



STATE OF ISRAEL

MINISTRY OF FINANCE

INTERNATIONAL AFFAIRS DEPARTMENT

October 10, 2007

Economic Highlights

3rd QUARTER 2007

Dear Friend,

Once again we are distributing our "Economic Highlights."
Your comments would be greatly appreciated at
FinancelIsrael@mof.gov.il

Throughout the highlights there are references to relevant issues in the attached PowerPoint presentation, in blue

(#15,19 means see slides number 15 and number 19 in the presentation)

**A new Minister of Finance has been appointed:
Mr. Ronnie Bar-On**

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A year has passed, and as projected by the Governor of the Bank of Israel, Professor Stanley Fischer, the northern conflict of the summer of 2006 had very little impact on the Israeli economy.

- The 2008 budget has been approved by the government, and now awaits Knesset approval.
→ *For the main issues – next page*
- Growth is stable (very high) and unemployment continues to shrink. → *See next page*
- Bank of Israel has raised its interest rate to 4.0%
→ *See page 5*

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2008 Budget – Main Issues

- **Total expenditure** without disengagement and northern conflict costs will rise as planned by 1.7% (the same rate as the population growth).
- **Education reform:** additional working hours for school teachers and additional authorities for principals. As for higher education: wide reform in order to bring back Israeli scientists from abroad and improvement of research quality using grants and a quality assurance system.
- **Promotion of competition** in cellular communications, electricity, public transportation and gas markets. Promotion of competition in the health industry as well, establishing a 5th health-care authority.
- **Integrating working mothers in the labor force** by expanding day-care facilities and further subsidizing according to income.
- **Predating** the time in which the Ministry of Finance submits the budget proposal for the following year in order to prevent future delays.

Demand and Output

Quarterly and semiannual data is calculated annually, and all data is seasonally adjusted.

Data from previous editions is being updated as well as forecasts.

GDP growth (#6,7,8): 1st half 2007: **6.6%**

Q2: **6.1%**; Q1: **6.2%**

2006: **5.1%**; 2005: **5.2%**

Growth expected for 2007: **5.4%**

Private Consumption Growth (#8,22):

1st half 2007: **6.2%**;

Q2: **3.7%** Q1: **9.2%**

Growth expected for 2007: **5.2%**

OECD forecast for 2007: **2.5%**

Business GDP growth (#26):

1st half 2007: **7.9%**

Q2: **6.9%**; Q1: **7.4%**;

Growth expected for 2007: **6.2%**

Public Consumption Growth (#8):

1st half 2007: **4.9%**;

Q2: **2.6%** Q1: **0.9%**

Growth expected for 2007: **3.7%**

OECD forecast for 2007: **2.0%**

GDP per Capita, based on PPP (#40): \$27,688 (2006) – 21st place in a descending list including Israel and OECD members. OECD Average: **\$32,098**

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Foreign Trade

Goods and Services, excluding Diamonds

Import growth (#12):

1st half 2007: **9.4%**;
 Q2: **13.2%** Q1: **5.2%**; 2006: **3.1%**
Growth expected for 2007: 7.9%

Export growth (#9,11):

1st half 2007: **6.3%**;
 Q2: **5.9%** Q1: **7.6%**; 2006: **5.9%**
Growth expected for 2007: 6.7%

Investments

Semiannual data – compared to same half in previous year

Total Gross Local Investment (#27):

1st half 2007: **9.3%**
 2006 (total): **4.1%**

⇒ The 1st quarter registered a **23.7%** increase in fixed asset investment.

Investment in Fixed Assets:

1st half 2007: **11.4%**
 Q1: **6.8%**; Q2: **3.2%**

Growth expected for 2007: 9.1%

Israeli Investments abroad: (B\$)

2006: **30**; 2005: **18**; 2004: **13**.
 → Growing trend.

Foreign investments (#15): (B\$)

Jan-Aug 2007: **10.6** **;
 2006: **24.4** (including TEVA-Ivax deal)

Foreign direct investments (#15)(B\$):

Jan-Aug 2007: **9.0** **; 2006: **14.2**;
 2005: **9.9**; 2004: **9.1**.

** Annual Rate

Balances

Current account surplus (#23):

2006: **5.7%**; 2005: **3.4%**; 2004: **2.3%**

Gross Debt (#21): (% of GDP)

(General government gross financial liabilities)

2007 projection: **84%**;
 2006: **87.7**; 2005: **97**; 2004: **100.7**

Budget deficit (#22):

(Central Government):

2007 estimate: **0.5%**;
 (Planned deficit was **2.9%**)

2006: **0.9%**; 2005: **1.9%**;
 2004: **3.7%**

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Challenges

- **Maintain the budget framework.** Implementing sound and responsible fiscal policy.
- **Narrowing socio-economic gaps and reducing poverty.**
- **Continuation of the reduction of the high public 87.7% debt to GDP ratio in 2006 (#21).** Projected debt in 2007 is: **81.7%**.
OECD: **54%** (GDP weighted average [pop. 1M-50M], 2005)
OECD 2007 projection (all countries): **76.8%**
- **Reducing the rate of unemployment (#16)** is still a challenge even though it is in a downtrend. Expected average rate in 2007: 7.5%.
Unemployment rate in the 2nd quarter of 2007: **7.6%**.
(The lowest rate in 10 years).
(2006: **8.4%**; 2005: **9.0%**; 2004: **10.4%**) (OECD: **6.0%**).
- **Increasing participation rate in labor force (#16):**
1st quarter 2007 participation rate: **56.6%**.
(2006: **55.6%**; 2005: **55.2%**) (OECD: **70.0%**).

Continue reforms

- **Continue reducing corporate tax** – from **29%** in 2007 to **25%** by 2010. (Plan is: 2008 – **27%**; 2009 – **26%**)
- Introducing **negative income tax** (EITC).
- **Pension benefits for all.**
- **Reducing tax burden (#24)** on low and medium income levels (Increase disposable income).
- **Continue privatization process:** recent privatization of the Haifa oil refinery (estimated at \$1 billion).

Latest News

" HOW TO MAKE A BILLION SHEKELS "

The Ministry of Finance has formulated a plan composed of several actions:

- Merging government accounts reserves to one general reserve to prevent duplicities.
- Issuing fewer bonds in order to pay less interest. The Accountant General has devised a method to issue sufficient bonds to cover the debt and therefore has saved roughly a billion NIS from unpaid interest.
- Issuing short-term bonds to allow the government to bridge intervals where a lack of cash is expected.

Bank of Israel raised its interest rate to 3.75% (#28) in August and again to **4.0%** in September as part of the policy to stabilize the inflation and the prices. US Federal Funds rate: 4.75%

The U.S.A and Israel have signed an agreement granting Israel \$30 billion for defense purposes over a period of 10 years.

A new law regarding prohibition of money laundering is on the verge of being passed in the Knesset.

This law expands the previous one by enabling authorities to prosecute individuals suspected in large scale tax evasion on the count of money laundering.

It also allows improved access to information regarding the matter.

The first private harbor in Israel has been opened for business in Haifa and will supply port service for raw sugar. The harbor, owned by Mispenot Yisrael, is permitted to unload no more than 5% of the total amount of cargo unloaded in Israel and as of now it is only allowed to unload cane sugar. However, progress is being made toward receiving a permit to unload a larger verity of goods.

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Israeli High-Tech companies Raised \$436 (#27) million from venture investors in the 2nd quarter of 2007, a 7% increase from previous quarter. All together: \$842 million in the 1st half of 2007, a 10% increase from the 1st half of 2006.

Tax on apartment purchase lowered substantially; up to \$4000 discount for a single purchase.

An initial prevention of double taxation agreement has been signed with Estonia (#43).

Like most agreements, this one too is based on the OECD model.

Business service revenues (#26) up by 9.2% in 2006 totaling **\$10.7 billion**.

Global Competitiveness Index (#31) :
2006 rank: **15th**; 2005 rank: **23rd** (WEF)

World Bank will sell up to \$1 billion of its bonds in Israel, in Shekels. Its bonds are sold worldwide in only 30 countries.

Israeli Start-Up companies raised \$319 million (#27) in the 2nd quarter of 2007, a 4% increase from the previous quarter This marks the 3rd quarter with over \$300 million in investments in the start-up field.

The tax on company cars has been raised while a billion NIS exemption from income tax on middle-income households was confirmed.

ECONOMIST (#29):

Israeli stock exchange achieved an 18% yield, ranking 13th in the world.

China: 56%; Germany: 20.5; USA: 7.7%;
EU countries: 7.7%; Japan: 0.8%

Current long term foreign currency ratings (#30) are at:

S&P: **A-**; Moody's: **A2**; Fitch: **A-**

Business Competitiveness Index(#33):
2006 rank: **19th**; 2005 rank: **22nd** (WEF)

IMD has ranked Israel 1st out of 55 ranked in R&D expenditure (#32), both public and private.

Israel to host an International Water Technologies and Environmental Control Exhibition, starting October 30th. Based on its accumulated experience, Israel is poised to play a major role in supplying the world with cutting-edge water and environmental solutions. www.watec-israel.com



The Minister of Finance, Ronnie Bar-On and the Minister of Education, Yuli Tamir, have agreed on **integrating financial studies in the Israeli education system**. On the first stage, it will be added to grade-school teaching smart consumption and personal budget management.

Infrastructure development

Beginning construction of the Tel-Aviv subway. (\$2.5 billion, completion estimate: 2014).

Construction of the Light Rail in Jerusalem. (\$750 million, completion estimate: 2010).

Five-year plan for intercity highways. (\$4 billion, Time frame: 2006-2010)

Natural gas – laying the Ashkelon-Dead Sea pipeline.

Investments in desalination's infrastructure – The Hadera site totals 100 million cubic meters, Ashkelon site 105 million and Palmahim site 30 million, totaling 235 million cubic meters. There is a planned expansion of an additional 300 million. (All of the above – per year)

Israel Railways – further implementation of a multi-year plan. (\$6.5 billion) Date of completion: 2010 (estimate).

Carmel Tunnel – Connecting the Haifa shoreline with its center. (\$250 million, completion estimate: 2010).

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Sources: Ministry of Finance, Central Bureau of Statistics, Bank of Israel, Israel Venture Capital, Bank Leumi, Israel Export Institute.

We welcome your feedback!

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