GOVERNMENT OF ISRAEL MINISTRY OF FINANCE
OFFICE OF THE ACCOUNTANT GENERAL

Investor Newsletter

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The Pandemic and Israel's Economy

Israel, to date, has weathered the pandemic notably better than many other advanced countries. In 2020, Israel's Gross Domestic Product (GDP) growth declined 2.2 percent, while the average GDP for the OECD[1] countries fell 4.7 percent.

Ministry of Finance estimates growth for 2021 at 7.1 percent, nearly 2 percent above growth estimates for the OECD country average of 5.3 percent. Managing both a health crisis, stemming from the COVID-19 pandemic, and an economic crisis resulting from lock-downs and supply and demand shocks, have proven challenging for many of the world's advanced countries. Yet, Israel forged ahead, enacting swift government actions to temper COVID-19 and offering innovative solutions to keep the economy moving.

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From the onset of the pandemic in December 2019, Israel implemented measures to reduce the virus's spread and to mitigate negative economic impacts. Initial actions included business closures, travel restrictions, mandatory face masks and social distancing guidelines. The Government began a mass vaccination program on December 19, 2020, with at-risk populations. The program expanded to all citizens aged 16 and older on February 4, 2021 and to all citizens aged 12 and older on June 2, 2021. In July 2021, Israel began offering third shots ("booster doses") to the population, beginning with at-risk adults. In November 2021, Israel once again expanded vaccine eligibility to those aged 5 to 11.

During the initial wave of the pandemic, Israel locked down swiftly and severely. Subsequent lock-downs became less and less restrictive as lessons from the harsher, initial lockdown were learned. When a fourth wave of new cases appeared in Israel, the largest to date, fatalities remained low and no lockdown was required.

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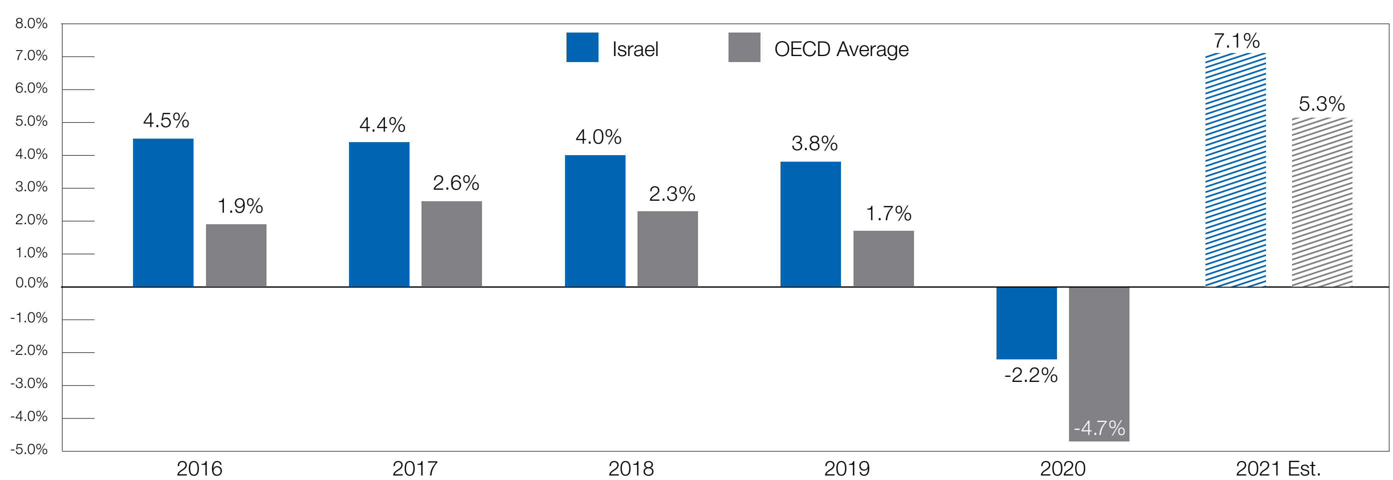
GDP Growth



Source: Ministry of Finance

1 OECD, or the Organization for Economic Co-operation and Development, is an intergovernmental economic organization with 38 member countries, including Israel.

The Pandemic and Israel's Economy (continued)

Israel's recovery rate from COVID-19 is 99 percent, much higher than the global average of 90 percent. Likewise, Israel's fatality rate from the virus is a mere 0.6 percent, much lower than the global average of 2 percent. This is partially a result of Israel's world-leading vaccination drive early on, as well as the benefits of a relatively healthy and young society.

The Bank of Israel was quick to enact a quantitative easing program, lower the key interest rate, open swap lines for currency, and other activities that proved successful in sustaining confidence in Israel's economy and banking system. On the fiscal side, the government provided a support package equal to approximately 14 percent of GDP, focused on four key areas: health and civil provisions, social resilience, business continuity, and economic growth and development.

Included in the program was a scheme to support the labor market. In exchange for companies retaining workers on unpaid leave, the government program funded 85 percent of employee salaries. Israel's broad unemployment rate[2] rose to more than 36 percent in the early months of the pandemic. Despite the high percentage, most of those defined as unemployed continued to receive salaries and retain their jobs. The vast majority of these special unemployment payments ran from the beginning of the pandemic until mid-2021, with some benefits remaining for unemployed people over the age of 45, maternity benefits for those unemployed for an extended period of time prior to giving birth, and others. As of October 2021, unemployment, using the broader definition, fell to 7.1 percent.[3]

Israel entered the pandemic in an excellent economic position. GDP growth in 2019 was 3.8 percent, more than 2 percent higher than the OECD average, while unemployment was near historic lows at 4.3 percent (OECD unemployment was 7.1 percent). Israel's external vulnerability risk was low having been boosted by robust external accounts that include nearly two decades of a surplus in the current account and one of the strongest net external creditor positions for a non-commodity-centric export country.

Reduced imports and increased exports in the energy sector buttressed the current account surplus over the past two years. Although Israel is not heavily reliant on commodities for economic growth, it does have sufficient natural gas to meet domestic demand. In 2020, exports of natural gas began to neighboring Egypt and Jordan.

Israel's Credit Ratings, as of December 2021		
Standard & Poor's Global Ratings	Moody's Investors Service	Fitch Ratings
AA-	A1	A+
All Stable		

Recent developments for Israel's natural gas industry include Chevron, in 2020, purchasing stakes in two of Israel's largest gas fields and Mubadala, from the United Arab Emirates, taking a stake in one of its gas fields in 2021, an outcome of the 2020 Abraham Accords.

> Israeli companies had their second-best year of capital raising in 2020, with $10.3 billion raised from global venture capital firms. This figure was surpassed in just the first three quarters of 2021, marking Israel's best-ever funding year with $17.8 billion raised.

Contributing roughly 15 percent to GDP, and comprising 51 percent of Israeli exports, high tech performed well during the pandemic. Israeli companies had their second-best year of capital raising in 2020, with $10.3 billion raised from global venture capital firms. This figure was surpassed in just the first three quarters of 2021, marking Israel's best-ever funding year with $17.8 billion raised.

Over the past decade, service exports have expanded rapidly. In the first half of 2021, service exports were 20 percent higher relative to the first half of 2019, before the pandemic. More service exports result in fewer raw material imports needed for manufacturing. This dynamic helps insulate Israel from current supply chain issues and made working from home easier, relative to economies that are more manufacturing- or tourism-oriented. Roughly 30 percent of goods exports are chips and technology for devices manufactured by other producers. This too buffers Israel from some of the current market dynamics, as demand remains strong for these high value-added products. The outperformance of high tech during the pandemic gives Israel's economy a structural advantage. Like other countries, Israel's tourism sector was negatively impacted; however, tourism is not a large sector of Israel's economy at approximately 2 percent of GDP.

In 2020, revenues to the government fell to NIS 317.8 billion from NIS 346.5 billion in 2019. This, in conjunction with increased expenditure to fight COVID-19, produced

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2 Takes into account unemployed persons, those temporarily absent from work for reasons related to the pandemic, and/or not participating in the labor force due to government mandated closures

3 Excluding those unemployed due to directly to the impacts of COVID-19, the unemployment rate declined to 5.1 percent.

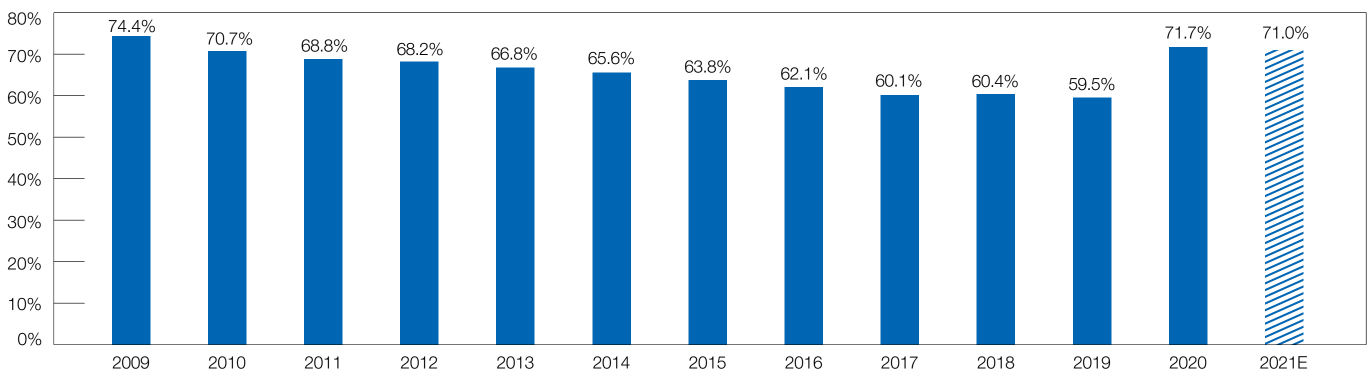
The Pandemic and Israel's Economy (continued)

early deficit estimates as high as 14 percent. A boost in economic activity and large tax revenues late in 2020 resulted in the budget deficit equaling 11.4 percent of GDP.

The new budget sets deficit targets for 2021 and 2022 at 6.8 and 3.9 percent of GDP, respectively. With less COVID-19 expenditure, an expanding economy, and tax revenues currently totaling NIS 336.3 as of October 2021, the expected budget deficit in 2021 should be lower than the target.

Over the past decade, the government has been able to consistently reduce its general debt-to-GDP ratio, down from 74.4 percent in 2009 to 59.5 percent in 2019. This long-term commitment to debt reduction, as a percent of GDP, generated the necessary buffer to fight COVID-19. 2020 concluded with a debt-to-GDP ratio of 71.7 percent, lower than early forecasts of 75 to over 80 percent. Current Ministry of Finance estimates for the ratio in 2021 are roughly 71 percent. Just as it has in the past, the government remains committed to lowering the debt-to-GDP ratio over time.

Debt-to-GDP



Source: Ministry of Finance

2020 Global Issuances

Prior to the pandemic, in January 2020, the State issued a dual-tranche dollar bond: $1 billion for ten years with a yield of 2.55 percent and a $2 billion bond for 30 years with a yield of 3.509 percent.

When the pandemic began, the State returned to the global markets. In March, Israel issued its first triple-tranche dollar bond, consisting of a 10-, 30-, and, for the first time, a 100-year tranche, raising $2 billion, $2 billion, and $1 billion, respectively. The yields on the tranches were 2.75, 3.875, and 4.5 percent, respectively. Investor interest for those bonds broke all previous Israeli records with demand of more than $20 billion for each of the respective bonds. In April, the State once again returned to the global markets, dual-listing on the Taiwan Stock Exchange for its first-ever "Formosa" bond. This was a $5 billion 40-year issuance with a yield of 3.8 percent. Investor demand on this bond reached more than $11 billion.

In addition to these public issuances, the government also executed 14 private placements, raising an additional €5.6 billion.

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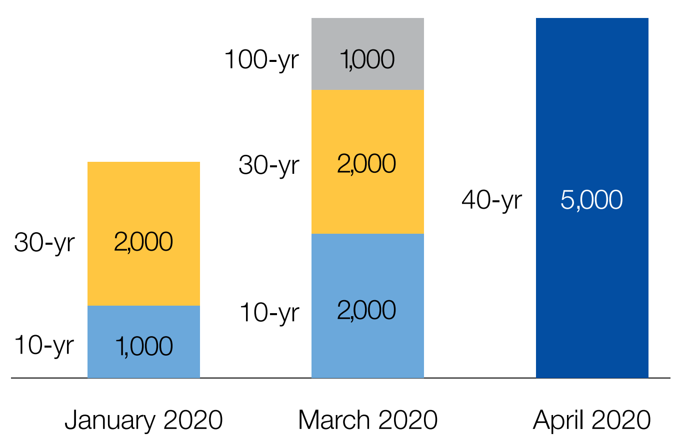
2020 Global Public Issuances (USD Millions)



Source: Ministry of Finance

2020 Global Issuances (continued)

Early expectations for the 2020 budget deficit was estimated to be approximately 14 percent of GDP and subsequent government financing was executed with that in mind.

However, Israel ended the year with a deficit of just 11.4 percent of GDP, resulting in a large liquidity buffer in the government's accounts. Similarly, 2021 began with expectations of a 9 percent budget deficit. Ministry of Finance expectations have since been revised down to a deficit potentially below 6 percent. Given the larger-than-expected pre-funding that took place in 2020, and influx of tax revenues in 2021, no sovereign issuances were executed in 2021. The potential liquidity buffer will help finance the deficit in 2022 and 2023.

Monetary

Inflation in Israel, as measured by its consumer price index (CPI), rose 0.1 percent in October 2021, to 2.3 percent over the trailing 12 months. This is within the Bank of Israel's desired 1 to 3 percent range and relatively low compared to other advanced countries. Excluding energy and fruits/vegetables, inflation increased by 2.1 percent.

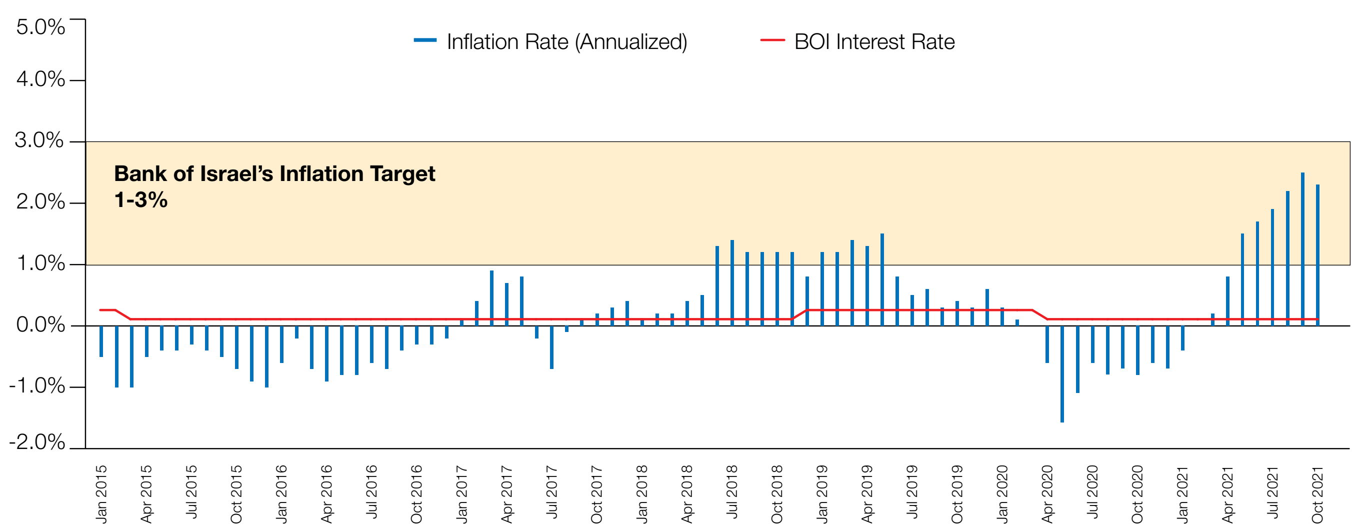
Israel's inflation rate is generally lower than other advanced countries for several reasons: First, Israel's inflation had been low for some time, averaging just 0.02 percent between 2015 through 2020. Second, Israel's currency, the shekel, has been one of the strongest currencies this year, which improved purchasing power and reduced the cost of imports. Third, the government has made strides in its policies to reduce the cost of living and to increase competition, which tempered the rise in prices. Fourth, the weightings in Israel's CPI are larger for housing *rentals*, which remained relatively moderate, and a smaller weighting for housing *prices*, which jumped approximately 10 percent over the past 12 months. Fifth, Israel's natural gas is self-supplied and is based on fixed-price contracts, buffering much of the volatile prices in the energy market.

The Bank of Israel has kept its key interest rate at 0.1 percent for November 2021 and anticipates inflation to remain within its 1 to 3 percent target range. Additionally, the Bank expects inflation to be lower in 12 months than it is today.

As stated earlier, the shekel strengthened to levels not seen in decades. The shekel was boosted by robust service exports, particularly in the high tech sector, natural gas exports, Israel's strong net external creditor position, and the structural surplus in the current account. In 2021, the Bank of Israel completed a $30 billion FX purchasing program to alleviate some of the impact on non-high tech exporters and better prepare the economy for the reality of a stronger exchange rate. Although the program is now complete, the Bank of Israel stated that $30 billion is not a final ceiling and that it has the ability to continue to intervene, as it sees fit, based on the state of the economy.

The next interest rate decision by the monetary policy committee will be on January 3, 2022.

Inflation



Source: Bank of Israel

New Government, Budget Reforms and Designated Bonds

On March 23, 2021, for the fourth time in two years, elections were held. A new government was formed on June 13, 2021. The governing coalition, comprising 61 of the 120 seats, is led by Prime Minister Naftali Bennet, with an agreement that current Alternate Prime Minister/Foreign Minister Yair Lapid, will serve as Prime Minister beginning in August 2023. The new Finance Minister is Avigdor Liberman, leader of the Yisrael Beiteinu party.

Although Arab political parties have been part of the Knesset for years, for the first time in Israel's history, an Arab party, Ra'am, now holds a place within the governing coalition.

The first task of this government, as with most Israeli governments, was to pass a budget. In November 2021, the Knesset successfully approved Israel's first new budget since 2019, covering 2021, as well as an additional budget for 2022.

Along with the budgets, the government also passed an Economic Arrangements Law which outlines positive reforms for the economy.

In the coming years, the government will be allocating financial resources toward several important initiatives. To improve productivity and reduce air pollution, the government committed NIS 150 billion to drastically enhance public transportation, including an investment in a light-rail system for Tel Aviv, mainly through public-private-partnerships. Green energy reform also passed and is designed to encourage the transition to clean energy by removing regulatory barriers and increasing investment in solar infrastructure. New investments in Arab society, an estimated NIS 35 billion, aims to boost educational training, provide childcare, reduce inequality and increase representation in the labor force. Other important reforms include reducing the cost of living by lowering barriers to imports and setting new import regulations, new reforms to enhance competition in the banking sector and encourage FinTech innovation, and raising the retirement age of women, currently at 62, to decrease the gender salary gap.

Of the many important reforms passed in the new budget, designated bond reform is one of the most significant for debt management. For decades, pension funds were required to hold 30 percent of their portfolios in special bonds issued by the government, known as "designated bonds." These bonds have a 15-year maturity, 4.86 percent coupon, are CPI-linked and non-tradable. As other investments in pension portfolios rose, such as equities, additional designated bond issuance would be required to maintain the 30 percent holdings; when markets were down, designated bonds did not need to be issued. The pro-cyclical nature of this instrument created an uncertain fundraising tool for the government and the high coupon premium dramatically inflated the government's interest payments.

Governing Coalition

	Seats
United Arab List "Ra'am"	4
Meretz	6
New Hope	6
Yamina	6
Yisrael Beiteinu	7
Labor	7
Blue & White	8
Yest Atid	17
Total Seats	61

Source: Knesset

The new reform ends issuance of designated bonds in late 2022. Rather than issue a large subsidy via fixed income securities, the government will guarantee an annual 5.15 percent, CPI-linked, yield on 30 percent of pension fund investments. In place of holding designated bonds, pension funds must invest that portion of their portfolio as they invest the other 70 percent. Every five years, the government will calculate the average annual return the pension funds earned and ensure the 5.15 percent yield. If the average return were 4.15 percent, for example, the government would only subsidize the 1 percent difference. If the pension fund earns an annual average above 5.15 percent, it would be required to transfer the surplus amount to the government, where it will be held in a special account to be used to subsidize the pension funds in the future.

This reform will drastically reduce government interest payments and ensures that the government debt management unit will be able to control 100 percent of debt issued. As tens of billions of shekels annually will no longer be raised via designated bonds, those funds are freed to be raised through cheaper instruments such as tradable domestic bonds and/or global sovereign issuances.

Other News

Israel's Prime Minister Announces Commitment To Fighting Climate Change

At the recent COP 26 Climate Conference in Glasgow, Israel's Prime Minister Naftali Bennett spoke about the country's plans to commit to cutting greenhouse gas emissions to net zero by 2050 and phasing out the use of coal by 2025.

According to the Prime Minister's Office, the steps Israel will take include developing technology for green energy, finding ways to store it, trapping carbon, and educating consumers on energy conservation.

Bennett also noted that developing green technology is a way to provide regional stability and for neighboring countries to work together.

— *Times of Israel*

https://www.timesofisrael.com/pm-israels-tech-sector-must-pivot-from-making-apps-to-fighting-climate-change/

UAE Seeking $1 Trillion in Economic Activity With Israel Over Next Decade

In a recent interview with *Bloomberg News*, United Arab Emirates (UAE) Economy Minister Abdulla Bin Touq Al Marri reported that the UAE is seeking to grow economic ties with Israel to more than $1 trillion in the next decade, further amplifying a year-old relationship that has already produced billions of dollars of business.

"We have $600 million dollars of bilateral trade happening, we have funds of billions of dollars that have been announced jointly between the two countries, and we are moving into so many areas of economic opportunity," he noted.

The UAE was the first Arab nation after Egypt and Jordan to formally recognize Israel. Bahrain, Morocco and Sudan have also recently recognized Israel.

— *Bloomberg News*

https://www.bloomberg.com/news/articles/2021-09-13/uae-seeks-1-trillion-in-economic-activity-with-israel

New Unicorns in Israel Growing At Unprecedented Rate

A report by the Viola Ventures showed that new unicorns (private companies valued $1 billion or more) in Israel are growing at an unprecedented rate, with 21 new ones announced in the first half of 2021 alone. This brings the total number of Israeli unicorns to 68.

Israel's unicorns are represented in many sectors, including adtech, consumer, fintech, infrastructure, e-commerce, cybersecurity, and vertical applications. Viola's data also showed that the "time-to unicorn" parameter has also declined in recent years.

According to Daniel Cohen, General Partner at Viola Ventures, "We believe the trend of keeping full management in Israel and not shifting them to the destination market, as was done in the past, will only strengthen as digital distribution enables a different operational model. This is important because we think that Israeli companies have a better chance to hire top talent in Israel than abroad."

— *CTECH*

https://www.calcalistech.com/ctech/articles/0,7340,L-3916983,00.html

Israeli Tech Companies Break Records Raising $17.8 Billion in First Three Quarters

The Israeli high tech sector broke funding records again, raising $17.78 billion in the first nine months of 2021, an increase of 71 percent on the $10.3 billion raised for all of 2020. In the third quarter, Israeli companies raised $5.9 billion in 177 deals, compared to the $2.3 billion average in the two previous years.

Israeli high tech exits soared to $18.92 billion in the first nine months of 2021, up 92 percent from 2020. IPOs jumped in the first three quarters with 65 deals amounting to $9.78 billion.

— *CTECH*

https://www.calcalistech.com/ctech/articles/0,7340,L-3919593,00.html

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 (GDMU)
http://mof.gov.il/en/PolicyAndBudget/GovernmentDebt/Pages/default.aspx

Israel's Annual Debt Report
https://mof.gov.il/en/PolicyAndBudget/GovernmentDebt/GovernmentDebtIndices/Pages/AnnualDebtReport.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

Tel Aviv Stock Exchange
https://www.tase.co.il/Eng/Pages/Homepage.aspx

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