GOVERNMENT OF ISRAEL MINISTRY OF FINANCE
OFFICE OF THE ACCOUNTANT GENERAL

Investor Newsletter

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- S&P and Fitch affirm Israel's credit rating and outlook
- Israel issues two unprecedented private placements
- Yields fall across Israel's outstanding sovereign debt

Credit Ratings

In August 2019, one year after raising Israel's credit rating to AA- / Stable, S&P Global Ratings affirmed its rating and outlook. In the report, S&P noted that growth is likely to stay resilient despite a weaker external environment. Some of the reasons cited include: Israel's strong institutions and ability to weather political turbulence, a diversified and competitive economy that is estimated to grow by an annual average of 3 percent over the medium term, and a highly effective monetary policy.

A positive rating action could result from strong fiscal consolidation, resulting in a "material" reduction in the net general government debt-to-GDP ratio or interest payments, or a major improvement in the region's security environment. Conversely, S&P stated that a negative rating action could potentially be taken should Israel's economic, balance-of-payments, or fiscal performance weaken markedly compared to the company's forecast or in the event that security risks substantially increase.

Similarly, in August 2019, Fitch Ratings affirmed its A+ / Stable rating and outlook. In its report, Fitch underscored Israel's strong external finances, robust macroeconomic performance, and high financing flexibility. In its affirmation, Fitch also took into consideration Israel's continued political and security conditions. On this topic, Fitch made mention of Israel's history of resilience to these types of risks and highlighted Israel's current account, which has been in surplus since 2003; its net external creditor position that remains significantly stronger than similar 'A' (and 'AA') rated countries, and foreign reserves that are equal to 11 months of current external payments. Fitch believes Israel's economy will remain "buoyant" and estimates a 3.1 percent GDP growth in 2019. Fitch upgraded Israel to A+ in November 2016.

Private Placements

In July and August, Israel executed two historic private placements.

In July 2019, Israel issued €500 million, at a 2 percent fixed rate, for a term of 50 years. The issuance, maturing in 2069, represents Israel's longest debt to date. Israel Finance Minister Moshe Kahlon stated: *"The test of the strength of the Israeli economy is the faith in it on the part of global investors and financial institutions. This placement is a vote of confidence in Israel and in the Israeli economy, but more than that, it expresses the world's confidence that the State of Israel is here to stay."*

Israel Accountant General Rony Hizkiyahu said: *"The growing demand from leading investors around the world for Israeli long-term debt issues signifies the great confidence that exists in the Israeli economy and the ready access that Israel has to international markets."* Barclays and Deutsche bank acted as the deal's underwriters.

In August 2019, Israel issued ¥15 billion, at a fixed rate of 0.15 percent, for a term of seven years. The deal, the first yen-denominated private placement in Israel's history and the first issuance in yen since 1997, was made to a major strategic Japanese investor. The transaction represents the investor's first investment in Israeli debt. Israel Accountant General Rony Hizkiyahu stated: *"This strategic offering, together with the 50-year offering last month, attests to the increasing demand from high-quality global investors who are interested in investing in the Israeli economy, and the importance of expanding the investor base."* Goldman Sachs was the underwriter for the deal.

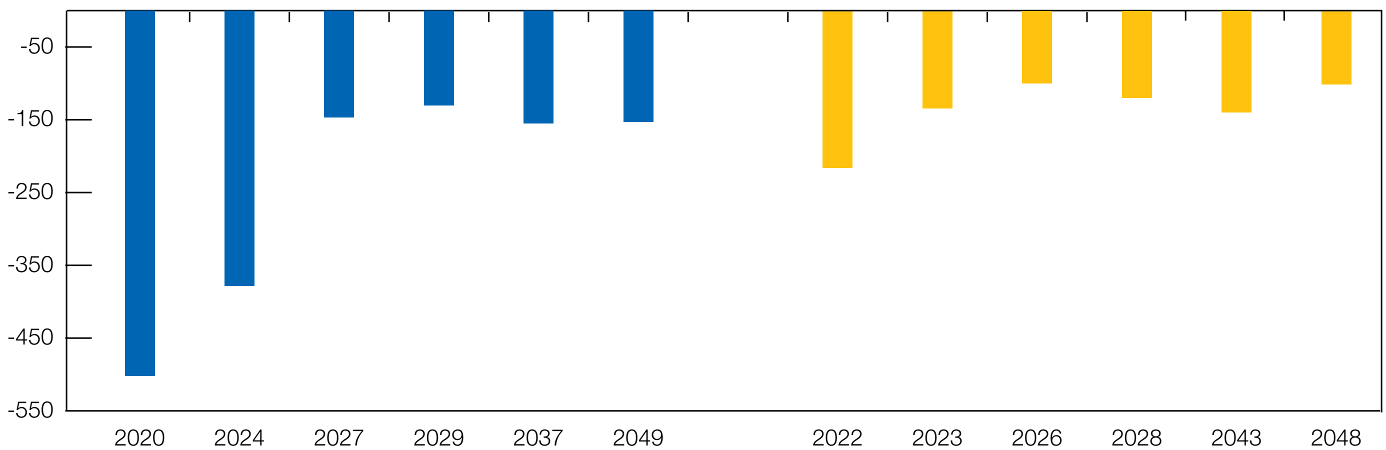
This continues Israel's strategy of using private placements as a tool to reach new investors and new markets. Thus far, Israel has executed four private placements in the last two years, with its previous private placement deal completed in 2012.

In light of Israel's dynamic economy, news of its potential addition to the benchmark World Government Bond Index, and strong bond performance, demand for Israeli debt has been quite high. This was demonstrated at the start of 2019 when Israel issued its largest-ever public sovereign bond at €2.5 billion as well as in early 2018, when Israel issued $2 billion with an order book of approximately $18 billion.

While private placements are one of Israel's financing options, they are not a major funding source for the government. To date, the Ministry of Finance's Global Debt Management Unit has executed private placements to strategically expand the investor base or to take advantage of exceptional financing terms.

Yield Change for Israel's Sovereign Issuances

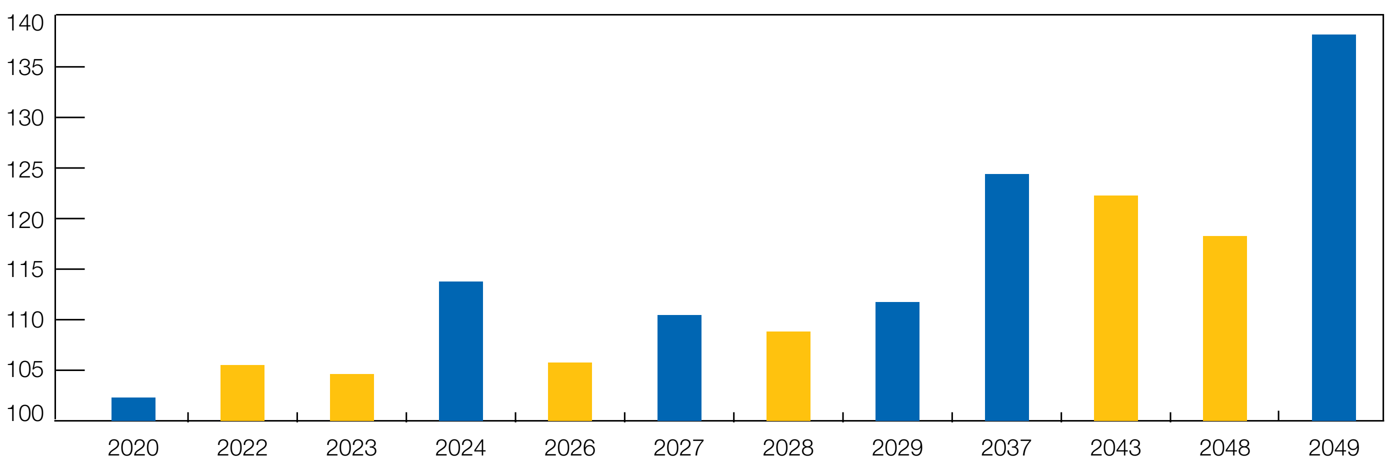
(By year of maturity; change in yield-to-maturity percentage by basis points, from issuance to September 11, 2019)
(Blue = Euro issuances; Gold = USD issuances)



Source: Bloomberg

Israel's Sovereign Issuances by Price

(By year of maturity; as of September 11, 2019; par = 100 for all)
(Blue = Euro issuances; Gold = USD issuances)



Source: Bloomberg

Election

Israel's most recent general election was held on April 9, 2019. Following the election, on April 17, Israel's President Reuven Rivlin selected Benjamin Netanyahu of the Likud Party to form a coalition government. Prime Minister Netanyahu did not form a coalition in the newly elected Knesset by the deadline. The Knesset passed a dissolution bill, declaring new elections for the 22nd Knesset to be held on September 17, 2019. The current government will remain in power as caretaker until a new government is formed following the upcoming elections.

Macro

In the second quarter of 2019, Israel's annualized GDP growth rate dropped to 1 percent. This followed the first quarter's high growth rate of 4.7 percent. Growth in the first quarter was boosted by a jump in automobile purchases before the expiration of a green tax went into effect. Despite the drop in GDP growth, Israel remains on track for the Ministry of Finance's estimate of 3.1 percent growth for 2019. The Bank of Israel estimates Israel will grow at 3.1 percent as well. For reference, GDP growth in Q2 of 2018 was 1.4 percent and the year-end growth rate was 3.3 percent. In Q2 2017, the growth rate was 4.5 percent; however growth in the first quarter of that year was 0.7 percent. Still, 2017 concluded with year-end growth of 3.5 percent.

In Q2 2019, exports were affected by Israel's currency, the shekel, which strengthened at the end of the quarter to 3.57 against the U.S. dollar, from 3.63 at the end of Q1 and 3.74 at the end of 2018. The shekel has continued to strengthen against the dollar in Q3 hitting a one-year low of 3.48 on August 9.

Israel's unemployment rate in July 2019 fell to 3.7 percent from 4.1 percent in June 2019. The unemployment rate has remained below 5 percent since April 2016.

Israel's trailing 12-month budget deficit is 3.8 percent of GDP. This equates to approximately NIS 52 billion ($14.7 billion). The budget deficit target for 2019 is 2.9 percent. According to the Accountant General's report, expenses have been kept diligently in check at slightly above 100 percent of target. The current budget deficit stems from lower-than-forecasted revenues. Unlike previous years, there has not been a major revenue-producing acquisition in the private sector, such as Mobileye or Waze. The Finance Ministry's most recent published estimates (January 2019) state that, barring any major changes, the year may conclude with a budget deficit of 3.6 percent. Exceeding the deficit target is not common for Israel. In 2018, it met its 2.9 percent target, and has not exceeded its estimated target in any year since 2013, beating it by an average of 0.82 percent during those years.

Monetary Policy

In its August decision, the Bank of Israel maintained its base interest rate at 0.25 percent. The rate has remained at this level since November 2018. The Bank noted that in light of a downward shift in the inflation environment, accommodative monetary policies of major central banks, slowing in the global economy, and the strength of the shekel, it would not increase the rate "for an extended period." The Bank continued to note that it was prepared, if necessary, to take additional steps toward making a more accommodative monetary policy to stabilize inflation around the midpoint of the target range and to support economic activity. In the meantime, the Bank stated it will continue to monitor all economic and fiscal developments in Israel and abroad. The Bank also asserted that economic activity continues to grow near its potential rate and is not adversely affected by the negative global sentiment.

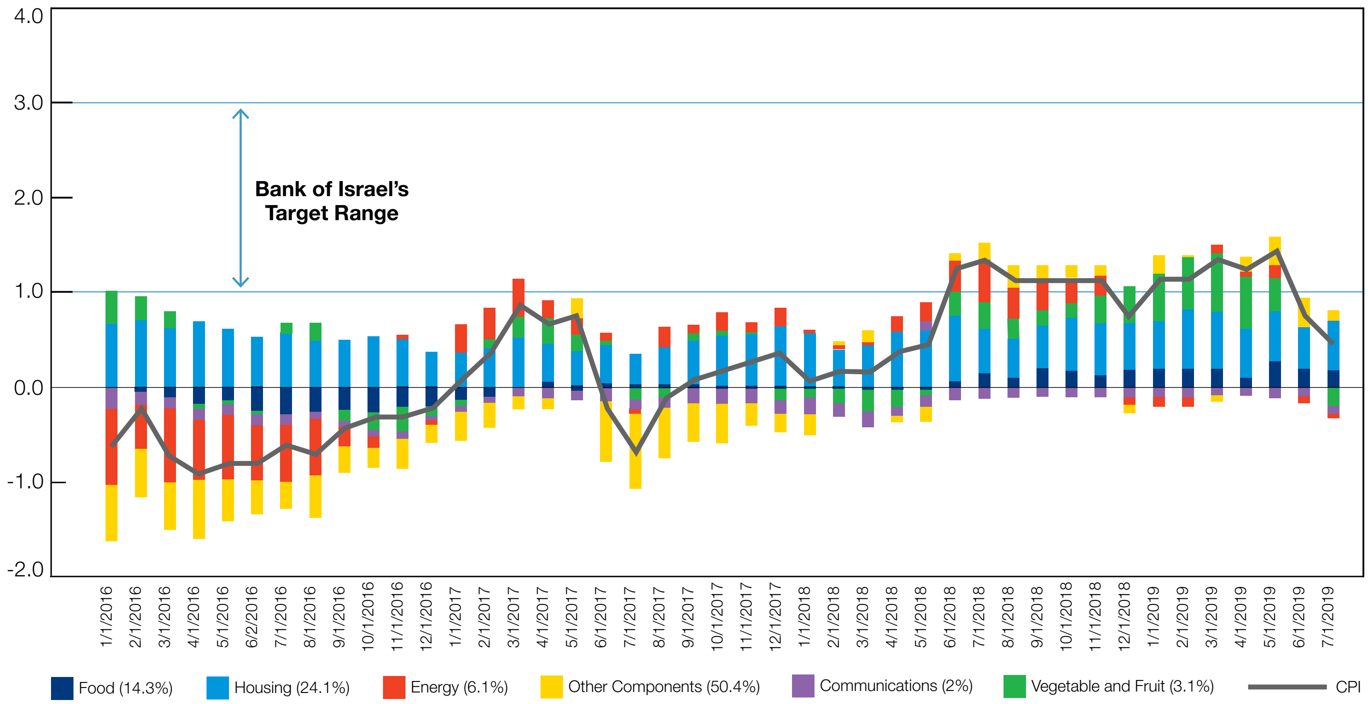
At the end of Q2 2019, Israel's consumer price index (CPI), a measure of inflation, fell 0.6 percent to 0.8 percent from the previous quarter. Of the components that comprise the index, fruit and vegetables, clothing and shoes, and transportation were the sectors negatively pulling the index down. The Bank explained in its announcement that the fruit and vegetable component is highly volatile and that other constituents in the index were weakened as a result of the appreciation of the shekel. However, the housing component rose from last quarter, continuing a long-term trend. Since January 2014, housing prices have risen 21 percent.

From the beginning of 2019 until the August interest rate decision, the nominal effective exchange rate of the shekel increased 8.7 percent. Following the decision, short- and medium-term inflation expectations declined, while long-term inflation expectations remained anchored near the midpoint of the Bank's inflation target range (1 to 3 percent).

More on the Bank of Israel's interest rate decision and analysis of Israel's economic environment can be found here.[1]

1 https://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/28-8-19.aspx

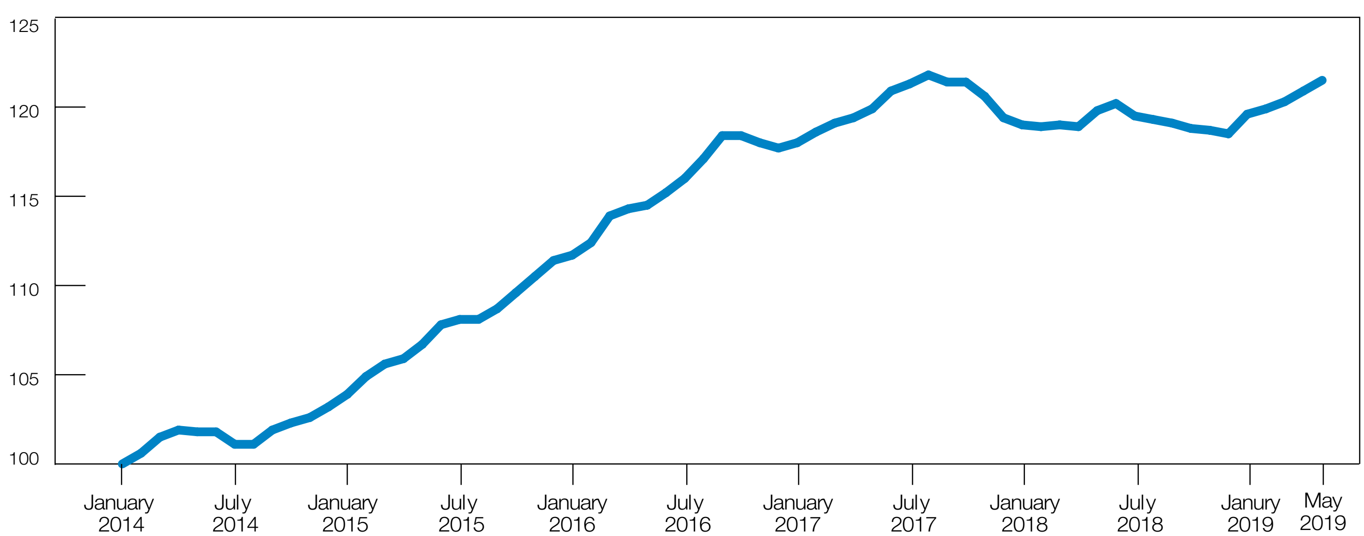
CPI Components



Source: Bank of Israel; Central Bureau of Statistics

Housing Prices

(January 2014 = 100)



Source: Bank of Israel

Other News

Candy Giant Mars to Build Tech Research Hub in Israel

Jerusalem Venture Partners (JVP) has joined forces with Mars, the $35 billion producer of M&Ms, Snickers, and Iams pet food to create a research and development center in Israel dedicated to scaling and commercializing tech solutions that would impact the global food system, from farming to nutrition. This is Mars' first venture in Israel, though the candy and pet food giant has recently launched similar centers in other parts of the world.

According to Erel Margalit, JVP Founder and Executive Chairman, the research center will give funds to Israeli startups and will also work with academic institutions, including the Hebrew University, the Weizmann Institute, The Technion, Migall, and Tel Hai. Early successes, reportedly, may get spun into new companies.

“A lot of times the innovation comes from the universities. It comes from younger people. It comes from small companies. You need people who are able to put things together. What we do is bring people together,” said Margalit.

— *Forbes*

https://www.forbes.com/sites/chloesorvino/2019/05/15/candy-giant-mars-will-build-a-food-tech-research-hub-in-israel-with-jerusalem-venture-partners/#6430e5db413a

Ford Motor Opens Research Center in Tel Aviv

Ford Motor opened a research center in Tel Aviv, joining other leading automakers and suppliers in the race to develop self-driving cars. The Tel Aviv lab will focus on technologies in connectivity, sensors, automated systems research, in-vehicle monitoring, and cyber security

With rapidly increasing development costs of autonomous and connected cars, Ford and other carmakers are seeking outside investors and alliances.

“No company can do it alone. We're going to need partnerships,” said Chairman Bill Ford during his recent visit to Israel. “Partnerships with big and medium companies and especially startups. The ecosystem of startups that I've seen here is just incredible.”

— *Reuters*

https://www.reuters.com/article/us-ford-motor-israel-idUSKCN1TD0SN

Salesforce to Buy Israel's ClickSoftware for $1.35 Billion

U.S. cloud- based service provider, Salesforce, has agreed to purchase U.S.-Israeli software developer ClickSoftware, for $1.35 billion in cash and shares, in a bid to accelerate growth of its cloud-based products to manage customer service operations.

ClickSoftware produces cloud-based field service management software, which tracks and manages technicians and employees who work outside office locations--for customers such as Bosch, Deutsche Telekom and Ericsson.

This marks the second major deal by Salesforce in Israel since July 2018 when it paid $850 million for Datorama, a cloud-based artificial marketing platform. The new acquisition would bring the number of employees at Salesforce in Israel to more than 600, said Elad Donsky, Vice President of Engineering of Salesforce Israel.

— *Reuters*

https://www.reuters.com/article/us-salesforce-com-m-a-clicksoftware/salesforce-to-buy-israels-clicksoftware-for-1-35-billion-idUSKCN1UY0R1

Via to Manage New York's School Bus System

Via, an on-demand transit provider that was founded in 2012 by two Israeli entrepreneurs, has been selected by the New York City Department of Education to manage its school bus system. The company will provide the city with an automated school bus routing system that will allow schools, parents, and students to track buses in real-time and receive updates on any changes to the service. Via's system will allow buses to adjust their routes to make flexible pick-up and drop-off stops. The largest school district in the U.S, the New York City Department of Education transports around 150,000 students on 9,000 bus routes every day.

Via currently operates transportation services in 50 locations in more than a dozen countries around the world, including Tel Aviv, Berlin, and Texas.

— *Ctech*

https://www.calcalistech.com/ctech/articles/0,7340,L-3768793,00.html

Other News

Israel's Delek Acquires Chevron's U.K. Oil Fields for $2 Billion

Delek Group Ltd. has agreed to buy North Sea oil and gas fields from Chevron Corp for about $2 billion. The purchase is part of the company's strategy to expand beyond the domestic market. Delek's Ithaca Energy unit will acquire Chevron's Central North Sea assets.

"We can't wait to get our hands on the steering wheel and really take it forward," said Ithaca Chief Executive Officer Les Thomas. "It makes us one of the largest producers in the U.K. sector and we think there is a lot of potential."

Delek will add about 500 people to its workforce, about 200 of whom will help operate the fields. The company has been seeking skilled workers to transform from a conglomerate with holdings in real estate and insurance into an international oil and gas company.

— *Bloomberg*

https://www.bloomberg.com/news/articles/2019-05-30/israel-s-delek-buys-chevron-north-sea-for-about-2-billion

Israel to Begin Exporting Gas to Egypt by November

Israel will begin natural gas exports to Egypt within four months, according to Energy Minister Yuval Steinitz. The flow will secure the start of a $15 billion export agreement between Israel's Delek Drilling and Texas-based partner Nobel Energy with an Egyptian counterpart. The deal, which was signed early last year will bring natural gas from Israel Israeli offshore fields, Tamar and Leviathan, into the Egyptian gas grid.

Minister Steinitz discussed the possibility of building an additional pipeline across the Mediterranean directly from Israeli and Cypriot gas platforms to LNG terminals in the Nile Delta and the feasibility of building a new on-land connection.

"It can be one line, it can be two lines, it can be one line taking gas both from Cyprus and Israel to Egypt," Minister Steinitz said.

— *Reuters*

https://www.reuters.com/article/egypt-israel-energy/update-2-israel-to-begin-gas-exports-to-egypt-within-four-months-minister-idUSL8N24P3LM

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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