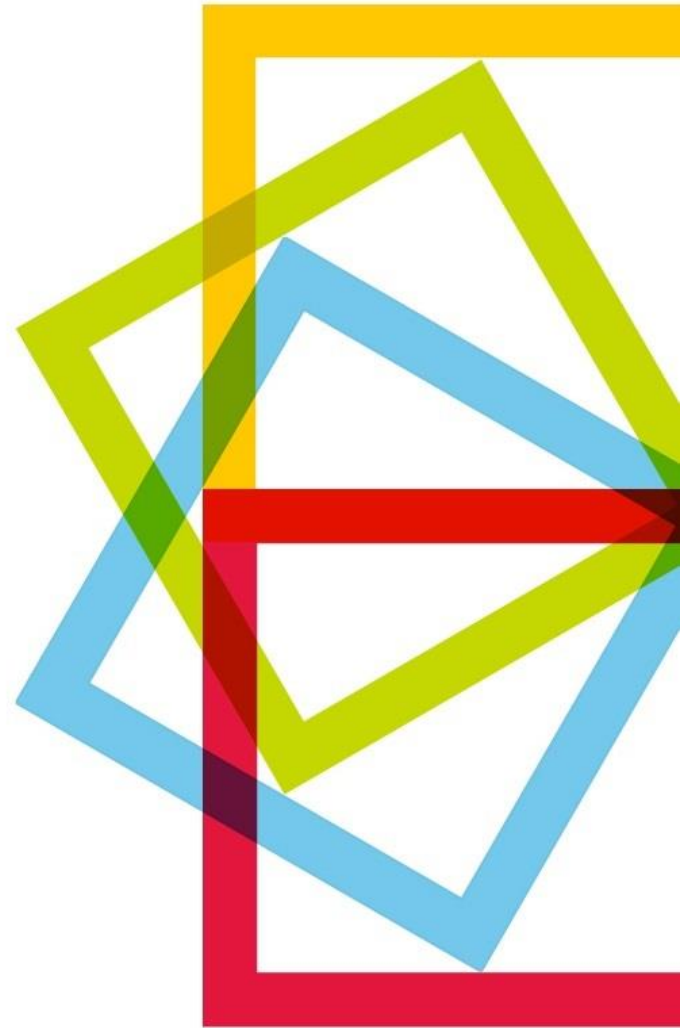


Israel's A+ Sovereign Rating

Structural Challenges Ahead

**Moritz Kraemer
Chief Rating Officer**

Tel Aviv, April 30, 2014



Agenda

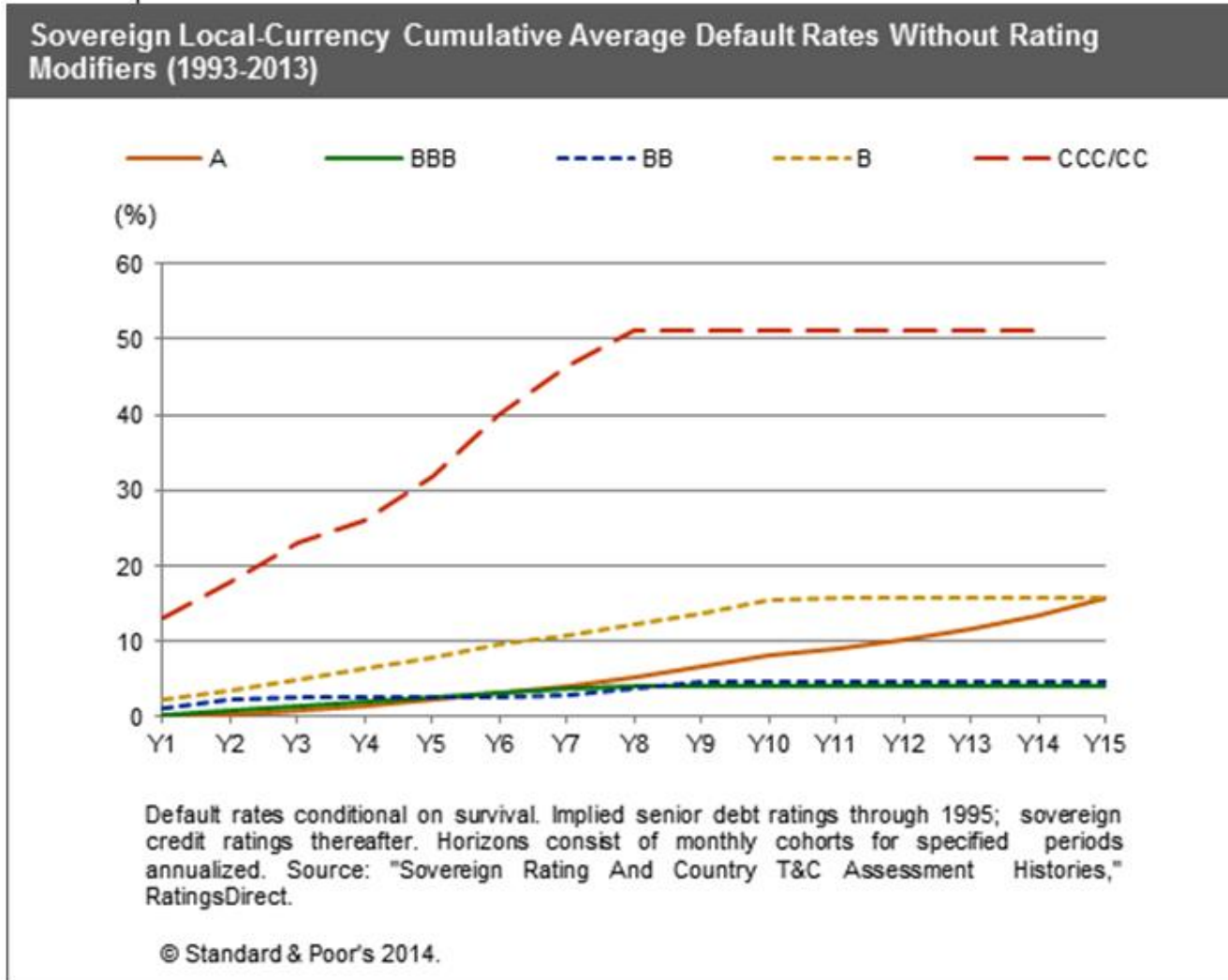
- 1. Israel in Sovereign Rating Context**
- 2. Israel's Performance – viewed from S&P criteria**
- 3. Now for the Hard Part – Future Challenges**

Key Messages

1. Double upgrade (2007, 2011) reflects **absolute and relative** boost to Israel's sovereign creditworthiness, driven by 3 trends: high economic growth/wealth; external surpluses and public debt reduction.
2. ***Now for the Hard Part***: future upgrades would require remaining weaknesses in governance framework, geopolitical context and public finances.
3. And success breeds **new risks**: asset bubbles, capital inflows and currency appreciation can derail stability and limit monetary flexibility

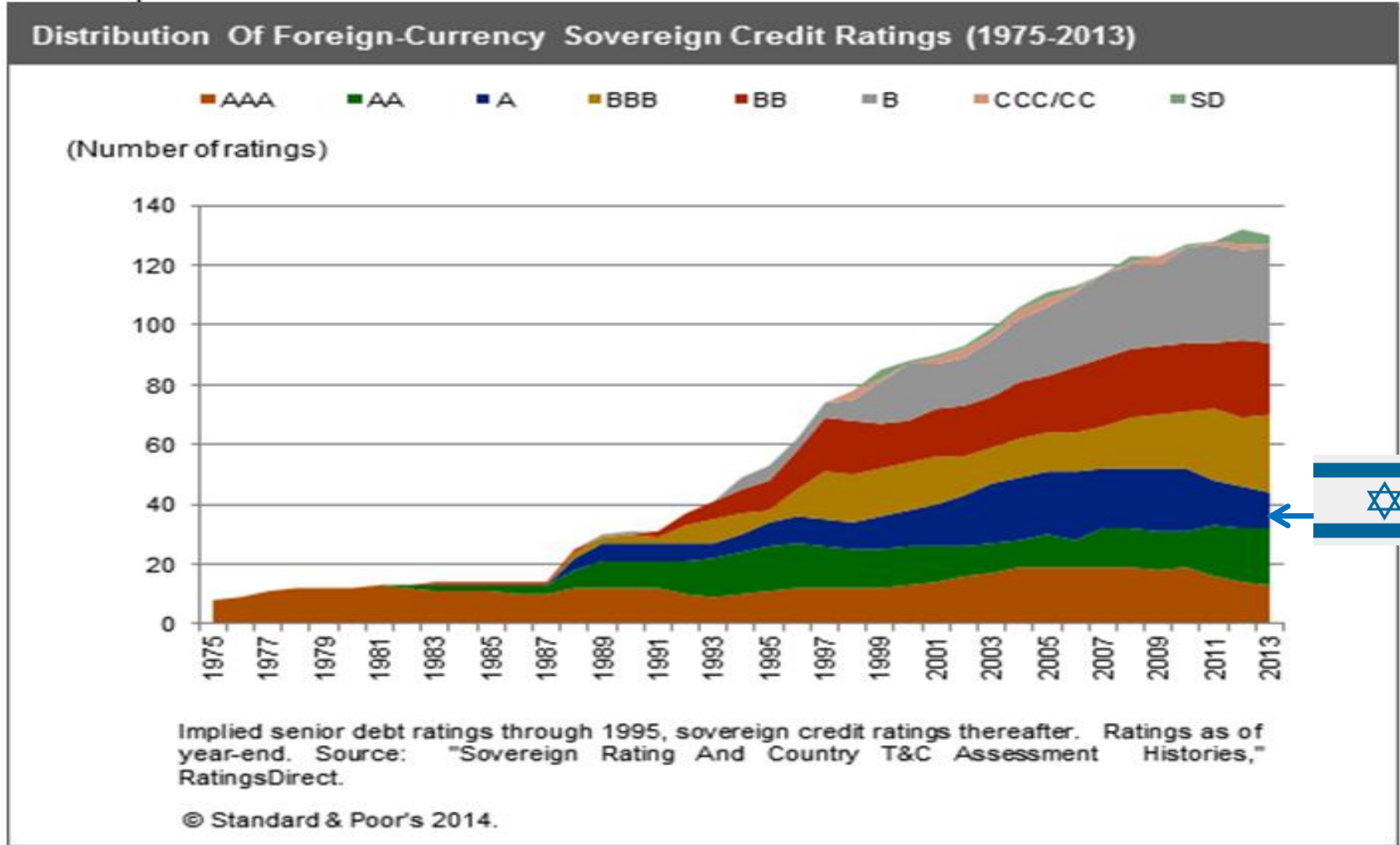
Israel in Sovereign Rating Context

Ratings as a forward looking opinion on likelihood of default



Source: Sovereign Defaults And Rating Transitions Data, 2013 Update, RatingsDirect. April 18, 2014.

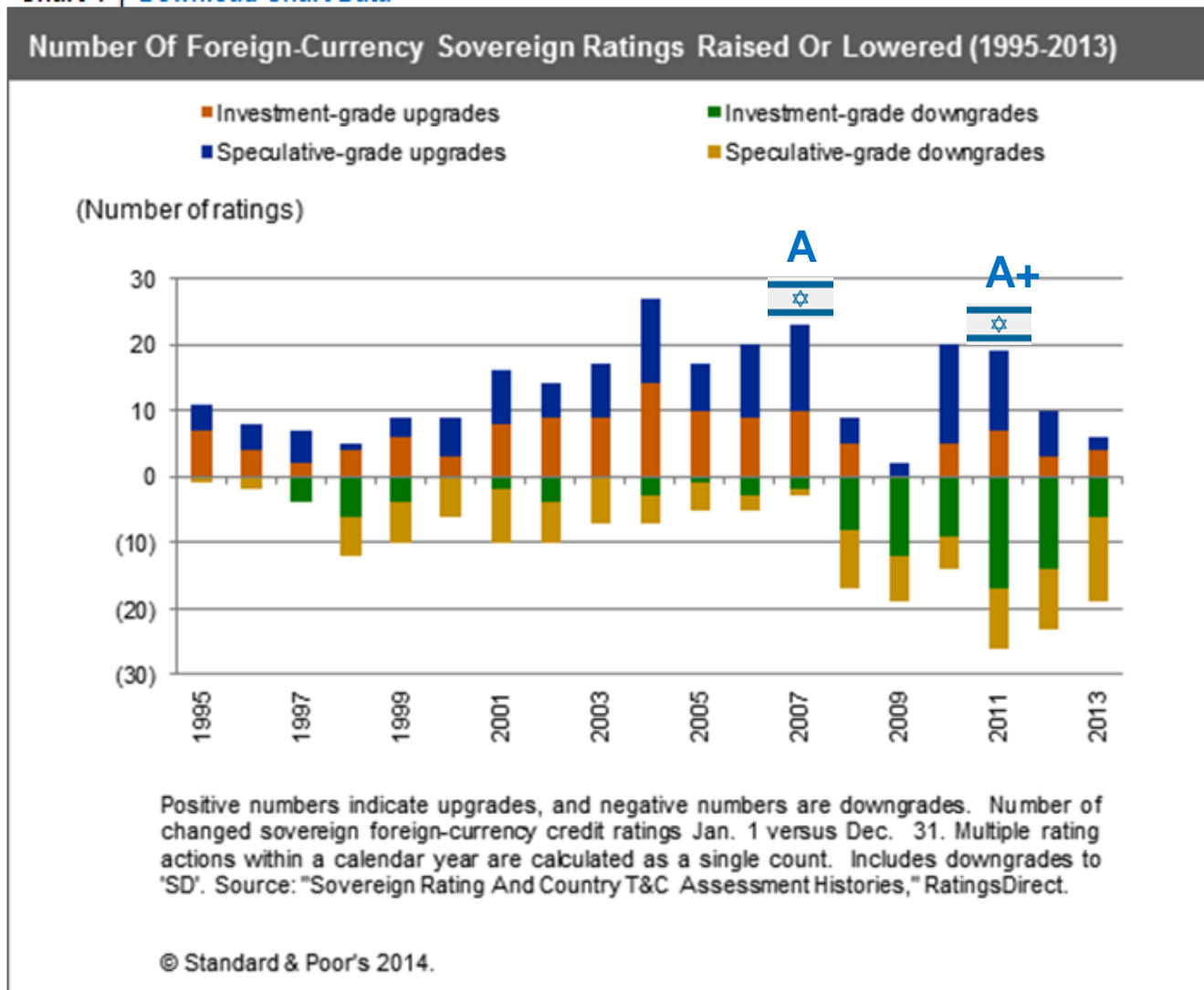
Sovereign Ratings: Growth and Distribution Trends



Implied senior debt ratings through 1995; sovereign credit ratings thereafter.

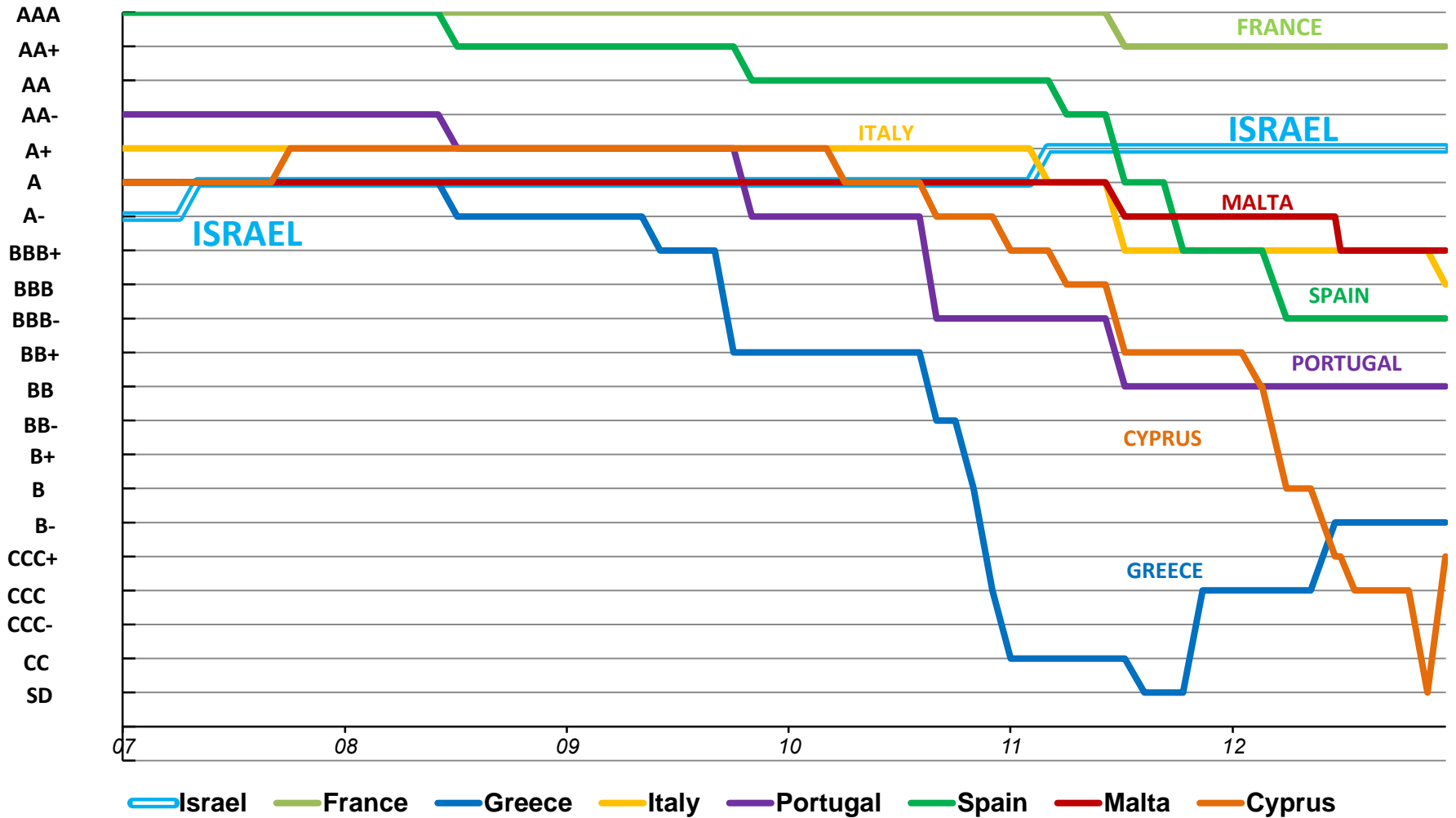
Source: Sovereign Defaults And Rating Transitions Data, 2013 Update, RatingsDirect. April 18, 2014.

Sovereign Ratings: Growth and Distribution Trends



Source: Sovereign Defaults And Rating Transitions Data, 2013 Update, RatingsDirect. April 18, 2014.

From lowest to 2nd highest Euromed rating

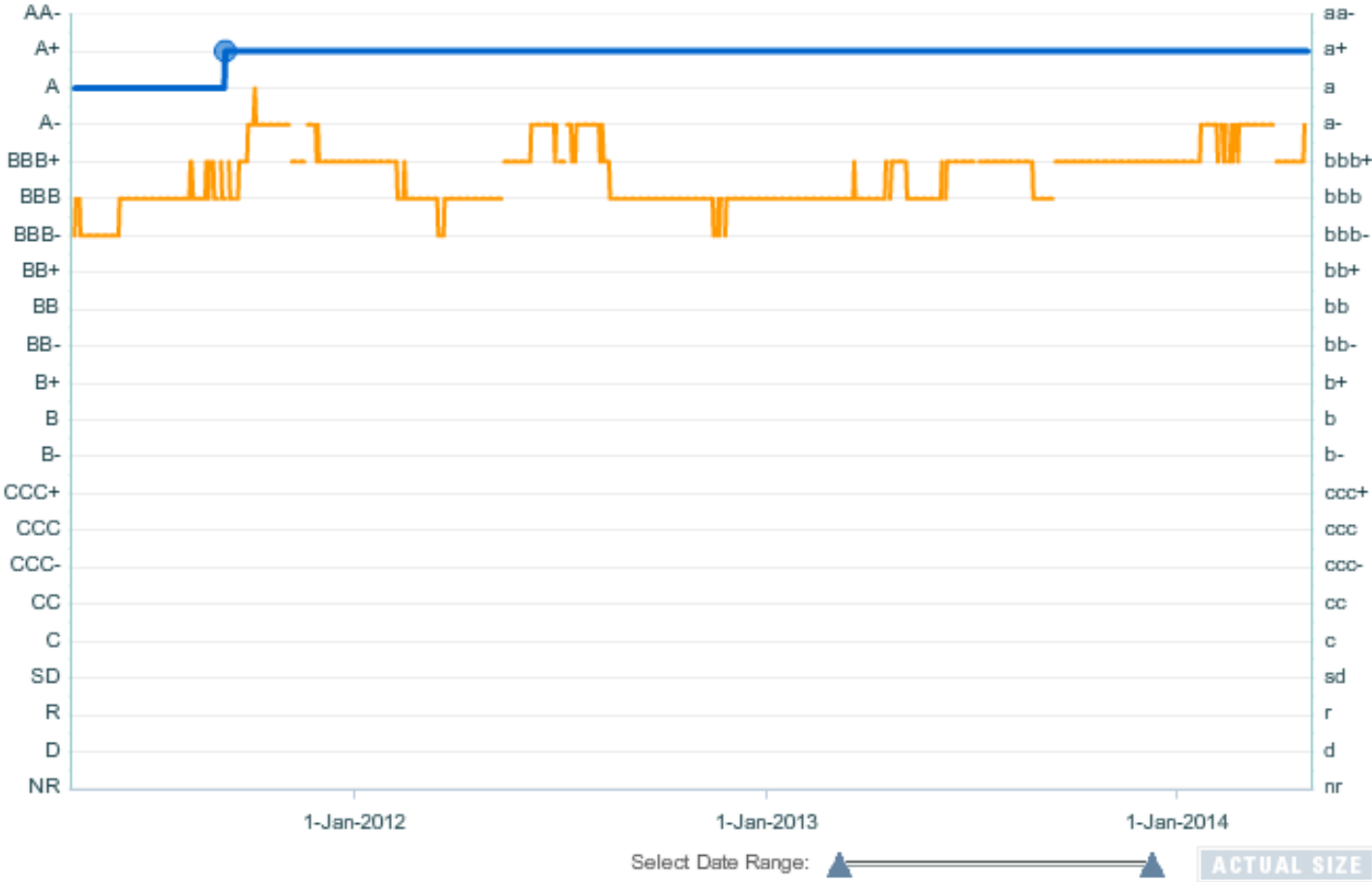


Source: Standard&Poor's

Israel: S&P Rating v. CDS Implied Ratings

Ratings and Indicator Trendlines

■ ICR-Foreign Currency LT
 ■ MDS
 ● CWOL Action

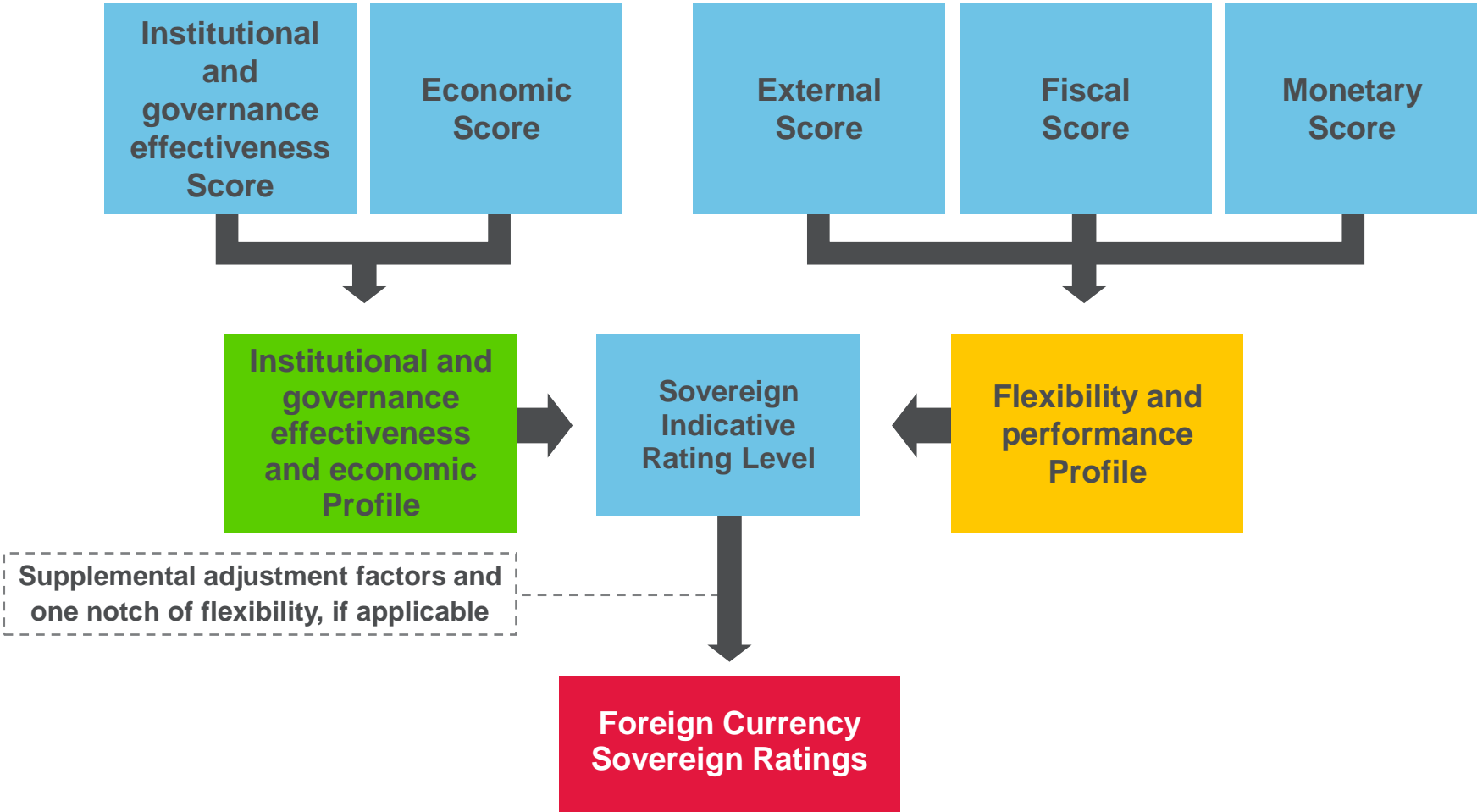


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Israel's Performance by S&P Sovereign Criteria

Framework for Sovereign Foreign Currency Ratings



Five Scores: #1 Institutional And Governance Effectiveness

Based on the qualitative analysis of the following factors :

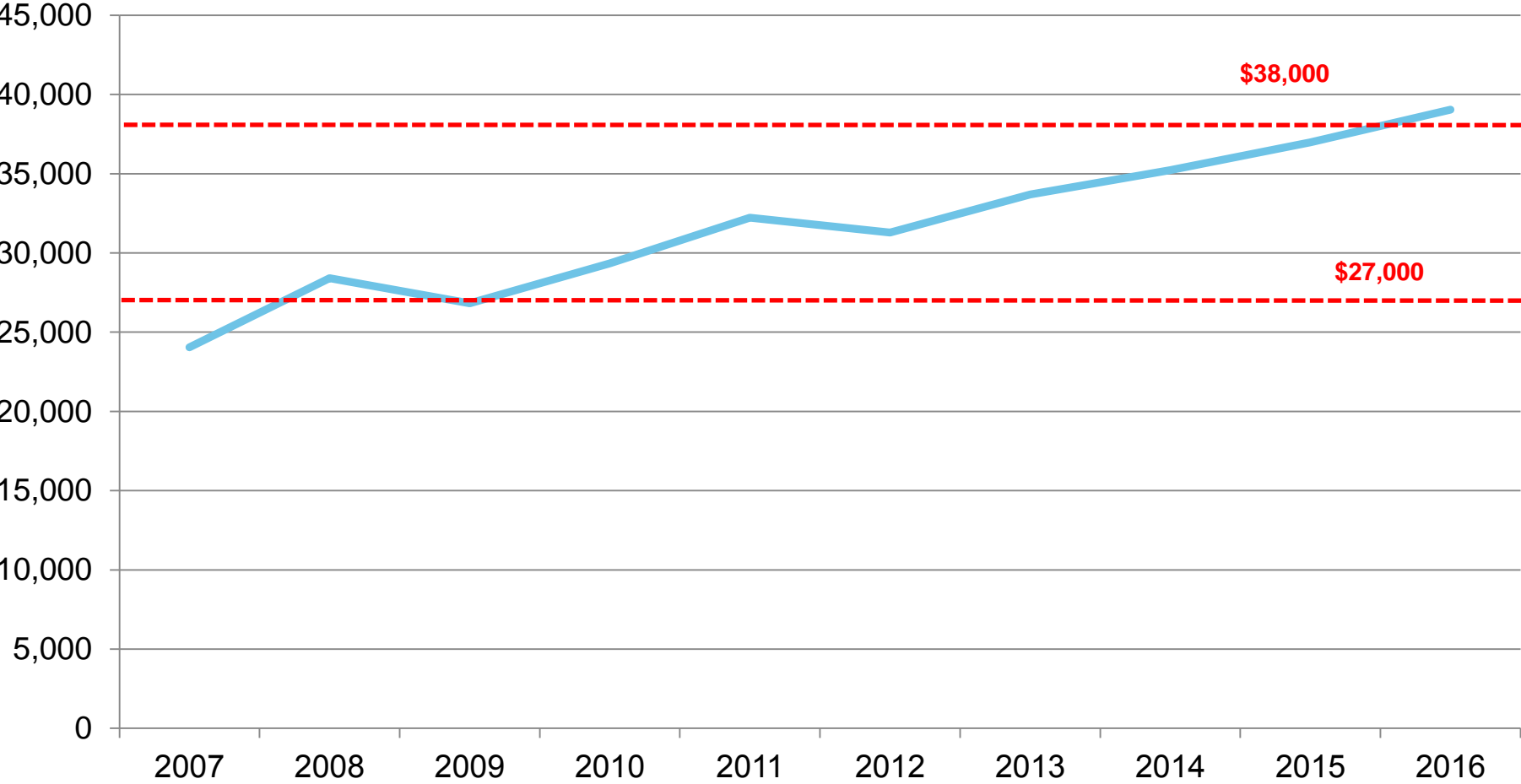
- The effectiveness, stability, and predictability of policymaking, political institutions, and civil society
- The transparency and accountability of institutions, data, and processes
- The sovereign's debt payment culture
- Impact of external and domestic security risks



Israel: performance broadly flat – low end of OECD club, but security impact makes overall ranking even lower

Israel is now a wealthy country...

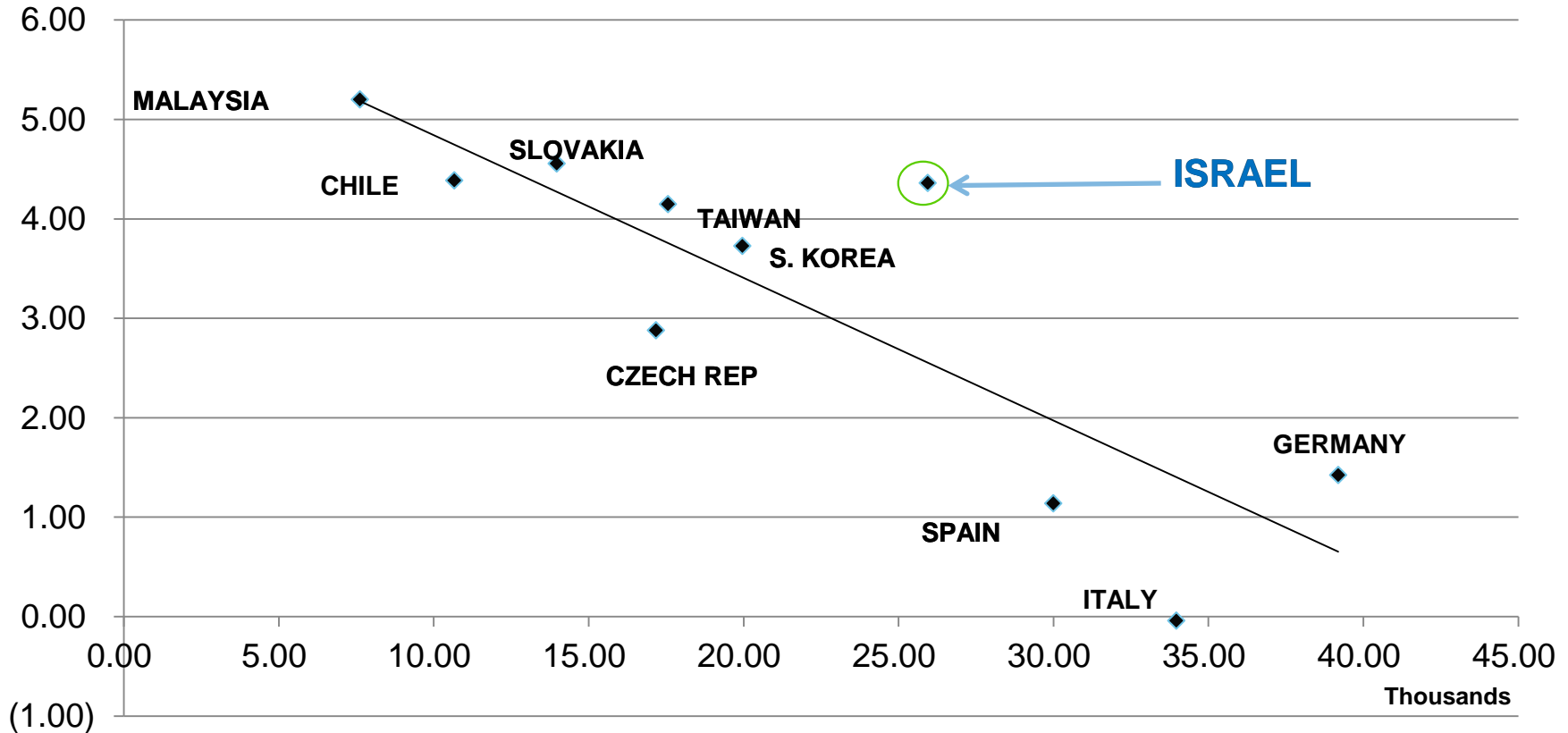
GDP per capita in Israel (US \$)



Source: Standard&Poor's

...but is still growing like middle-income

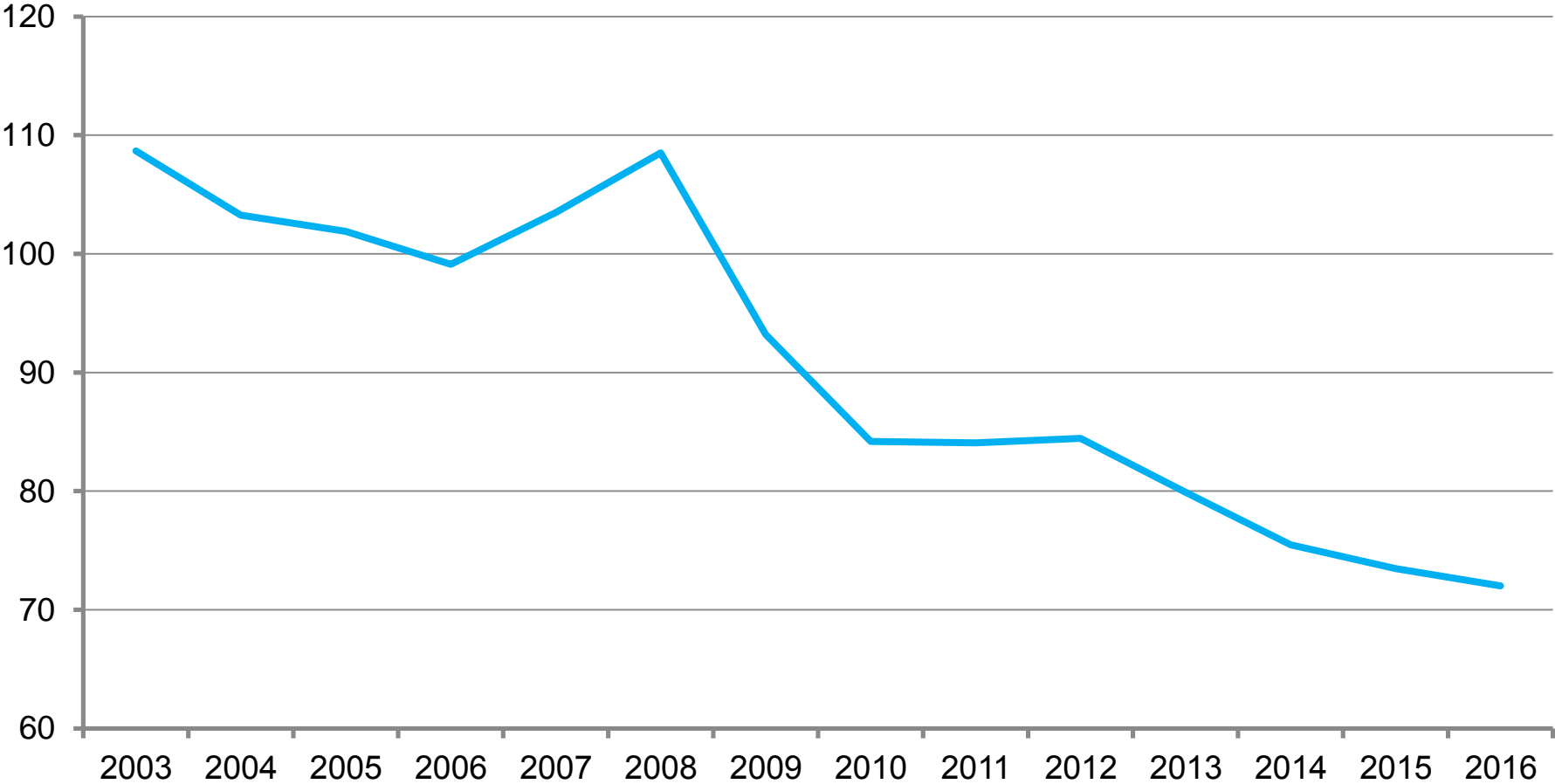
GDP growth relative to GDP per capita



Source: Standard&Poor's

External financing needs shrinking rapidly and...

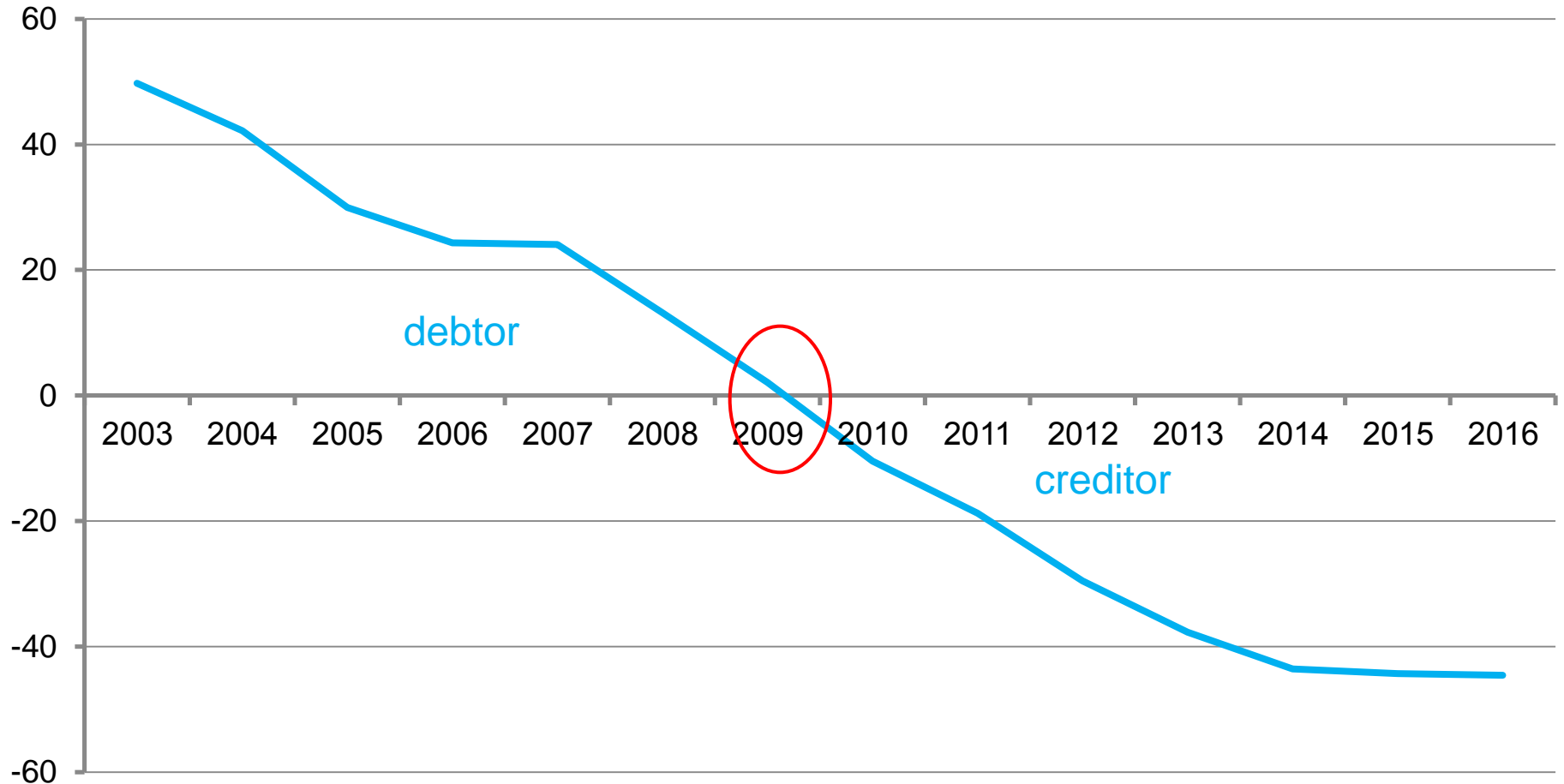
Israel: Gross external financing needs / usable reserves + current account receipts (%)



Source: Standard&Poor's

... Israel is now an external creditor

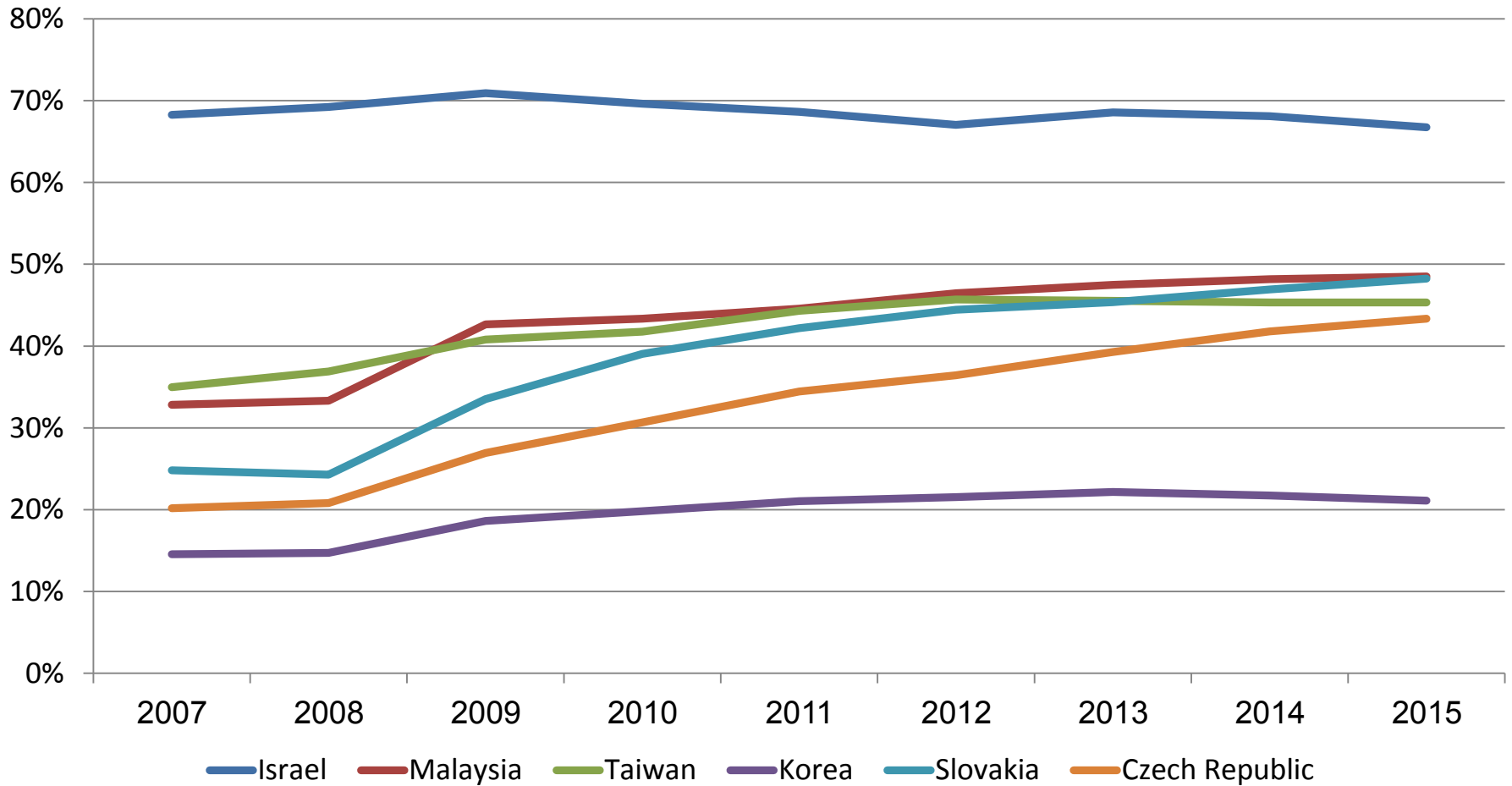
Narrow net external debt / current account receipts (%)



Source: Standard&Poor's

Debt burden far worse than any peers...

Net General Government Debt as % of GDP



Source: Standard&Poor's

S&P Views **Event Risk** as **High** for Israel

Geopolitical risks of fallout from:

1. Conflict with Palestinians in West Bank / Gaza
2. War with Hezbollah
3. Spill-over violence from Syria
4. Lawlessness in Sinai / Chaos in Egypt
5. Iran (mainly through impact on 1-4)

Future Challenges

Structural Challenges

- **Raise labour participation rate**
 - Despite improvements still some 10%points below G7 avg. And 8%pints below OECD avg.
- **Improve business environment**
- **Governance indicators of peers are improving, while Israel's stagnate on high level.**
- **Currency appreciation pressure**
- **Avoid property market overheating in order to maintain financial stability**

Areas relevant to doing business

<i>Ease of Doing Business</i>	<i>Israel</i>	<i>Comments</i>
Overall Rank	38	
Registering Property	144	Duration way longer than average
Dealing with Construction Permits	139	Complexity and duration
Enforcing Contracts	94	Slow speed of legal system
Getting Electricity	91	Complexity and duration
Paying Taxes	82	Not tax rate, but administrative burden
Resolving Insolvency	47	
Starting a Business	41	
Getting Credit	12	
Trading Across Borders	10	
Protecting Investors	6	

Source: World Bank Report: Doing Business 2013

Gap opening between world-class innovation and mediocre / bifurcated education system

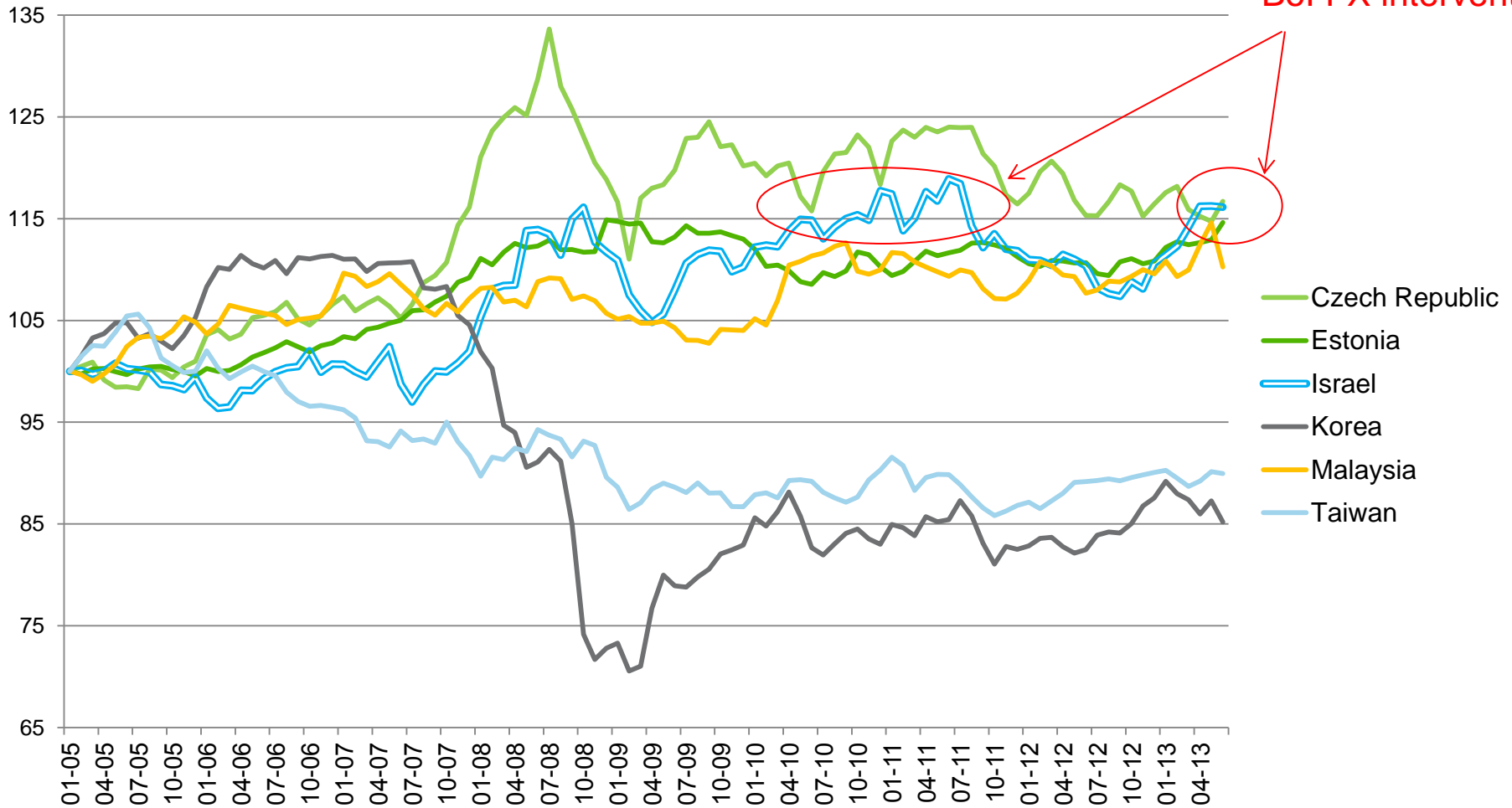
	Indicator	Rank
Innovation	Quality of scientific research institutions,	1
	PCT patents, applications/million pop.	4
	Capacity for innovation,	6
	Company spending on R&D,	6
	Gov't procurement of advanced tech products,	6
	University-industry collaboration in R&D,	8
	Availability of scientists and engineers,	9
Education	Secondary education enrollment, gross %	23
	Quantity of education,	27
	Higher education and training,	28
	Tertiary education enrollment, gross %	28
	Internet access in schools,	39
	Primary education enrollment, net %	40
	Quality of management schools,	40
	Quality of education,	47
	Quality of the educational system,	53
	Primary education,	56
	Quality of primary education,	71
	Higher ed quality of math and science	89

Israel remains clear #1 in R&D expenditure as % of GDP (4.4% vs runner-ups 3.3 - 3.8% for Nordics & Korea)

Source: WEF Competitiveness Report 2013

External & Monetary: Currency appreciation provokes FX intervention

REER (since 2005)



Source: Bank for International Settlements

ILS not affected by EM concerns

xe USD per 1 ILS

INV

ILS/USD close:0.28762, low:0.26953, high:0.28994

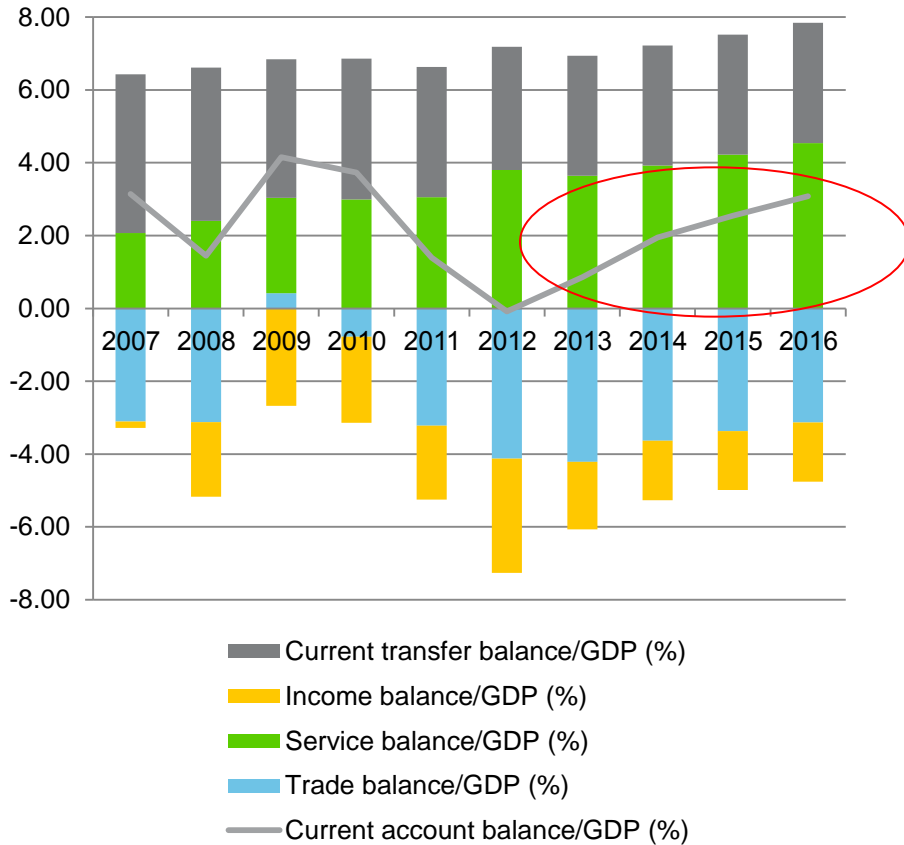
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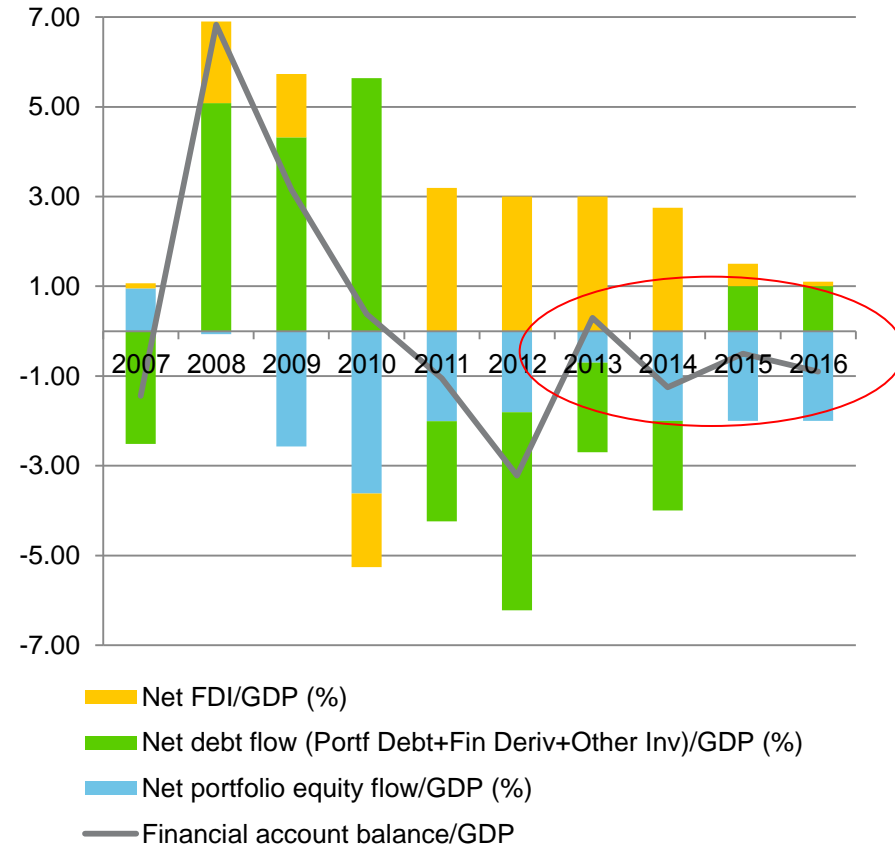
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External: Current account surpluses – especially with future natural gas - should lead to net financial outflows...

Israel Current Account



Israel Financial Account

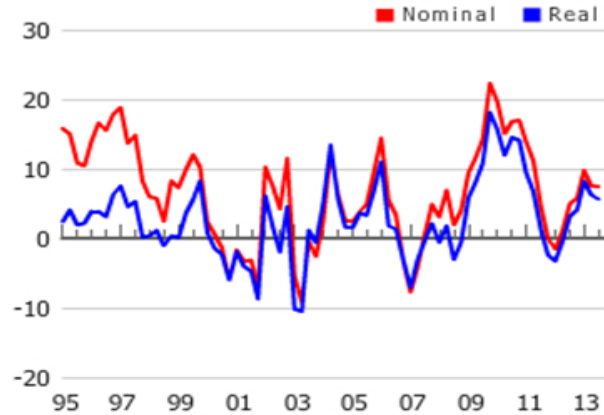


Source: Standard&Poor's

...or money flows into domestic property?

House price change

% change over a year earlier



	Q1	Q2	Q3	Q4
2013	3.00	-1.29	2.39	
2012	-0.63	2.48	-0.40	-1.03
2011	2.71	-0.83	-1.25	-1.78
2010	5.50	1.63	4.75	4.21
2009	7.83	5.70	3.22	4.00
2008	2.55	3.78	0.71	-2.88
2007	4.38	0.00	5.67	-4.88
2006	9.55	-3.65	0.68	-8.87
2005	4.87	4.56	2.73	-2.73

% change over a quarter

Source: Central Bureau of Statistics

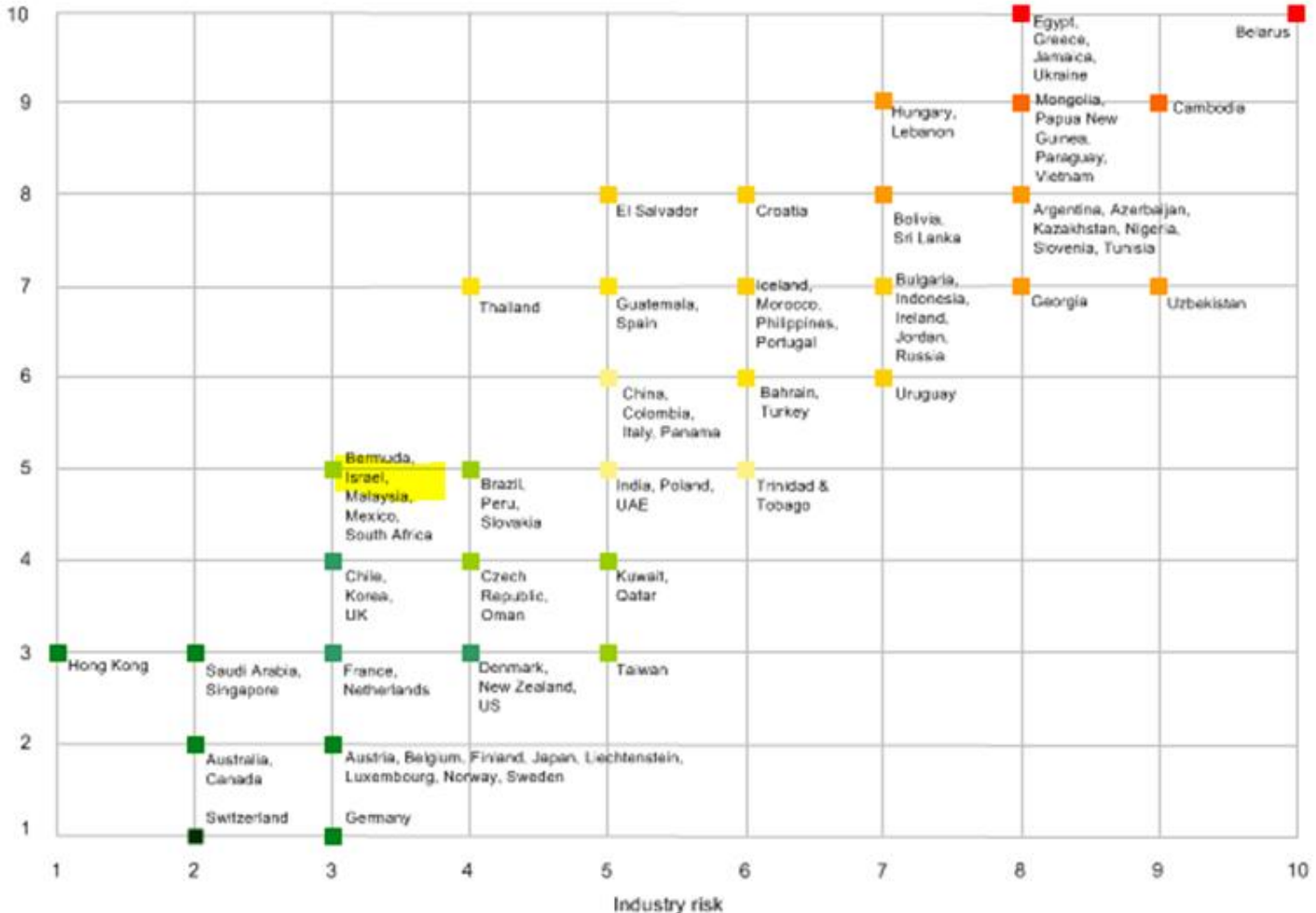
Average Prices of Owner Occupied Dwellings (in NIS)



BICRA groups: Lowest to highest risk



Economic risk



Domestic Banking System remains stable for now

Appendix: Key Economic Indicators

State of Israel - Selected Indicators										
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Nominal GDP (US\$ bil)	175	213	206	232	258	258	288	306	313	330
GDP per capita (US\$)	25,248	29,989	28,292	31,222	34,234	33,703	36,974	38,582	38,652	40,007
Real GDP growth (%)	6.9	4.5	1.2	5.7	4.6	3.4	3.3	3.2	3.3	3.4
Real GDP per capita growth (%)	4.3	1.9	(1.1)	3.6	2.9	2.0	1.4	1.3	1.4	1.5
Change in general government debt/GDP (%)	(1.8)	2.8	6.4	1.1	2.7	3.4	2.5	3.3	2.8	2.4
General government balance/GDP (%)	(0.6)	(2.6)	(5.6)	(3.5)	(3.2)	(4.2)	(3.2)	(3.3)	(2.8)	(2.4)
General government debt/GDP (%)	74.6	72.9	75.3	71.5	69.7	68.2	67.7	67.8	67.2	65.6
Net general government debt/GDP (%)	65.2	65.4	67.1	65.2	64.6	65.3	64.4	64.7	64.2	62.8
General government interest expenditure/revenues (%)	11.4	11.0	11.4	11.2	11.0	10.7	10.5	10.2	10.2	10.0
Oth dc claims on resident non-govt. sector/GDP (%)	93.1	94.4	88.6	89.8	89.5	86.5	86.8	87.7	89.1	89.8
CPI growth (%)	0.5	4.6	3.3	2.7	3.5	1.7	1.5	1.3	2.0	2.5
Gross external financing needs/CARs +use. res (%)	103.2	108.3	93.4	84.8	84.3	84.8	78.4	76.8	73.0	71.2
Current account balance/GDP (%)	3.2	1.4	3.8	3.1	1.3	0.3	2.5	2.3	2.5	2.8
Current account balance/CARs (%)	6.0	3.1	9.5	7.4	3.0	0.8	6.3	5.8	5.9	6.5
Narrow net external debt/CARs (%)	23.8	13.1	2.1	(10.4)	(17.4)	(28.5)	(35.4)	(38.4)	(40.1)	(39.6)
Net external liabilities/CARs (%)	6.9	(9.1)	(11.1)	(40.0)	(59.7)	(72.3)	(75.5)	(79.8)	(86.2)	(88.7)

Other depository corporations (dc) are financial corporations (other than the central bank) whose liabilities are included in the national definition of broad money. Gross external financing needs are defined as current account payments plus short-term external debt at the end of the year plus nonresident deposits at the end of the prior year plus long-term external debt maturing within the year. Narrow net external debt is defined as the stock of foreign and local currency public- and private- sector borrowings from nonresidents minus official reserves minus sector liquid assets held by nonresidents minus financial sector loans to, deposits with, or investments in nonresident entities. A negative number indicates net external lending. CARs--Current account receipts.

The data and ratios above result from S&P's own calculations, drawing on national as well as international sources, reflecting S&P's independent view on the timeliness, coverage, accuracy, credibility, and usability of available information.



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