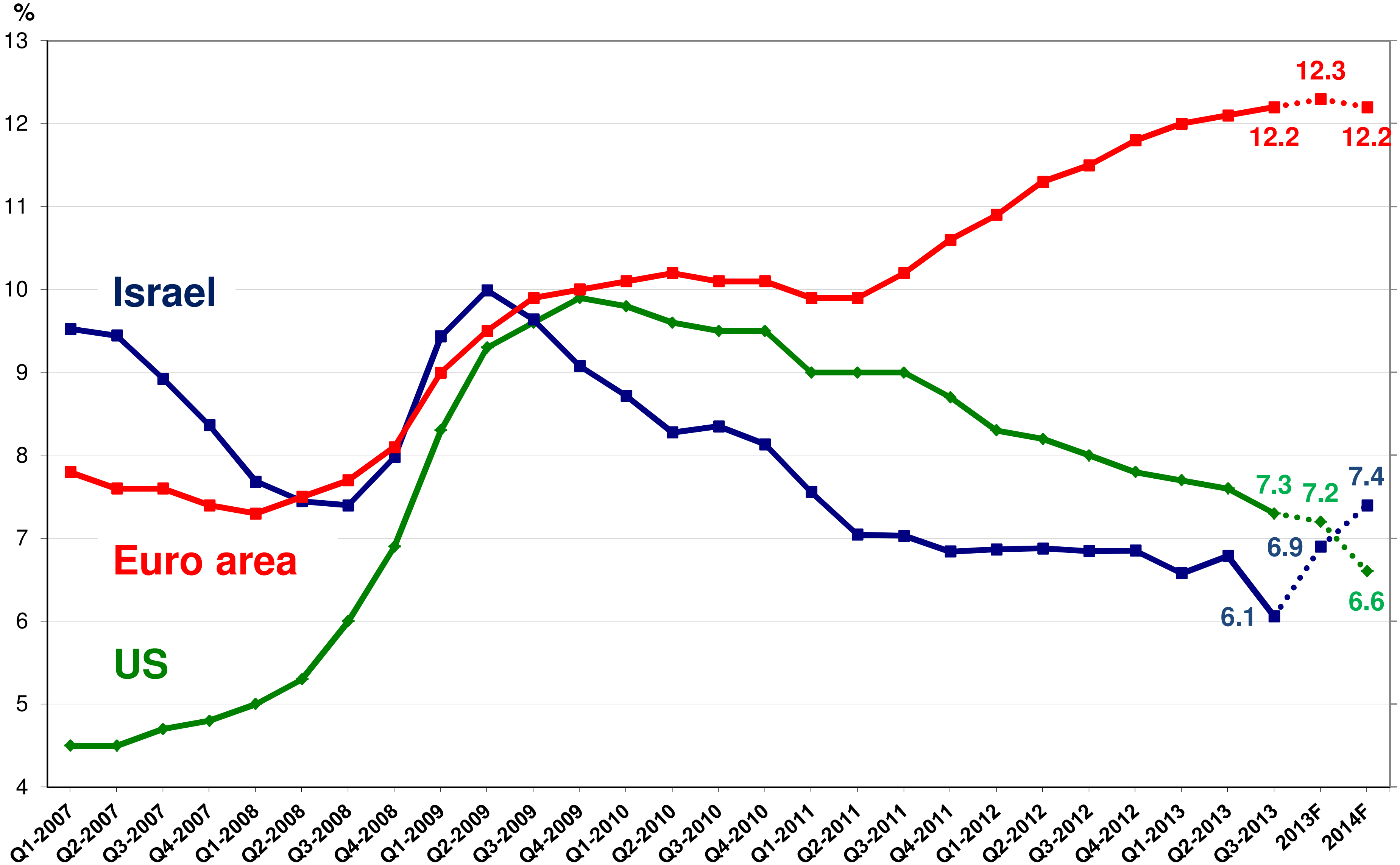
Source: CBS and OECD data, forecasts by BOI (September 2013), Federal Reserve (September 2013) and IMF (October 2013).

IMG Growth Forecast



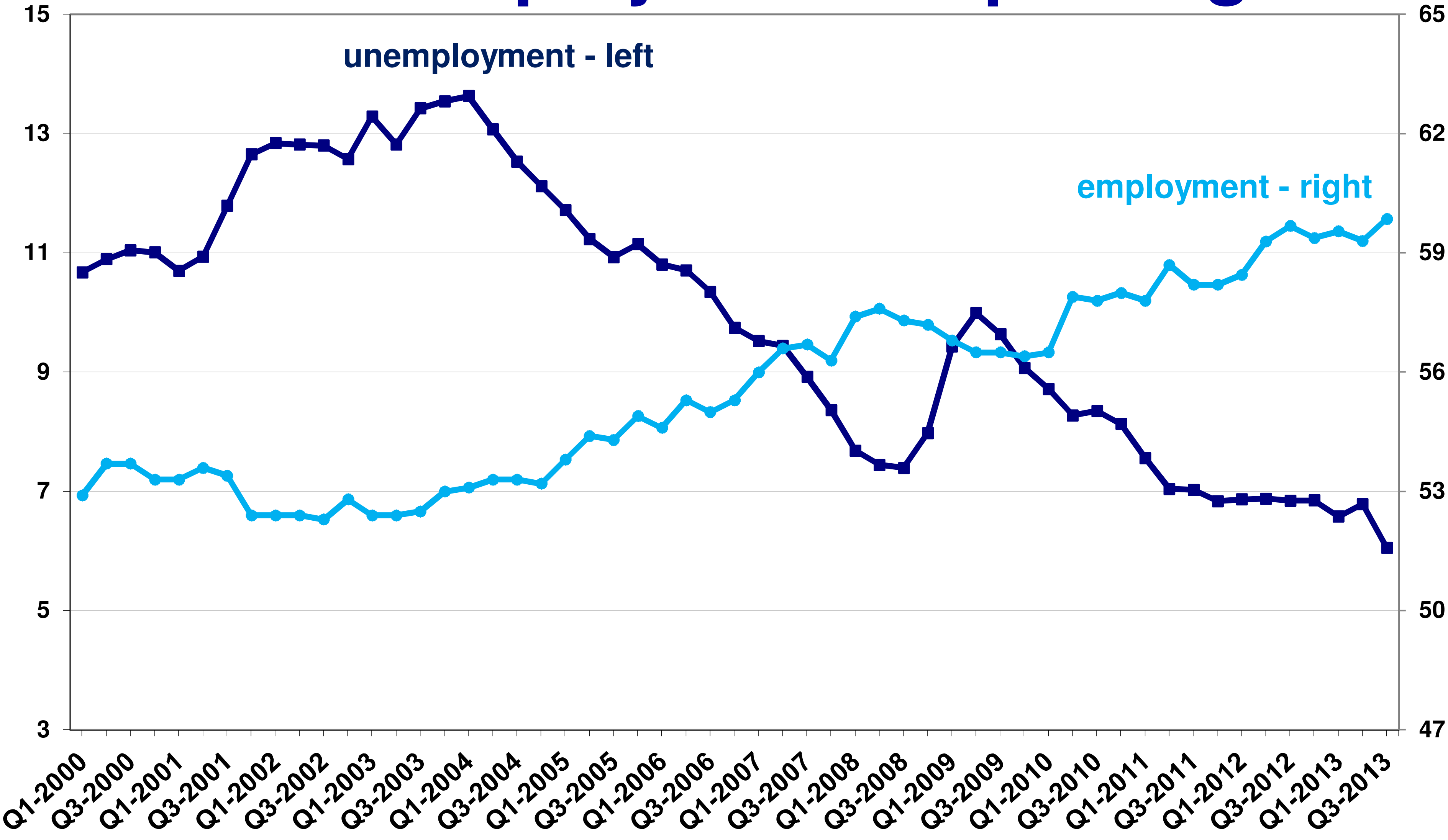
Source: IMF (October 2013).

Unemployment signals that the real crisis remains in US and EU - less so in Israel



Source: OECD, BOI and CBS data, forecasts by BOI (September 2013), Federal Reserve (September 2013) and IMF (October 2013).

Is unemployment back to normal? Would employment keep rising?



Source: BOI and CBS.

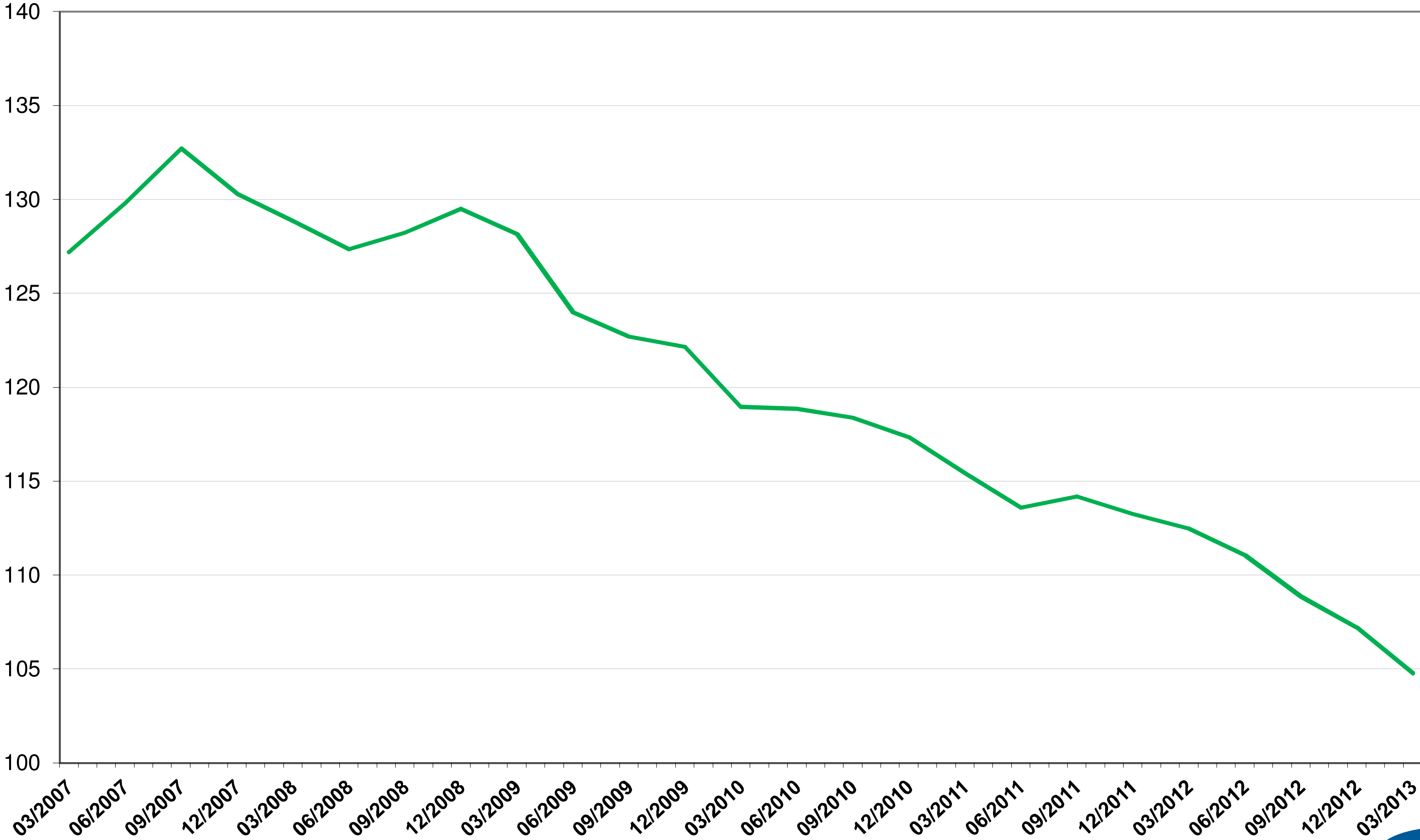
Israel's Economic Strength: resilience to shocks

- Financial markets
- Fiscal policy - Government budget
- Balance of payments
- Monetary policy and price stability

Financial Markets are stable functioning very well, but…

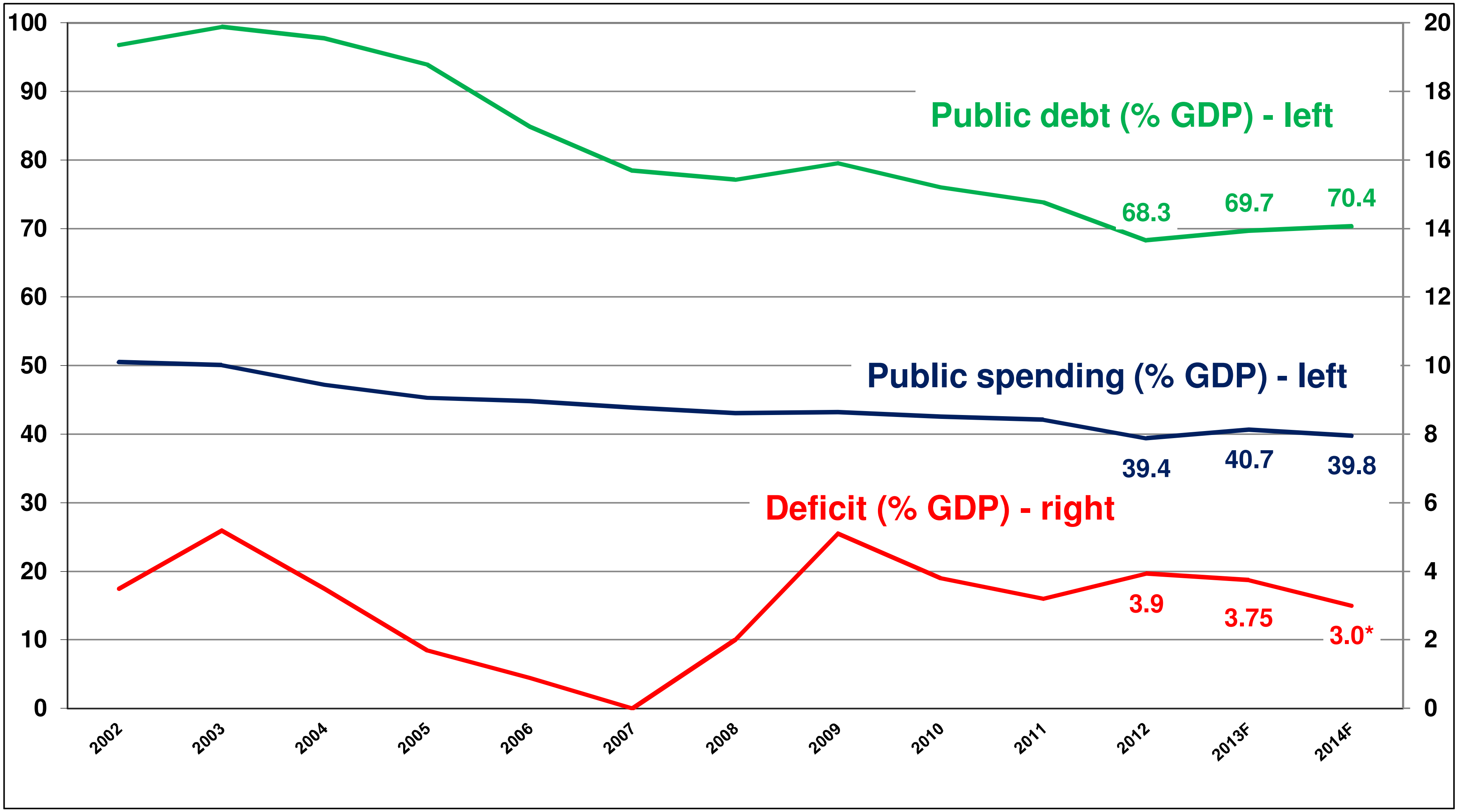
- Private and public debt are reasonable, with no exceptional growth - except for corporate debt
- Banking capital level at world average (14.9%; core tier 1 8.7%): Banks are stable - but continuous decrease in ratio of credit to business sector product
- Savings rate relatively high (18.3%)
- No exposure to advanced financial instruments (MBS, CDO, CDS); small inter-banking market; Last 5 years residential housing prices increased by more than 50%.
- Capital requirements from banks, non-bank credit restrictions and lack of securitization - create limits on business credit growth.

Business Sector Credit (% of business sector product)



Source: BOI,

Fiscal policy: Conservative and *credible*



Data for 2012 and forecasts are according to the new GDP definitions. Deficit for 2014 is the target.

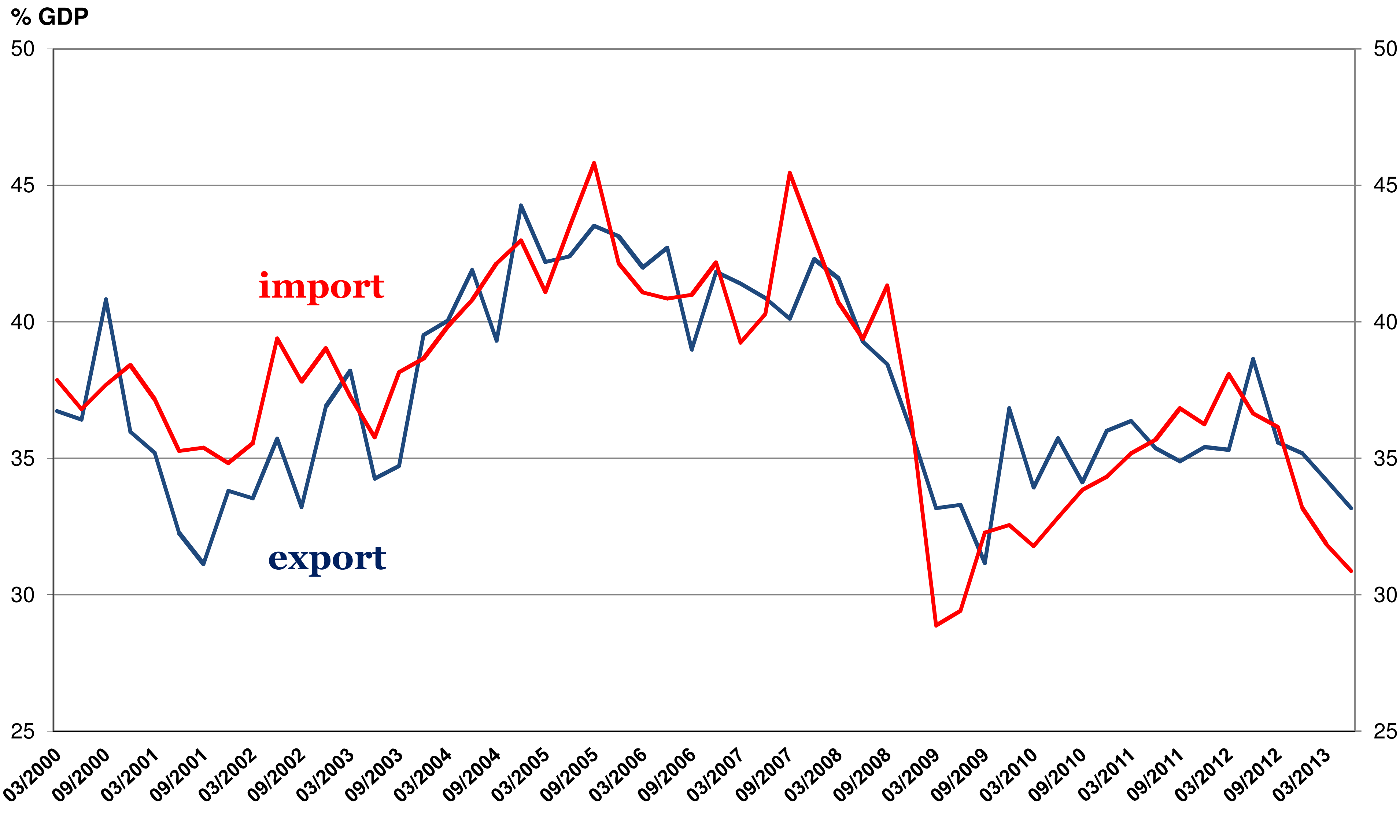
2012 according to the old GDP definitions: Debt 73, spending 42.1, deficit 4.2.

Source: BOI and CBS.

2013-2014 Budget

- Success of budget rules since 2003
- 2013 public expenses increased by 7% in real terms compared to 2012, deficit target is 4.65%, actual ~3.75%.
- Back to credible budget policy as tax collection is on track
- 2014 public expenses will rise by 1.1% compared to 2013, deficit target is 3%. Tax revenues and expenses according to path
- 2015 – Change budget rules? Reforms? Too small government?
- Positive and significant change in debt to GDP ratio in the last 5 years - revenues from gas (~$40) and Bank of Israel reserves of $80b

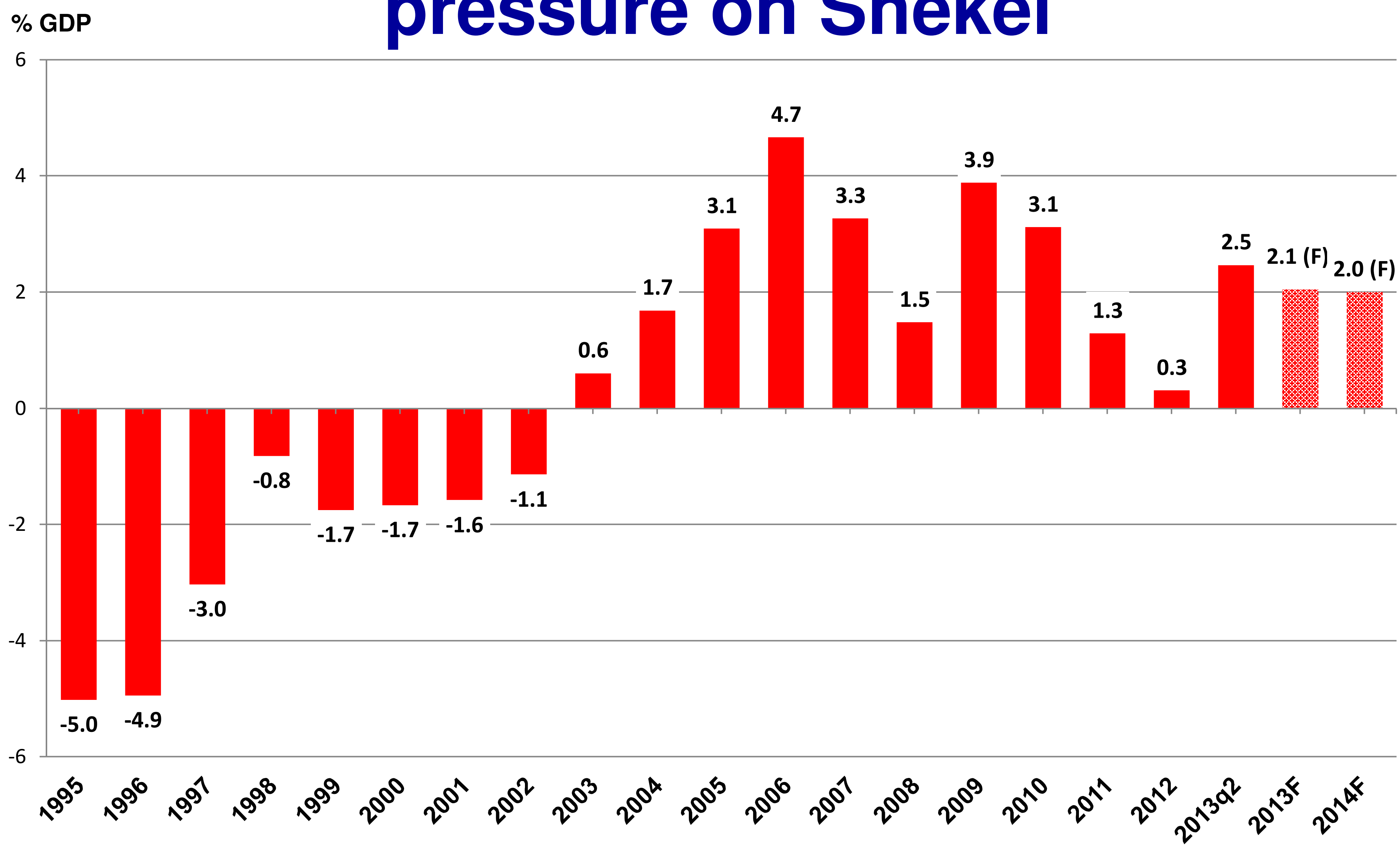
Balance of payments: Back to surplus



Total goods and services, calculated from current prices series.

Source: CBS.

Current account: Growing surplus, pressure on Shekel



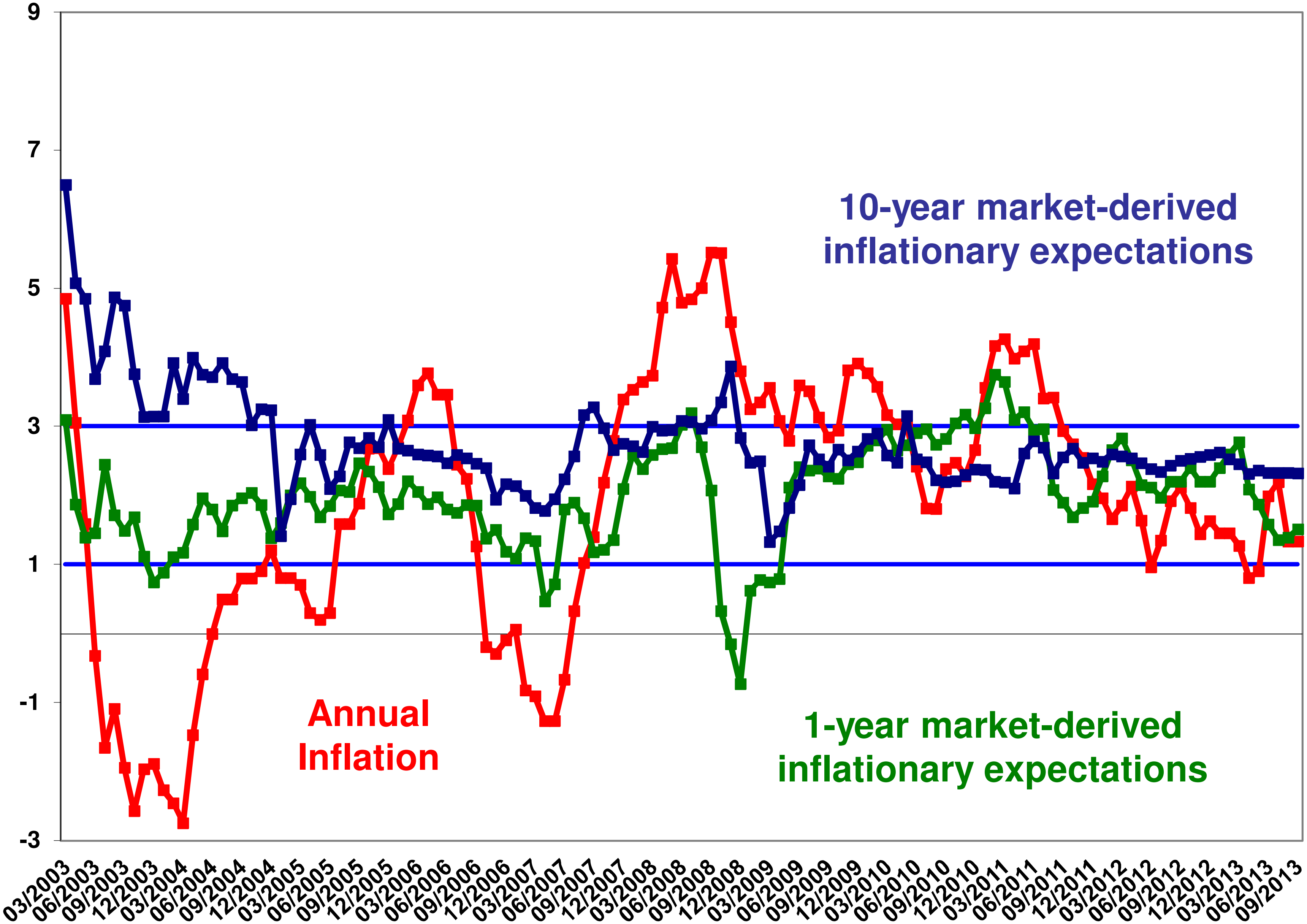
Source: CBS, estimated forecast calculated from BOI (September 2013).

Monetary Policy

Monetary Policy Goals

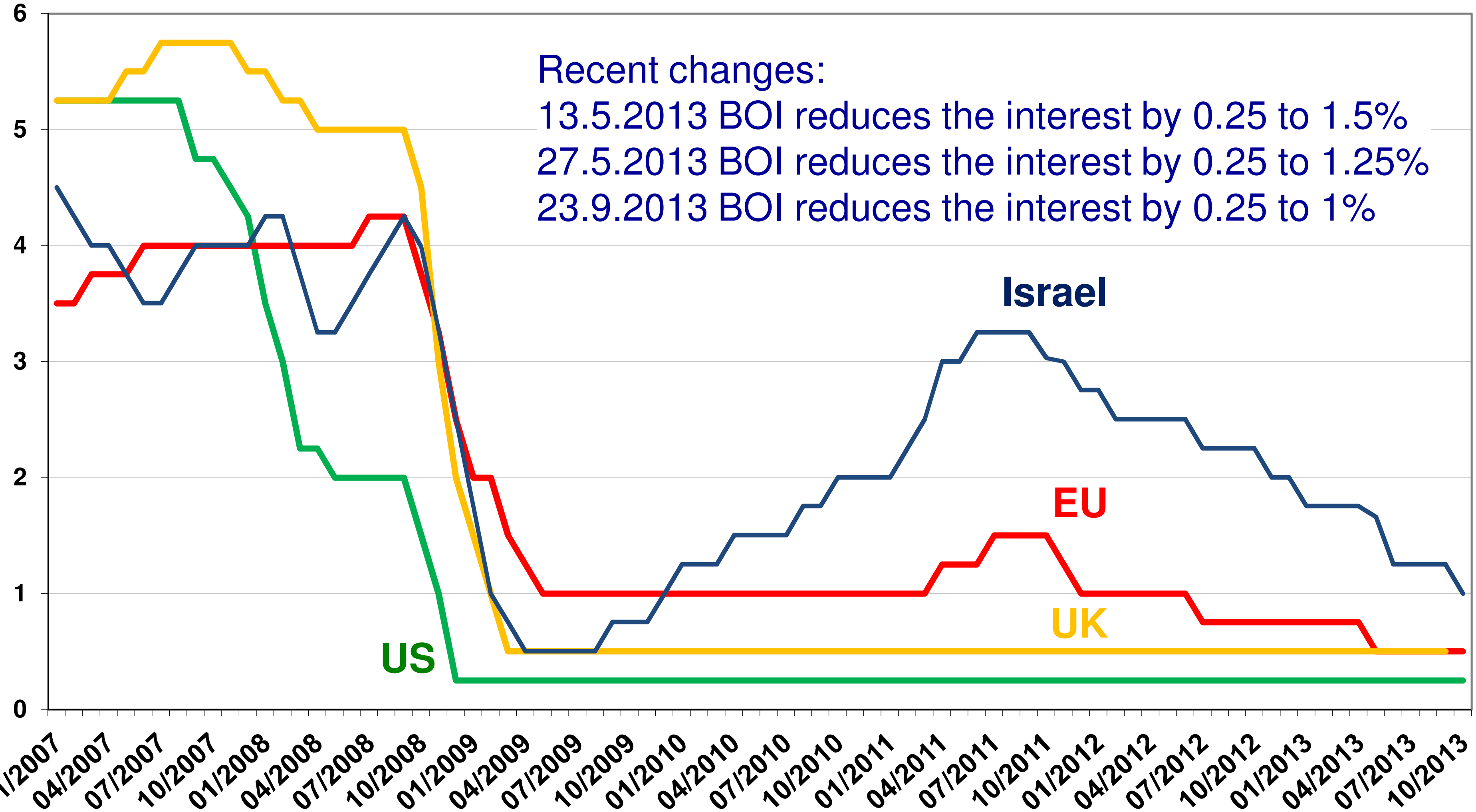
- **Main goal:** Price stability, inflation target 1-3%
- **Secondary goal:** Support employment and growth (subject to price stability)
- Tools: Interest rate and FX market interventions
- **Additional goal:** Support financial stability
- Tools: Financial markets interventions and "macro-prudential" actions (e.g. restrictions on the expansion of the real estate market and restrictions on purchasing bonds and foreign currency derivatives)

Inflation below mid-target

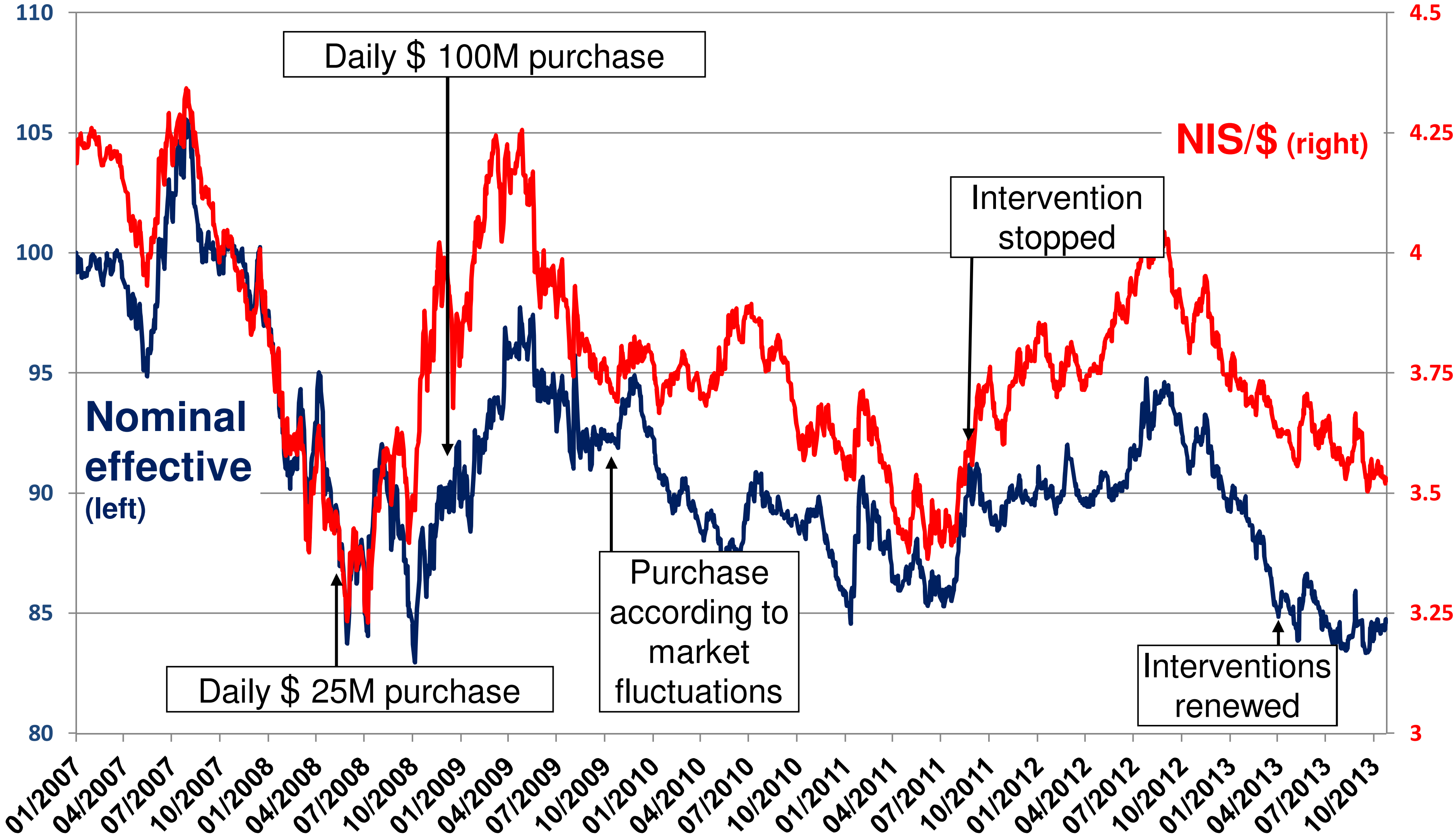


Source: CBS and BOI.

Interest rate policy: Expansionary in the west - how long? Slightly expansionary in Israel - how long?



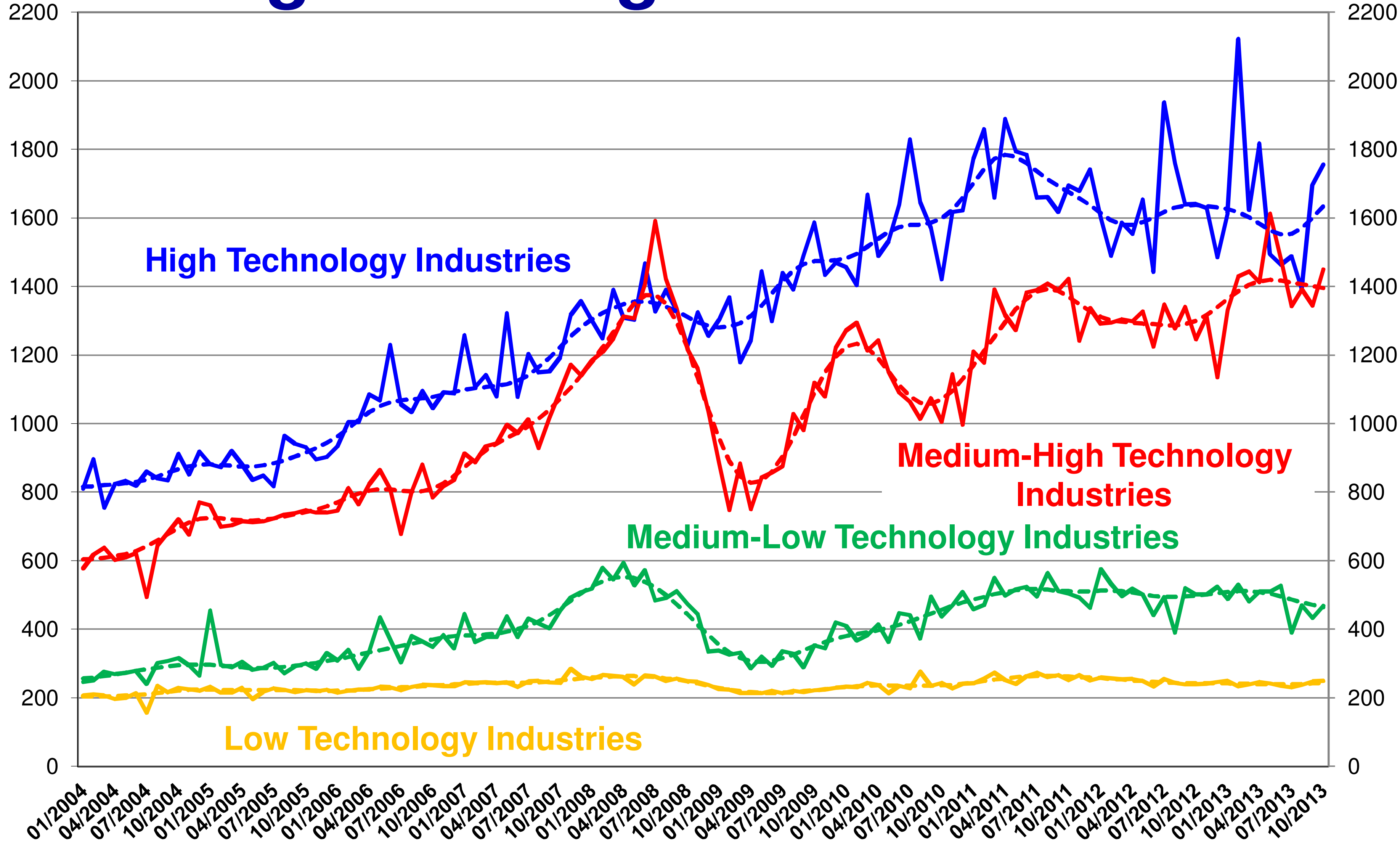
Shekel too strong? Intervention during unusual trends affecting market; Accumulating balances; In the long-term - avoiding intervention



Source: BOI.

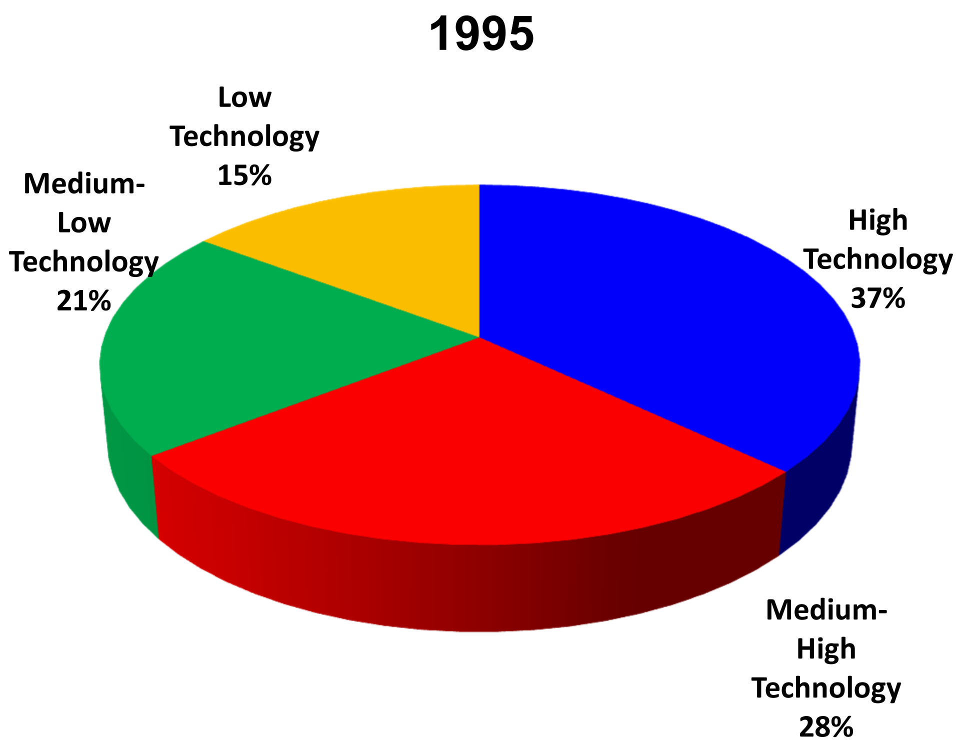
Exports by technology intensity: "The growth engine is stuck?"

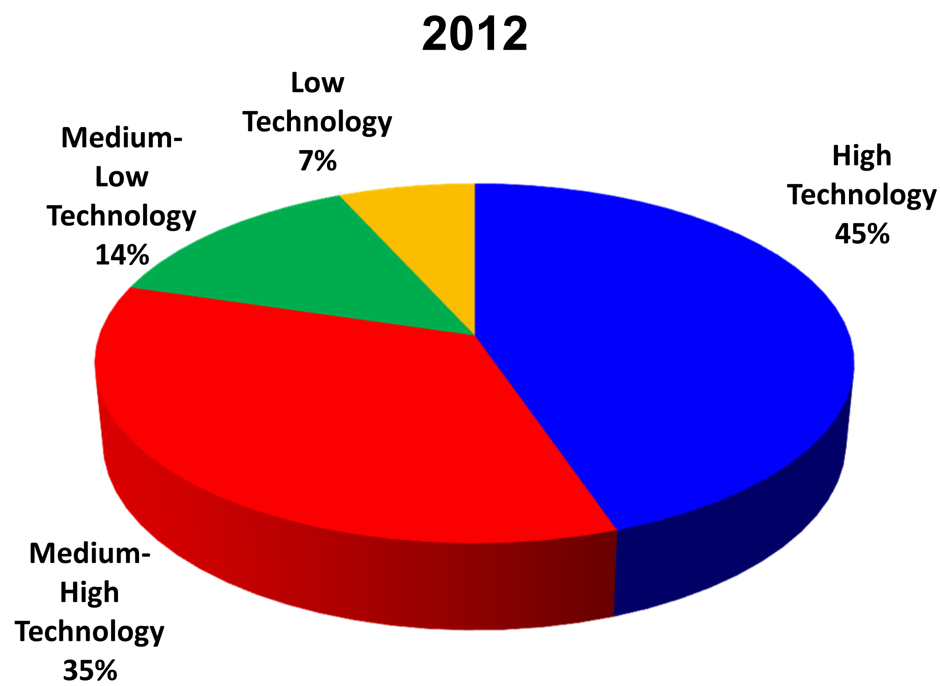
$ monthly millions



Source: CBS.

Export by technology intensity: Transition to High-Tech exports





Source: CBS.

Challenges

- Labor productivity is low in non-traded
- Low employment and high poverty among Ultraorthodox and Arabs (low skilled)
  - Invest in productive human capital
  - Active employment policy
- Education Quality and human capital - employment skills
- Peace and the economy

Thank You!