Euler Hermes Economic Research

Country Report

Israel

A future Mediterranean energy power?

General Information

GDP	USD304.226bn (World ranking 37, World Bank 2014)
Population	8.22mn (World ranking 96, World Bank 2014)
Form of state	Parliamentary Democracy
Head of government	Benyamin NETANYAHOU
Next elections	2017, Parliament

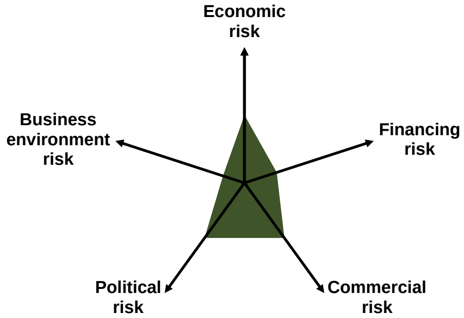
Strengths

- Overall political stability, with entrenched democratic system, including peaceful transfers of power and effective rule of law.
- Strong military.
- U.S. political and economic support.
- High incomes.
- Relatively good data transparency.
- Classification in MSCI indices as developed market economy. Member of OECD.
- Offshore gas reserves provide potential for future energy independence and for limiting import costs.
- Strong scientific environment, with the world's highest ratio of R&D expenditure to GDP.
- Sound banking sector and vibrant hi-tech industries.

Weaknesses

- Protracted conflict with the Palestinians, uneasy links with Lebanon and Syria and poor relations with Iran contribute to security concerns, constrain growth and can limit the effectiveness of economic policy.
- Unstable coalition governments.
- Although there were little direct contagion effects from the Arab Spring, social protests using similar communication techniques emerged in mid-2011, although protests focus on social factors and job prospects, rather than regime change.
- Dependence on U.S. economic cycle and close links with that country include grants and aid that can be rescinded.
- High public debt in nominal terms (67% of GDP).
- High short-term external debt.

Country Rating **BB1**



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	28%	1	12%	United States
Hong Kong	8%	2	8%	Germany
Belgium	5%	3	7%	China
United Kingdom	4%	4	5%	Belgium
China	4%	5	5%	Netherlands

By product (% of total)

Exports		Rank		Imports
Jewellery, Works Of Art	30%	1	13%	Crude Oil
Pharmaceuticals	11%	2	9%	Jewellery, Works Of Art
Electronic Components	7%	3	7%	Refined Petroleum Products
Precision Instruments	5%	4	5%	Cars And Cycles
Toiletries	5%	5	3%	Plastic Articles

Source: Chelem (2013)

Political Overview

The political environment is highly developed and transfers of power occur peacefully within a democratic framework. The rule of law is well established, the judiciary is independent and corruption levels, although evident, are modest by regional standards. However, policymaking is constrained by an electoral system that tends to produce unstable coalition governments dependent on small non-secular parties for survival. The current government is a Likud-led coalition. Broad policy continuity remains consistent, whatever the outcome of polls. International relations centre on close but sometimes fractious links with the U.S. and significant uncertainties relating to regional developments, particularly recent events in Syria and concerns of an existential risk because of Tehran's occasional verbal threats. Israel became a member of the OECD in 2010.

Economic Overview

Israel is classified as a high-income economy by the World Bank, and per capita GDP in nominal terms is currently estimated at over USD35,000. Although output is diversified, exports are concentrated in manufactures (particularly from the high-technology sector but also including worked diamonds). Moreover, reliance on the U.S. for almost 30% of total export earnings implies that output follows closely U.S. business cycles. Israel has the world's highest ratio of R&D expenditure to GDP (4%), enabling strong growth in its human capital and an advanced scientific environment in which the development of high-tech exports of goods and services flourishes.

Gas will buoy GDP growth and have other economic benefits

Long-term (ten-years to end-2014) annual average GDP growth was +4.2% but a generally weak global environment in recent years has capped annual growth at +3.5% since 2012. GDP growth was +2.8% in 2014 and we forecast only +2.5% in 2015. In 2016 and 2017, we expect GDP growth of around +3.5%, reflecting a moderate global rebound and investment in the domestic gas sector (see below). The economic outlook is subject to significant downward and upward influences, depending on developments in the global economy but also on highly uncertain regional factors.

In addition to providing a boost to GDP, the gas sector will engender longer-term independence in energy supply and underpin the trade and current accounts. Israel's deepwater gasfields of Tamar (output from March 2013) and Leviathan (commercial output perhaps from 2017) are part of an East Mediterranean gasfield that is estimated to contain around 1tn cubic feet of natural gas, at least.

Inflation will remain firmly within the official target band

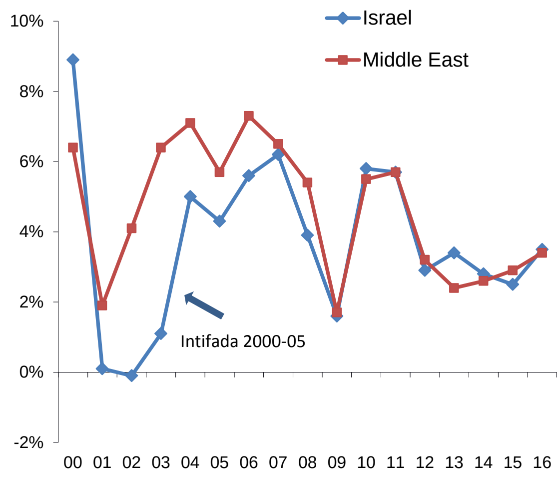
The overall stance on monetary policy has not altered significantly in recent years, although the challenges have veered from limiting inflationary pressures (CPI 5.7% in 2002) to managing deflation (-0.5% in 2015). Inflationary expectations are usually well managed by the authorities, with the independent central bank's target range of 1-3% growth in consumer prices broadly maintained, even in periods of high oil prices (fuels account for around 20% of the total import bill). EH expects the rate of inflation will be below the target range at end-2016 and remain comfortably within it in 2017.

Key economic forecasts

	2014	2015f	2016f	2017f
GDP growth (% change)	2.8	2.5	3.5	3.5
Inflation (%, end-year)	-0.2	0.5	1.3	1.8
Fiscal balance (% of GDP)	-2.6	-2.7	-3.0	-2.5
Public debt (% of GDP)	65.9	67.1	67.0	66.0
Current account (% of GDP)	3.7	5.0	5.0	4.5
External debt (% of GDP)	31.9	32.0	31.0	30.0

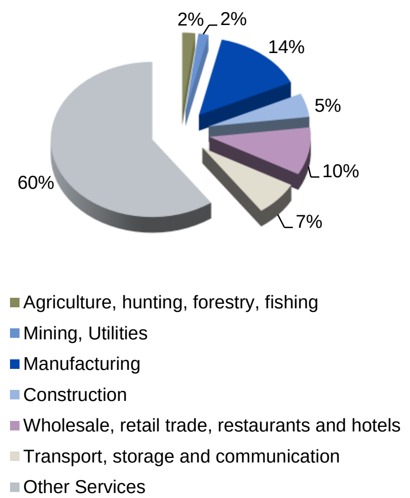
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

GDP Breakdown (%)



Sources: UN, Euler Hermes

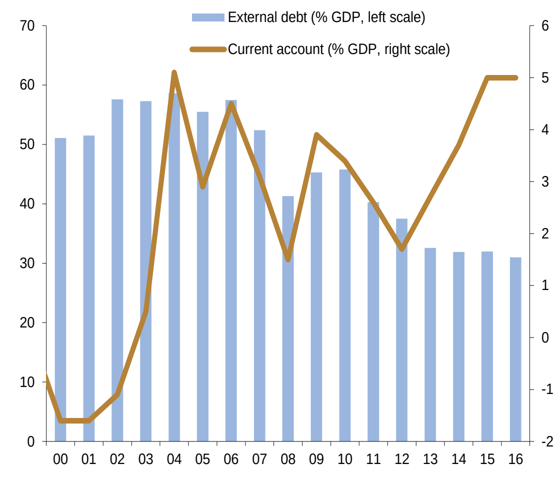
Already robust external accounts will improve as the gas sector develops

External trade is critical for such a small country with limited natural resources to exploit (although natural gas reserves are now being developed). Exports of merchandise goods and services are equivalent to over 32% of GDP and imports of goods and services to over 30% (2014). Israel has a significant high-tech sector and its export base reflects its competitive advantage derived from its human capital.

Small deficits on the current account (below -2% of GDP) were recorded in 2000-02 but since then surpluses of variable magnitude (see chart) have been registered on a regular basis. Israel is a beneficiary of official transfers, particularly from the U.S., and these bolster the external accounts. Current relatively weak oil prices have limited pressures on the import bill (20% of imports is accounted for by energy requirements) at a time when development of the country's own natural gas reserves is reducing growth in demand for such imports. As a result the annual current account surplus, +2.7% of GDP in 2013, is likely to improve to around +5% in the period 2015-17. Going forward, Israel has the potential to be a net energy exporter and contracts with regional customers are being negotiated.

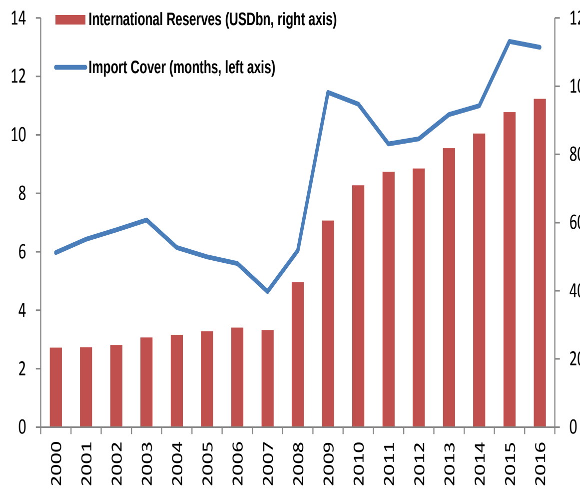
Import cover remains strong at over 11 months, with FX reserves currently around USD90bn and eclipsing total short-term external debt (usually rolled over with comfort) and principal repayments, so financing problems stemming from the external sector are unlikely.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves and import cover



Sources: National sources, IHS, Euler Hermes

External debt remains low

Nominal external debt ratios are comfortable (debt to GDP 32% in 2014 and debt to export revenues 81%) and servicing obligations on that debt is unlikely to cause any short-term problems. The debt service ratio (repayments/total export revenues) is now around 8%.

The business environment is assessed as above the regional average

The World Bank's Doing Business 2016 survey ranks Israel 53 out of 189 economies in terms of the ease of doing business, below Cyprus and Chile but above Colombia and Turkey. Contract enforcement ranks below the OECD high-income average but Israel ranks highly in relation to insolvency resolution, trading across borders, getting credit and starting a business. The Heritage Foundation's Index of Economic Freedom (IEF) 2015 ranks Israel 33 out of 178 countries assessed, below South Korea and Austria but above Latvia, Belgium and Poland. Israel has a high openness to global commerce.

Last review: 2015-12-17
Country Risk Analyst:
Andrew Atkinson
andrew.atkinson@eulerhermes.com