



GOVERNMENT OF ISRAEL MINISTRY OF FINANCE  
OFFICE OF THE ACCOUNTANT GENERAL

# Investor Newsletter

**Editors:**

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- Israel issues \$2 billion in a dual-tranche global issuance with record demand
- Growth is strong, 2017 deficit under target, and debt-to-GDP continues downward trend
- Israel's external accounts continue to reflect the strength of its international position

## Issuance

In January 2018, Israel issued a benchmark size, dual-tranche, dollar-denominated issuance in the global markets. The first tranche was a 10-year \$1 billion bond with a coupon of 3.25 percent. It was issued with a yield of 3.334 percent, representing a spread of +75 basis points over the U.S. Treasury, the tightest spread for Israel on a 10-year dollar issuance. The second tranche was a 30-year \$1 billion bond with a coupon of 4.125 percent. It was issued with a yield of 4.178 percent, representing a spread of +125 basis points over the U.S. Treasury, again the tightest spread for Israel on a 30-year dollar issuance.

Demand for the issuance was the strongest in Israel's history. With an order book of approximately \$18 billion, the issuance was roughly nine times oversubscribed. This set new records for both demand, in absolute terms, as well as the oversubscription ratio.

More than 300 investors participated in Israel's offering, representing more than 30 countries.

Accountant General Rony Hizkiyahu, stated: "The impressive investor demand for this issuance reflects the growing strength of Israel's economy. Our shrinking debt-to-GDP ratio, stable deficit, and prudent debt management policies have made our global bonds a very attractive investment. The incredible demand allowed us to price our bonds at the lowest spread for a global issuance in Israel's history."

## Allocations for the Issuance

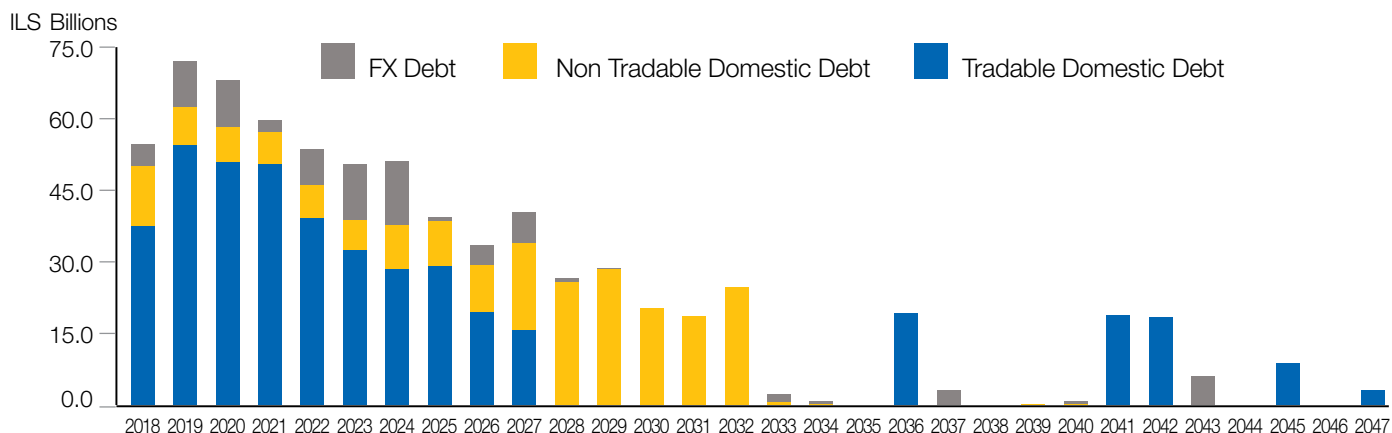
10-Year Allocations, Geographic	
USA	61%
APAC	11%
UK	10%
EUROPE	9%
ISRAEL	5%
SWITZERLAND	4%

30-Year Allocations, Geographic	
USA	73%
APAC	9%
UK	8%
EUROPE	7%
SWITZERLAND	3%

10-Year Allocations, By Investor Type	
Asset Manager	60%
Banks/PBs	12%
Sup/SWF/Gov	11%
Hedge Funds	11%
Ins/Pensions	6%

30-Year Allocations, By Investor Type	
Asset Manager	74%
Ins/Pensions	10%
Banks/PBs	7%
Hedge Funds	7%
Sup/SWF/Gov	2%

## Israel's Redemption Schedule (Prior to Issuance)



## Growth

Israel's Gross Domestic Product (GDP) continues to outperform its OECD peers, growing by 3 percent in 2017, according to the preliminary estimate. The OECD is estimated to have grown approximately 2.4 percent in 2017. The 10-year average GDP growth rate of Israel is 3.3 percent. The growth rate is in line with the Ministry of Finance's Chief Economist's growth potential of 3-3.5 percent.

The primary driver of growth in 2017 was private consumption. In recent years, Israel's growth driver has shifted from an export-led to a consumption-led economy. In 2017, private consumption contributed roughly 1.7 percent of the 3 percent growth in GDP, with investments contributing roughly 1.1 percent, public consumption 0.6 percent, and net exports contributing -0.4 percent.

An increase in investment to develop the Leviathan natural gas field is also expected to boost growth in the coming years. Israel similarly experienced an increase in investment growth during the development of the Tamar gas field in 2011 and 2012.

The strength of the shekel has been a headwind for exports of Israeli goods. Service exports, of which roughly 50 percent are high-tech, compete mainly on innovation rather than price. Because of this, they have been able to avoid some of the negative effects of the currency strengthening. In fact, Israel's exports are concentrated in the high-tech sector, now comprising nearly half of goods exports as well.

Israel has extensive trade relations with the U.S., the EU, and numerous multi- and bi-lateral agreements across the globe. New trade relationships are being fostered in Africa following the Prime Minister's three visits to the continent in 2017.

Tourism to Israel recorded its best year ever in 2017, with revenues from tourism amounting to roughly NIS 20 billion. With a reported 3.6 million tourist visits, this represents an increase of 25 percent from 2016, which was also a record year. More than 700 thousand tourists came from the U.S., a 21 percent increase from the year prior. Russia was in second place, followed by France, Germany, and the UK. Fifty nine percent of the tourists were first-time visitors.

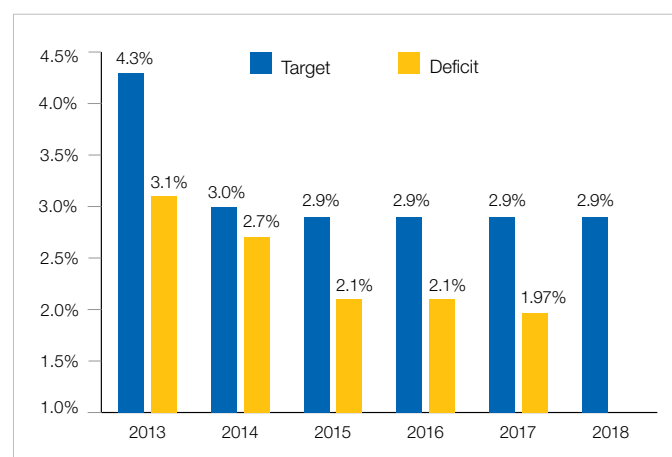
## Fiscal Rules

The Ministry of Finance's first estimate of Israel's central government debt-to-GDP ratio for 2017 is 59.4 percent, a 1.3 percent decrease from 60.7 percent in 2016. This is a continuation of Israel's 15-year trend of declining debt-to-GDP. In 2004, it was greater than 100 percent.

Keeping the deficit in check and the debt-to-GDP ratio on a downward trend are two significant goals for Israel's Ministry of Finance. To assist in accomplishing this, Israel has created two fiscal rules to monitor itself and remain prudent with government spending.

The first fiscal rule is the setting of a deficit target. This target acts as a soft ceiling for the maximum amount of deficit the Government of Israel is aiming for in a particular year. The reason for the soft ceiling is that, while one can know upcoming expenditures, there are still uncertainties with regard to revenues. The deficit target for 2017 and 2018 is 2.9 percent of GDP. In 2017, Israel's deficit was below the target at 1.97 percent of GDP, according to the Ministry of Finance's preliminary estimate. With disciplined expenditure and high revenues, Israel has remained under the deficit target for the last five years.

### Deficit vs Target



## Fiscal Rules (continued)

The second fiscal rule is the expenditure rule. This rule limits the amount of additional government spending compared to the prior year, in real terms. To calculate the expenditure increase, the government takes into account the growth of the population as well as the debt-to-GDP ratio. This fiscal rule can be seen below:

$$\text{Expenditure Increase} = \frac{50\%}{\text{Debt to GDP}} + \text{Average Population Growth of Previous Three Years}$$

As in past years, government spending in 2017 remained on target with the expenditure plan set forth in the biennial budget. Although this is a hard rule, there is some flexibility for occasional, agreed upon, one-off adjustments that are set during the budget building process.

While revenues from foreign direct investment flows and high-tech service exports were as anticipated for 2017, total revenues came in higher than expected. These additional tax revenues were sourced from events such as the sale of Mobileye to Intel, taxes collected on dividends (stemming from a temporary tax cut provision), as well as increased efficiency in collecting taxes from abroad.

Similarly, Israel also experienced higher-than-expected revenues in 2016, much of which can be attributed to a dramatic increase in car purchases. The increased revenues appeared to be a transitory event, with Israelis making higher-than-average car purchases in advance of an announced Green Tax Hike. As forecasted, car imports declined in 2017 with the biggest drop taking place in the first quarter.

On January 11, 2018, the Government approved the budget for 2019. It will now go to the Knesset for debate and approval. The process is scheduled to be completed by the end of March 2018. As it stands in its current version, the 2019 budget will increase from 2018 by 5.5 percent, nominally, to approximately NIS 397 billion. The deficit target will be 2.9 percent of GDP, the same target as 2015-2018. The main principles and focus in the 2019 economic plan are reducing the cost of living and inequality as well as increasing competition and growth.

## External Accounts

Israel's current account has been in a surplus for 15 years, buoyed by a vibrant high-tech sector and an increasing shift toward energy independence and natural gas exports. With strength in the balance of payments and low external leverage, Israel's net external creditor position has increased more than 3.5 times since 2007. Israel's foreign direct investment also continues to see strong inflows.

Israel's foreign currency reserves grew to more than \$113 billion in 2017. Since 2008, the Bank of Israel has intervened in the foreign exchange markets to suppress the over valuation of the shekel. Since 2013, the Bank of Israel has purchased foreign exchange specifically to offset the effects on the shekel from natural gas production. It publishes its assessment of the impact and amount purchased annually. According to the Bank of Israel, these interventions have become a regular monetary instrument, as is the case with many other central banks. The Bank of Israel announced it will purchase \$1.5 billion to offset the effects from the natural gas in 2018.

Additionally, Israel has created a sovereign wealth fund to manage the government proceeds from natural resources, mainly the sale of natural gas. Once Israel's sovereign wealth fund reaches \$1 billion in revenues, it will begin to invest in non-shekel assets, a model similar to other sovereign wealth funds.

## Cost of Living

The Government of Israel has made strides in lowering the cost of living for its citizens. The plan to reduce taxes on imported goods, the Net Family Plan, is not only in force to lower prices, but it also aims to boost consumer spending and private consumption growth.

The Net Family Plan abolishes the 12 percent customs tax on eyewear, electronics, televisions, baby products, and numerous other items. These cuts in customs levies amount to approximately NIS 800 million and are set to expire at the end of 2018. As the deadline to expiration draws closer, the Ministry of Finance will review which of the lowered taxes provide the most savings to the consumer. Lowering the cost of living can also be seen in the reduction of electricity prices by about 2 percent, a customs tax on cellular phones, as well as other programs.

## Cost of Living (continued)

Housing has been another cost-of-living concern that has been challenging for Israelis. Real estate costs have increased more than 120 percent between 2007 and H1 2017. These large price increases have been a central focus of the Ministry of Finance's policies. As of late, housing prices have been slowing down. This can be partially attributed to an increase in the supply of land (more than 90 percent of all land is owned by the Government of Israel). Additionally, demand for homes has declined in each of the four quarters preceding Q3, 2017. There was a drop in housing demand of 17 percent in Q3, 2017 compared to Q3, 2016. Homes purchased by investors, rather than tenants, fell more than 26 percent in Q3, 2017 compared to Q3, 2016.

Banks are highly regulated in Israel and the mortgage market is quite conservative, with a loan-to-value ratio of new mortgages at 50 percent. Additionally, there is virtually no secondary market for securitization of mortgages.

The average annual growth of households from 2012-2015 was approximately 52,000. It increased to 58,500 in 2016, according to Israel's Central Bureau of Statistics.

In Q3 of 2017, the volume of homes completed increased to 12,100 for the quarter. This represents an 18 percent increase from the previous year.

The decline in housing demand resulted in a slowdown in construction starts in Q3, 2017. Construction permits, on the other hand, increased in the past six months. There are currently more than 113,000 homes under construction in Israel.

## Other News

### Hyundai, Mercedes-Benz Open Development Centers in Israel

Korean giant Hyundai Motors and Mercedes Benz are the latest international car manufacturers to establish development centers in Israel.

The Hyundai facility will focus on energy, smart cities, artificial intelligence, smart transportation and robotics. According to the chief innovation officer of strategy and technology, Dr. Youngcho Chi, the company plans to work with the startup community and identify venture capital investments and collaborations that connect new technologies with Hyundai's operations.

At the Mercedes-Benz digital hub in Tel Aviv, a team of 25 employees will contribute to and support the worldwide activities in mobility services and digitalization. "Israel is among the top five ecosystems for innovation, digital technologies, new mobility services and car IT. And it is one of the four largest talent pools in the world," said Dieter Zetsche, chairman of the board of Daimler Ag and head of Mercedes-Benz Cars.

General Motors currently operates a major development center in Israel, employing hundreds of engineers. Other major car manufacturers have also opened R&D centers in Israel, including Renault, Honda, SAIC and Porsche. Renault-Nissan recently won a tender by the Israel Innovation Authority to establish a technological innovation laboratory (incubator) for young companies developing smart car and shared transportation technologies.

— *Globes*

<http://www.globes.co.il/en/article-hyundai-to-set-up-israel-smart-car-rd-center-1001209989>

[http://news.xinhuanet.com/english/2017-11/17/c\\_136758696.htm](http://news.xinhuanet.com/english/2017-11/17/c_136758696.htm)

### Israeli Pharma Company Sold for \$1.1 Billion

NeuroDerm Ltd. was purchased for \$1.1 billion by Japan's Mitsubishi Tanabe Pharma Corporation. This is the largest ever acquisition of an Israeli pharmaceutical company. NeuroDerm is a clinical stage pharmaceutical company that develops drugs for central nervous system disorders. Its lead product is ND0612 for the treatment of Parkinson's disease.

— *Reuters*

<https://www.reuters.com/article/us-neuroderm-m-a-mitsub-tanabe/mitsubishi-tanabe-pharma-to-buy-israels-neuroderm-for-1-1-billion-idUSKBN1A90IA>

## Other News (continued)

### ■ Mexicam Buys 80 Percent of Netafim for \$1.8 Billion

Mexican company Mexicam has purchased 80 percent of Netafim, a pioneer and world leader in drip irrigation and micro irrigation systems, for \$1.8 billion. Netafim has 16 production plants, three of them in Israel. It is active in 110 countries and employs close to 4,000 people in Israel and around the world. Its technologies are intended to increase yields and improve crop production while preserving quality and quantity of water and soil fertility.

Mexicam, a global leader in plastic piping and petrochemicals, has committed to preserve Netafim's activity in Israel for 20 years, including its production and R&D facilities.

— *Business Wire*

<https://www.businesswire.com/news/home/20170807005408/en/Mexichem-Acquire-Netafim-%E2%80%93-World-Leader-Smart>

### ■ GE Partners With Israeli BrightSource to Build Mega Solar Thermal Power Station

The Ashalim Solar Thermal Power Station, located in Israel's Negev desert, is one of the largest renewable projects of its type in the world. It is also the first solar thermal or concentrated solar power plant to be undertaken in Israel by GE and BrightSource Energy, combining GE's experience in the field of turnkey power plants and key power equipment with BrightSource's advanced solar technology. The project will be built and operated by Megalim Solar Power Ltd., a company formed by GE, BrightSource and Noy Infrastructure and Energy Investment Fund. Power from the project will be sold to Israel Electric Corporation under a long-term power purchase agreement.

The Ashalim plant will increase Israel's energy security by reducing its dependence on fossil fuel imports. It will also avoid 110,000 tons per year of CO2 emissions, helping the government to achieve its goal of generating 1 percent of its electricity from renewable sources by 2020.

— *Power Engineering International*

<http://www.powerengineeringint.com/articles/2017/01/israel-building-world-s-tallest-solar-power-tower.html>

### ■ Israeli Startups Raise More Than \$5 Billion in 2017

Israeli startups have raised more than \$5 billion in 2017, exceeding last year's record of \$4.8 billion.

Startups raised a record \$3.8 billion in the first nine months of 2017 and another \$1.3 billion in the fourth quarter, IVC-ZAG reported.

The trend where fewer startups are raising more money was evident in December, where three startups raised more than \$315 million.

— *Globes*

<http://www.globes.co.il/en/article-israeli-startups-raise-over-5b-in-2017-1001217444>

### ■ Amazon Expands Presence in Israel With Two New R&D Facilities

Amazon announced it was establishing two research and development centers in Israel dedicated to developing its Alexa Shopping platform. The company said it will be hiring about 100 scientists, engineers and project managers to work in a new group it is forming for Alexa, its personal assistant service, which among other things enables users to make purchases through voice commands in natural language.

".... Amazon is deepening its commitment to Israel and bringing a new strategic mission to the strong talent pool in Israel," the company said in a statement. "This opportunity will enable scientists and engineers to work at the forefront of technology in the field of [internet] search, natural language understanding and machine learning with a consumer focus."

Amazon first launched its Israel operations five years ago with a sales office for the Amazon Web Services unit, which provides on-demand cloud computing platforms to people, companies and governments. In January 2015, it bought the Israeli startup Annapurna Labs for a reported \$350 million to \$400 million.

— *Haaretz*

<https://www.haaretz.com/israel-news/business/1.815429>

## Relevant Links

### **Israel Government Portal**

<https://www.gov.il/en>

### **Israel's Ministry of Finance**

<http://mof.gov.il/en/pages/default.aspx>

### **Israel's Government Debt Management Unit**

<http://mof.gov.il/en/PolicyAndBudget/GovernmentDebt/Pages/default.aspx>

### **Bank of Israel**

<http://www.boi.org.il/en/Pages/Default.aspx>

### **Central Bureau of Statistics**

[http://www.cbs.gov.il/reader/cw\\_usr\\_view\\_Folder?ID=141](http://www.cbs.gov.il/reader/cw_usr_view_Folder?ID=141)

### **Tel Aviv Stock Exchange**

<https://www.tase.co.il/eng/pages/homepage.aspx>

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