



STATE OF ISRAEL
MINISTRY OF FINANCE
INTERNATIONAL AFFAIRS DEPARTMENT

April 2008

Economic Highlights

1st QUARTER 2008

Dear Friend,
Once again we are distributing our "Economic Highlights."
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Fitch Ratings has raised its long-term foreign currency sovereign credit rating on the State of Israel to 'A' (stable) from 'A-', and its long-term local currency credit rating to 'A+' from 'A'

→ For Israel's complete rating list see next page

The budget for 2008 has been approved by the Knesset.

→ See page 3

▶ Bank of Israel lowers its rate to 3.25% and buys \$US for the first time in 11 years.

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▶ "Vitalife" Life Sciences Venture Capital will invest \$178 million in Israeli Bio-Tech companies

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Latest News

Fitch Ratings: Israel's long-term credit rose to 'A' (foreign currency) and to 'A+' (local currency)

Fitch Ratings also stated that in some aspects Israel deserves a higher rating, for instance – the income per capita is higher than many countries that have AA rating.

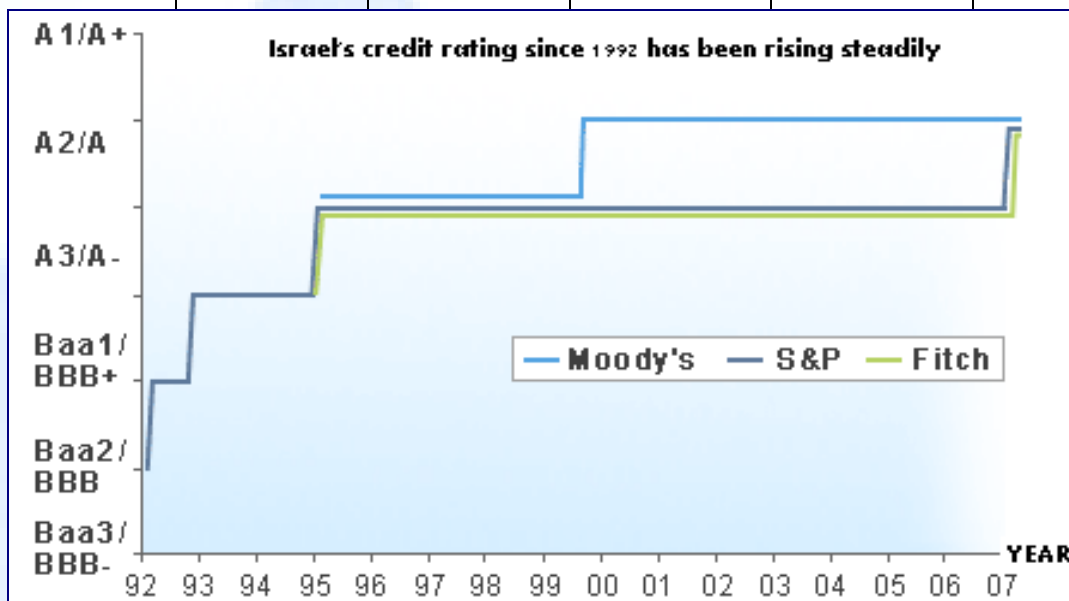
The main reason for raising Israel's credit is the ongoing reduction of the gross debt to GDP, which has decreased more than 20% in the past four years.

Ronnie Bar-On, the Minister of Finance: "Correspondingly with retaining the expenditure limits and the ongoing reduction of the gross debt to GDP, the Israeli market continues to present outstanding figures proving it belongs next to stable economies such as OECD members".

Israel's Credit Rating – Complete List

Source:
Accountant General

Ratings Firm	Term	Local Bonds		Foreign Bonds	
		Rating	Outlook	Rating	Outlook
Fitch Ratings	Long	A+	Stable	A	Stable
	Short	–		F1	
Standard & Poor's	Long	AA–	Positive	A	Positive
	Short	A–1+		A–1	
Moody's	Long	A2	Positive	A2	Positive
	Short	–		P1	



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Latest News

The 2008 Budget has been approved by the Knesset

As guaranteed, there will be a 1.7% budget growth (real terms) from 2007. Furthermore:

A 1% budget planned increase due to the 2006 northern conflict and a 0.5% increase due to the 2005 separation from Gaza.

The Ceiling for the planned deficit in 2008 is 1.6% of GDP.

An Avoidance of Double Taxation Agreement has been signed with Portugal

Main Issues include:

- Interest & royalties
- Income on capital
- Taxes on capital
- Permanent institution - regarding construction projects
- Cases where a firm has branches in both countries

The depreciation of the exchange rate vs. the \$US

Since July 2006 the Shekel–Dollar exchange rate has depreciated from 4.7 NIS to 1 \$US to 3.5 NIS to 1 \$US. The ongoing weakening of the Dollar is a worldwide phenomenon that can affect exports.

30% of Israel's exports are to the United States. The Ministry of Finance, together with the Ministry of Industry, Trade and Labor, will grant assistance to exporters and will set up tools for developing other export markets, such as the far east.

One action was the purchase of \$600 million (altogether) by the bank of Israel on March 13 and 14, due to a sharp deprecation in the exchange rate.

Bank of Israel has lowered its interest rate to 3.25 in April after reducing it to 3.75 in March from 4.25% (January).

The bank is performing these steps in order to keep the inflation within the target set: **1% – 3%**.

Other reasons include the ongoing depression in the US, Europe and Japan and the strengthening of the Shekel vs. other currencies.

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Latest News

The RTGS (Real Time Gross Settlement) system between banks has been put into place during 2007.

This is a major step towards the joining of the Bank of Israel to *CLS* (Continuous Linked Settlement), an international settlement system which includes 15 major currencies such as the US Dollar, Pound Sterling, Swiss Franc, Japanese Yen and more. The Israeli shekel is due to join throughout 2008.

The credit given to the business sector in Israel has risen by 11% in 2007.

The average annual rise in credit given to the business sector in the past 3 years is 10%.

These changes also appear in the structure of finance in the business sector: using more bonds and fewer loans.

In 2007, the business sector has issued a record high amount of bonds – 76 billion NIS.

"Vitalife" Life Sciences Venture Capital will invest \$178 million in Israeli Bio-Tech companies, together with SCP Partners

The two have raised the amount after initially asking to raise \$150 million.

The first stage of a tender to establish a solar-powered power plant has taken place on March 6

Accountant General, Shuki Oren: "This is the largest PPP type tender published by the state in the energy field. A step such as this brings Israel closer to accession to the OECD".

The Bank of Israel has begun issuing polymer-based 20 NIS bills in April

The polymer makes the bills more durable and allows the manufacturers to produce fewer bills annually. This technique has been adopted by 26 countries worldwide.

Starting March 23, the Bank of Israel will raise the foreign currency reserves by buying \$25 million every day, for two years.

Total purchase will be \$10 billion. This does not change the banks inflation-targeting policy and is insignificant compared to the \$2 billion daily trade cycle.

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Forbes Magazine: Israel – the #1 promise in the global real-estate market

Forbes Magazine has defined emerging countries as those transitioning their status from "developing" to "advanced".

April 2, 2008: "Israel is a strange duck in the context of emerging markets, because there's some argument as to whether it belongs in the ranks of fully industrialized markets. Tel Aviv, the nation's leading real estate market, is still finding its legs following a late '90s and early 2000s price slump. But macro conditions in Israel favor more wealth creation, as the economy has corrected its deflation problems and grown at a 5% rate for two years. It is projected to jump to 3.8% this year, according to the International Monetary Fund."

Runner ups are: Malaysia, Peru, Chile and Thailand.

Ongoing 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 cubic meters. (All of the above – per year)

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

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

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ECONOMIC FIGURES

Final data for the second half and last quarter 2007

Data is calculated in an annual rate

	<u>2nd half 2007</u>	<u>4th quarter 2007</u>
GDP growth:	6.0%	6.4%
Business GDP growth:	7.5%	8.6%
Investments in fixed assets growth:	25.6%	-12.3%
Export growth:	10.8%	15.5%

Demand and Output

Data from previous editions is constantly being updated.

All projections are done by the Economics and Research Department at the Ministry of Finance
Data is for 2007 unless stated otherwise

GDP growth:

Growth in 2007: **5.3%**

2006: **5.2%**; 2005: **5.3%**

Growth expected for 2008: 4.2%

OECD forecast for 2008: **2.7%**

GDP per capita growth: 3.4%

Private Consumption Growth:

Growth in 2007: **6.6%**

2006: **4.5%**; 2005: **4.0%**

OECD forecast for 2007: **2.7%**

Growth expected for 2008: 4.3%

Business GDP growth:

Growth in 2007: **6.1%**

2006: **6.5%**; 2005: **6.5%**

Growth expected for 2008: 4.9%

Industrial GDP growth: **4.3%**

Public Consumption Growth:

Growth in 2007: **2.6%**

2006: **2.3%**; 2005: **2.9%**

Growth expected for 2008: 2.0%

OECD forecast for 2007: **2.2%**

OECD forecast for 2008: **2.1%**

GDP per Capita, based on PPP, 2007: \$25,762, which is 80% of

OECD members' average GDP per capita.

2006: **\$24,271**; 2005: **\$22,812**; 2004: **\$22,429**.

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Foreign Trade

Goods and Services

Import growth:

Growth in 2007: **12.3%**
 2006: **3.3%**; 2005: **3.5%**
Growth expected for 2008: 4.6%

Export growth:

Growth in 2007: **8.4%**
 2006: **5.9%**; 2005: **4.3%**
Growth expected for 2008: 4.7%

Balances

Current account surplus:

2007: **3.08%**
 2006: **5.62%**; 2005: **3.3%**

Gross Debt: (% of GDP)

(General government gross financial liabilities)
 2007 projection: **81.5%**;
 2006: **87.7**; 2005: **97**; 2004: **100.7**

Budget deficit

(Central Government):
 2007: **0.02%** (100 million NIS)
 (Planned deficit was **2.9%**)
 2006: **0.9%**; 2005: **1.9%**;
 2004: **3.7%**

Investments

Total Gross Local Investment:

2007: **13.8%**
 2006: **5.3%**; 2005: **11.1%**
 2004: **3.1%**
Growth expected for 2008: 7.1%

Investment in Fixed Assets:

2007: **14.2%**
 2006: **10.1%** ; 2005: **2.3%**
Growth expected for 2008: 5.5%

Israeli Investments abroad: (B\$)

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

Foreign investments: (B\$)

2007: **10.5**;
 2006: **25.8** (including TEVA-Ivax deal)

Foreign direct investments (B\$):

2007: **9.6**; 2006: **14.2**;
 2005: **9.9**; 2004: **9.1**.

Challenges

- **Maintain the budget framework.** Implementing a sound, responsible fiscal policy, **narrowing socio-economic gaps and reducing poverty.**
- **Maintaining monetary stability** – Israel has an Inflation-Targeted monetary regime. The target is 1-3%.
2007 CPI change: **3.4%**. (2006: **-0.1%**)
- **Continuation of the reduction of the public debt to GDP ratio:**
2007: **80.8%**; 2006: **87.7%**; 2008 Projection: **77.3**
OECD 2007 projection (all countries): **76.8%**;
- **Reducing the rate of unemployment** is still a challenge even though it is in a downtrend. Average rate in 2007: **7.3%**;
Unemployment rate in the 3rd quarter was: **7.3%**; 4th quarter: **6.7%**.
→ Total employment grew by **102,000** in 2007.
(2006: **8.4%**; 2005: **9.0%**; 2004: **10.4%**; OECD, 2007: **5.4%**).
- **Increasing participation rate in labor force – The biggest challenge:**
Participation rate in 2007: **56.3%**. It is expected to rise in 2008.
(2006: **55.6%**; 2005: **55.2%**) (OECD, 2007: **70.0%**).

Ongoing 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.**
→ *See Economic Highlights from January 2008 for details.*
 - **Reducing tax burden** on low and medium income levels
(Increasing the disposable income which in turn may increase private consumption). → *See Economic Highlights from January 2008 for details.*
 - **Privatization processes, combined with structural changes:**
 - Splitting and sale of Oil Refineries – **US \$2.3 billion** (2006-7)
 - Sale of the controlling core of Bezeq – **US \$919 million** (2005)
 - Privatization of ZIM – **US \$112.5 million** (2004)
 - Privatization of Pi-Gliloth (terminals only) – **US \$197 million** (2007)

* The Governments share – approximately 50%.
- Total income from privatization of government, mixed companies & banks between 2000 and 2007: **US \$6.5 billion**

Sources: Ministry of Finance – Department of Economics and Research and the Accountant General, Central Bureau of Statistics, Bank of Israel, Tel Aviv Stock Exchange, Government Companies Authority, OECD, OECD Israel, Standard and Poor's, Moody's and Fitch Ratings.

We welcome your feedback!

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