

Israel Business Forecast Report Q3 2014

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Abstracts

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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 3.6% in 2015, from growth of 3.3% in 2013. The economy will remain in a soft patch this year, with fiscal austerity hitting consumer demand and export growth only modestly accelerating.

Major Forecast Changes

We believe that the Israeli shekel will gradually appreciate in 2015, a result of significant inflows of foreign exchange in the form of investment and payments by international gas companies, improvements in Israel's trade position and a reversal of the central bank's dovish monetary policy. We project the Israeli shekel to average ILS3.5000/ USD and ILS3.4000/USD in 2014 and 2015, respectively, from previous forecasts of ILS3.5400/USD this year and ILS3.600/USD the next.

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BMI Political Risk Ratings

Domestic Politics

Failure of Talks Intensifies Diplomatic Isolation

Israel will feel increasingly isolated on the international stage following the failure of peace talks with the Palestinians. While not irreparably damaged, relations with the United States will remain strained over the coming years.

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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Growth To Improve In 2015

We forecast real GDP growth in Israel of 3.2% and 3.6% in 2014 and 2015, respectively, from 3.3% in 2013. Slow growth in private consumption will depress economic expansion this year. However, a moderation of austerity policies and increasing exports underpin our relatively bullish medium-term outlook for the economy.

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The Bank of Israel will cut key interest rates by 25 basis points to 0.50% by the end of 2014 on the back of low inflation and sluggish economic growth. A reversal of these trends will lead the central bank to abandon its dovish monetary policy stance in 2015, and we

forecast interest rates to rise to 0.75% by the end of the year.

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ILS: Gradual Appreciation In 2015

We believe that the Israeli shekel will gradually appreciate in 2015, a result of significant inflows of foreign exchange in the form of investment and payments by international gas companies, improvements in Israel's trade position and a reversal of the central bank's dovish monetary policy. We project the Israeli shekel to average ILS3.5000/USD and ILS3.4000/USD in 2014 and 2015, respectively.

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Limited Profitability Amidst Stricter Regulation

A combination of low interest rates, stricter regulations and slack growth in the economy will ensure that profitability in the Israeli banking sector remains low in 2014. A robust regulatory framework will ensure that risks to stability in the segment will be minimal over the coming quarters.

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