

# Israel Business Forecast Report Q4 2013

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## Abstracts

### Core Views

Political risks remain elevated, with potential for an US military attack on Syria increasing risks of spill over effects. Investors' risk appetite may be tempered as a result.

We project consumer price inflation (CPI) averaging 1.9% and 2.3% in 2013 and 2014, respectively, from 1.7% in 2012. Relatively modest inflationary pressure will allow the Bank of Israel (BoI) to keep interest rates low, which we forecast to come in at 1.00% at end-2013 and 0.75% at end-2014.

### Major Forecast Changes

We project real GDP growth in Israel to come in at 3.5% in 2013 and 3.2% in 2014, respectively, down from our previous forecasts of 3.7% this year and 3.8% in the next. Despite the beginning of natural gas production in the Tamar gas field in H113, the economy will remain in a soft patch, with export growth remaining slack as a result of slow growth in key export markets, while fiscal austerity will hit consumer demand in H213 and 2014.

### 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 a further slowdown in external demand would see the outlook for exports deteriorating even further.

## Contents

### EXECUTIVE SUMMARY

### CORE VIEWS

### MAJOR FORECAST CHANGES

Key Risks To Outlook

### CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Political Risk Analysis

Peace Talks To Remain Constrained By Political Realities

Israeli-Palestinian peace talks resumed on August 14 after three years of suspension, yet cracks in the facade have quickly emerged. We retain our view that despite ongoing efforts by US Secretary of State John Kerry, the current political configuration in Israel, combined with the increasing fragmentation of the Palestinian Authority, will hinder any progress in negotiations.

TABLE: ISRAEL 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

SWOT Analysis

BMI Economic Risk Ratings

Economic Activity I

Sluggish Growth In 2013 and 2014

We project real GDP growth in Israel of 3.5% and 3.2% in 2013 and 2014, respectively. The domestic economy will remain in a soft patch, with austerity measures hitting private consumption, while weak growth in export markets will hinder the country's external position. Risks to the outlook are lying firmly to the downside as a result of the

potential for an escalation of the civil war in neighbouring Syria.

#### TABLE: ECONOMIC ACTIVITY

##### Monetary policy

##### Dovish Monetary Policy To Continue

Uncertainty surrounding the appointment of Israel's new central bank governor will not fundamentally change the Bol's dovish monetary policy stance. We forecast interest rates in Israel coming in at 1.0% in 2013 and 0.75% in 2014, before increasing gradually from 2015 onward.

#### TABLE: INFLATION

##### Banking Sector

##### Profitability To Remain Modest

Profitability in the Israeli banking sector will be modest in 2013, as deposit growth declines while banks will have to deal with stricter regulations. That said, underlying threats to stability will remain minimal.

#### TABLE: BANKING SECTOR ASSETS, LOCAL CURRENCY TERMS

##### Economic Activity II

##### Chart Of Day: Unemployment Rate Increasing In H213

We expect the joblessness rate in Israel, which came in at 6.9% in May, to gradually increase over the coming quarters. We forecast unemployment to average 6.9% and 7.0% in 2013 and 2014, respectively, compared to 6.7% in 2012.

##### Economic Activity III

##### Chart Of Day: Consumer Confidence Unlikely To Decline Further

After falling 8.5% in year-on-year terms in June, we expect Israel's Bank Hapoalim consumer confidence index is unlikely to decline much further. That said, consumer confidence will remain weak over the coming quarters.

##### Economic Activity IV

##### Chart Of Day: PMI To Fall Below

Israel's Bank Hapoalim Purchasing Managers' Index (PMI), which measures activity in the manufacturing sector, fell by 1 point to 50.8 in April. While manufacturing activity will remain above 2012 levels, when PMI averaged 43.6, the index is unlikely to remain above the 50 level which separates expansion from contraction in 2013.

## CHAPTER 3: 10-YEAR FORECAST

### Long-Term Outlook Slow But Steady

We are forecasting steady, if unspectacular, growth for the increasingly developed Israeli economy over the long term. As ever, political risks pose downside risks to our GDP growth forecasts.

#### TABLE: LONG-TERM MACROECONOMIC FORECASTS

## **CHAPTER 4: BUSINESS ENVIRONMENT**

SWOT Analysis

BMI Business Environment Risk Ratings

Business Environment Outlook

Institutions

TABLE: BMI BUSINESS AND OPERATION RISK RATINGS

TABLE: BMI LEGAL FRAMEWORK RATING

Infrastructure

Market Orientation

TABLE: LABOUR FORCE QUALITY

TABLE: MENA – ANNUAL FDI INFLOWS

TABLE: TRADE AND INVESTMENT RATINGS

Operational Risk

TABLE: TOP EXPORT DESTINATIONS

## **CHAPTER 5: KEY SECTORS**

Pharmaceuticals

TABLE: PRESCRIPTION DRUG MARKET INDICATORS, HISTORICAL DATA AND FORECASTS

TABLE: PATENTED DRUG MARKET INDICATORS, HISTORICAL DATA AND FORECASTS

TABLE: GENERIC DRUGS MARKET INDICATORS, HISTORICAL DATA AND FORECASTS

TABLE: OVER-THE-COUNTER (OTC) MEDICINE MARKET INDICATORS, HISTORICAL DATA AND FORECASTS

Telecommunications

TABLE: INTERNET DATA AND FORECASTS, 2010-2017

TABLE: FIXED-LINE DATA AND FORECASTS, 2010-2017

TABLE: MOBILE DATA AND FORECASTS, 2010-2017

TABLE: TELECOMS SECTOR – ARPU – HISTORICAL DATA & FORECASTS

Other Key Sectors

TABLE: OIL AND GAS SECTOR KEY INDICATORS

TABLE: INFRASTRUCTURE SECTOR KEY INDICATORS

TABLE: AUTOS SECTOR KEY INDICATORS

TABLE: FREIGHT KEY INDICATORS

TABLE: FOOD AND DRINK SECTOR KEY INDICATORS

## **CHAPTER 6: BMI GLOBAL ASSUMPTIONS**

Global Outlook

Lowering EM Growth Forecasts

TABLE: GLOBAL ASSUMPTIONS

TABLE: DEVELOPED STATES, REAL GDP GROWTH, %

TABLE: BMI VERSUS BLOOMBERG CONSENSUS REAL GDP GROWTH  
FORECASTS, %

TABLE: EMERGING MARKETS, REAL GDP GROWTH, %

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