

Israel Business Forecast Report Q2 2014

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Abstracts

Core Views

Political risks remain elevated, despite a reduced likelihood of an attack on Iran and Syria. In particular, spillover effects from the civil war in neighbouring Syria remain high, and investor confidence may be tempered as a result.

We project real GDP growth in Israel to come in at 3.2% in 2014 and 3.5% in 2015, from estimated growth of 3.3% in 2013. Despite the beginning of natural gas production in the Tamar gas field in H113, the economy will remain in a soft patch, with fiscal austerity hitting consumer demand in 2014.

Major Forecast Changes

We project consumer price inflation (CPI) averaging 1.6% and 1.9% in 2014 and 2015 respectively, from 1.5% in 2013. Relatively modest inflationary pressure will allow the Bank of Israel (BoI) to keep interest rates low, which we forecast to come in at 0.50% at end-2014, from our previous forecast of 0.75%.

Key Risks To Outlook

House prices in Israel have risen rapidly in recent years, raising concerns that a bubble has formed in the property market. However, an increase in supply, coupled with macroprudential measures on the part of the government designed to bring down prices, have seen the market cooling in the past quarters. As a result, a sharp drop in prices is unlikely at this stage.

A sharper-than-expected downturn in the global economy would hit Israel's economy badly. Exports have already been hit by stagnant demand in Europe and the US, and

lower-than-expected growth in those markets would see the outlook for exports deteriorating even further.

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Reform Of Exemption Law Boding Well For Economy

We expect a proposal by the Israeli government to gradually increase the participation of ultra-Orthodox men in the military force will be passed by the Knesset. Such reform will sideline ultra-Orthodox parties over the coming years, and positively impact the economy over the longer term.

Table: Political Overview

Long-Term Political Outlook

Will Long-Lasting Peace Be Achieved?

Over the next decade, Israel will continue to face external security threats from militant groups Hamas and Iran-backed Hizbullah. Downside risks to stability stem from the potential for renewed conflict with Hizbullah across Israel's northern border, although any peace settlement with the Palestinians would pose upside risks.

CHAPTER 2: ECONOMIC OUTLOOK

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Medium-Term Outlook Encouraging

We forecast real GDP growth in Israel of 3.2% and 3.5% in 2014 and 2015 respectively. The domestic economy will remain in a soft patch, while accelerating growth in the eurozone and the US will lead to an improvement in net exports. Increasing exports underpin our relatively bullish medium-term outlook for the economy.

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Budget Deficit Gradually Narrowing

The Israeli government's commitment to fiscal consolidation will lead to a gradual

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Table: FISCAL POLICY

Monetary Policy

Another Cut Likely In 2015

Following the Bank of Israel's 25 basis points cut to benchmark interest rates to 0.75 % on February 24, we forecast interest rates coming in at 0.5 0% at end-2014.

Accelerating growth in the economy and increasing price pressures will lead to a reversal in the central bank's dovish policy stance in 2015, with interest rates coming in at 0.75% by the end of next year.

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Total Assets Back To Growth In 2014

Total assets in the Israeli banking sector will return to growth in 2014, largely as a result of low base effects. That said, a combination of low interest rates, a stricter regulatory framework and slack growth in the economy will ensure that profitability will remain relatively modest despite positive Q313 results.

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Unemployment Rate To Increase Further

We see the job supply stagnating in 2014, while the supply of labour will increase over the coming quarters. We forecast the unemployment rate in Israel to average 6.7% and 6.5% in 2014 and 2015 respectively, compared to 6.4% in 2013.

Economic Activity II

Manufacturing Activity Increasing Mildly In 2014

Although Israel's Bank Hapoalim Purchasing Managers' Index could cross the 50.0 level in 2014, it is unlikely to remain consistently above such a threshold, indicating sluggish expansion in the manufacturing sector.

Economic Activity III

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We expect consumer confidence to remain modest in 2014, suggesting slow expansion of private consumption over the coming quarters.

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