Israel: A Resilient Global Economy

Israel's economy was ranked highest for its durability in the face of the global financial crisis by the IMD in its 2010 World Competitiveness Yearbook. The 2010 report also ranked the Bank of Israel highest among central banks for its efficient functioning, after receiving 8th place in 2009.

"Israel's economy has weathered extremely difficult periods in the past, even when government debt was more burdensome and the balance of payments more fragile... The government's ample access to credit is a crucial underpinning for the country's high ratings given its susceptibility to shocks." - Moody's

Strong Fundamentals Confront the Global Economic Slowdown

The world's three largest rating agencies, Moody's, Fitch, and Standard & Poor's, in a vote of confidence in the Israeli economy, maintained a high credit rating for Israel at a time when the economy's resilience was put to the test by both global financial pressures resulting from the credit crisis and geopolitical conflict. While Israel was not immune to the effects of the global credit crunch, as its main trading partners were hit by the crisis, the country's sound macroeconomic fundamentals and strict fiscal policy served as a buffer to dampen the impact of financial wobbles.

As a consequence of the macroeconomic strategy that Israel had adopted during the last two decades, together with the relatively conservative approach that was undertaken by the Israeli banking sector and the regulation carried out by the supervisor of banks, the Israeli economy was relatively well prepared to confront the challenges of the global crisis, including the prospects for economic slowdown.

The Israeli policy of removing barriers to trade in goods and to open capital movements has served the economy extremely well. Israel is committed to openness as a strategic approach, while recognizing the importance of financial sector regulation. The adoption of this strategy contributed significantly to Israel's economic growth and its increased economic efficiency.

Measures Aimed to Boost the Economy

To help safeguard the economy, Israel's Ministry of Finance, Ministry of Industry, Trade and Labor and the central bank implemented special initiatives including a creation of a pension safety net, an acceleration program, and a monetary program to help increase liquidity, create new jobs, protect private savings and promote continuous growth in Israel.

To help the economy deal with the effects of the global crisis, the Bank of Israel lowered the key lending rate to a record low of 0.50%; from late 2008 to early 2009 the central bank slashed lending rates by a cumulative 3.75%. The rate cuts, which were meant to support the economy by lowering the cost of credit and thereby contribute to financial stability and partially offset the downward pressure on prices, were in line with what central banks globally have done with their interest rates. As the Israeli market is heavily dependent on revenues from exports, the expansionary monetary policy also served to stabilize the Shekel relative to many of the globally weaker currencies to assist the competitiveness of Israeli products internationally. In August 2009, the Bank of Israel was the first central bank to start raising short-term lending rates again, in line with the continuous recovery of the Israeli economy and to maintain inflation within the range of 1% to 3%, which is defined as price stability. Israel's key lending rate stood at 1.5% in May 2010.

To help underpin the economy, the Bank of Israel also increased the level of foreign exchange reserves since March 2008 by purchasing about $100 million per business day with the aim of increasing reserves to between $40 billion and $44 billion.

Outstanding Economic Performance

Though Israel is a small country with limited resources, it stands out as one of the world's most competitive economies. In fact, The Swiss Institute for Management Development (IMD) ranked Israel 17th out of 58 of the world's most economically developed nations in its 2010 World Competitiveness Yearbook.

The country's market economy can be characterized as resilient, globally-oriented and technologically advanced. Over the last two decades, Israel has become famous for its high-tech capacity, particularly in telecommunications, information technology, electronics and life sciences. Its capacity for innovation coupled with a highly-educated, skilled workforce have played a key role in its rating as a high-tech center second only to Silicon Valley in California and Route 128 in the Boston area.

Despite the pressures of the global financial crisis, the Israeli economy continued to grow steadily in 2009. Gross domestic product grew 3.6% in the third quarter and 4.9% in the fourth quarter of 2009, while overall growth for 2009 reached 0.7%. The Israeli economy has grown 5 percent annually on average between 2005 and 2008. In purchasing-power-parity (PPP) terms, Israel's GDP per capita, which has averaged around $30,000 for the past couple of years, has been on par with other members of the Organization for Economic Cooperation and Development (OECD), which Israel joined in May 2010.

In fact, over the past 20 years, the country – with a population of only 7 million – was ranked as one of the world's five fastest growing emerging markets. As the Israeli stock market continued to surge in 2009 Israel was raised to developed-market status at MSCI Inc.

Responsible fiscal and monetary policies have accompanied reforms that have liberalized the economy, accelerated the process of privatization and made the economy more competitive.

The effectiveness of its fiscal and monetary policy is reflected in the Israeli economy's performance. Gross Public Debt as a percentage of GDP contracted from 102% in 2003 to 79.6% in 2009, while unemployment declined and price stability was maintained.

The growth has been fueled by a steady increase in exports and foreign investment. Foreigners continue to show their recognition of Israel's economic potential by increasing their investments in the country. Foreign direct investment in Israel was close to $10 billion in both 2008 and 2007, after reaching a record $14 billion in 2006.

Israel's Economic Indicators

Criteria	2006	2007	2008	2009
GDP (current prices, B$)	144	164.1	191.8	193.1
GDP Real Growth Rate (%)	5.2	5.4	4.0	0.7
GDP per Capita Growth Rate (%, Current Prices)	3.3	3.5	2.1	-1.1
GDP per Capita (thousands of $, based on purchasing power parity)	24,271	27,395	28,473	28,160
Exports of Goods & Services (B$)	62.6	71.2	80.4	70.4
Imports of Goods & Services (B$)	62.2	74.0	84.1	72.3
Unemployment Rate (%)	8.4	7.3	6.1	7.6
Inflation Rate (CPI, end of year)	0	3.4	3.8	3.9
Inward FDI (current prices in B$)	14.3	9.7	9.7	3.8
Current Account (% of GDP)	5.6	2.8	0.7	4.0

Sources: The Ministry of Finance (2010), Central Bureau of Statistics (2010)

Exports Lead the Way

Exports are the engine that drives the Israeli economy. Israel's trade deficit fell to $5.1 billion in 2009, the lowest level since 1990, and less than half of the trade deficit of $13.2 billion in 2008; exports amounted to 86% of imports in 2009. The share of industrial exports in 2009 grew to 83%, while the high-tech sector accounted for 51.4% of total industrial exports, maintaining Israel's position as one of the most technologically oriented markets in the world.

Though exports were weighed down by the effects of the credit crisis, they continued to be supported by an extensive network of international trade and economic agreements, and treaties for the avoidance of double taxation. Israel is integrated into the global economy through free trade area agreements with the NAFTA countries (the U.S., Canada and Mexico), the European Union, Mercosur, EFTA, Jordan and Turkey. It also cooperates with neighboring Egypt and Jordan through US-sponsored Qualified Industrial Zone (QIZ) agreements, giving co-produced goods preferential access to U.S. markets; a similar arrangement of accumulation of origin also exists with the EU and is already operational with Jordan.

In addition, Israel has developed an extensive network of technical cooperation, through R&D accords with many countries.

The Way Out of The Crisis: An Ecosystem of Support

Through government agencies like the Office of the Chief Scientist at the Ministry of Industry, Trade and Labor, a network of technology incubators for very-early-stage technologies and an active and alert private venture capital system, Israel provides extensive support for new ideas and technologies, and assists the refinement and further development of more traditional industries. Israel invests strongly in R&D, where its investment of 4.8% of GDP is one of the highest in the world. The investor-friendly environment is enhanced by government policies including lower tax rates and investment benefits.

It's hard to ignore the important role of Israel's venture capital industry, which the World Economic Forum has ranked second in the world after the U.S. Venture capital continues to pump a steady stream of essential financial resources into the technology sector by channeling its funds and knowledge into early-stage companies.

This ecosystem of support has fostered what has become the world's highest percentage of high-tech production relative to GDP, and the second highest concentration of high-tech companies, after California's Silicon Valley. The fact that Israel is the foreign country with the most companies listed on NASDAQ, the main stock exchange for technology companies, is testimony to its high-tech prowess.

The Investors Keep Coming

In recent years, Israel has become a magnet for foreign investors. The list of those who have taken advantage of Israel's uniquely skilled, and highly educated workforce and cutting-edge R&D capabilities by establishing subsidiaries, production lines or R&D centers include top international companies like Intel, Microsoft, Motorola, Google, Applied Materials, HP, Deutsche Telekom, and Samsung among others. Given Israel's emphasis on innovative technologies and research, Israeli companies continue to attract foreign investors. Despite the global credit crisis multinational concerns continue to invest in Israeli expertise. Global demand for breakthrough technologies in the field of life sciences is expected to be less affected by the slowdown, due to the long R&D processes required in this field, and the culmination of patent licenses for some popular medicines in upcoming years. Hence, analysts expect the Israeli sector to be largely safeguarded from financial pressures. Since late 2009, multinational companies have been acquiring Israeli companies from all different sectors. Among others, Siemens bought Solel Solar Systems for $418 million, Telefonica O2 UK bought Jajah Technologies for $207 million, Broadcom Corp acquired Dune Networks for $178 million, IBM bought Guardium for $225 million, and Roche Holding bought Medingo for $160 million.