



The State of Israel's Economy

Bank of Israel Annual Report 2013

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Topics

- **Data on Israel's economy**
- **Monetary policy**
- **Housing market**
- **Financial stability**
- **Fiscal situation**

The economies of Israel, Eurozone, and OECD – a comparative view, 2013

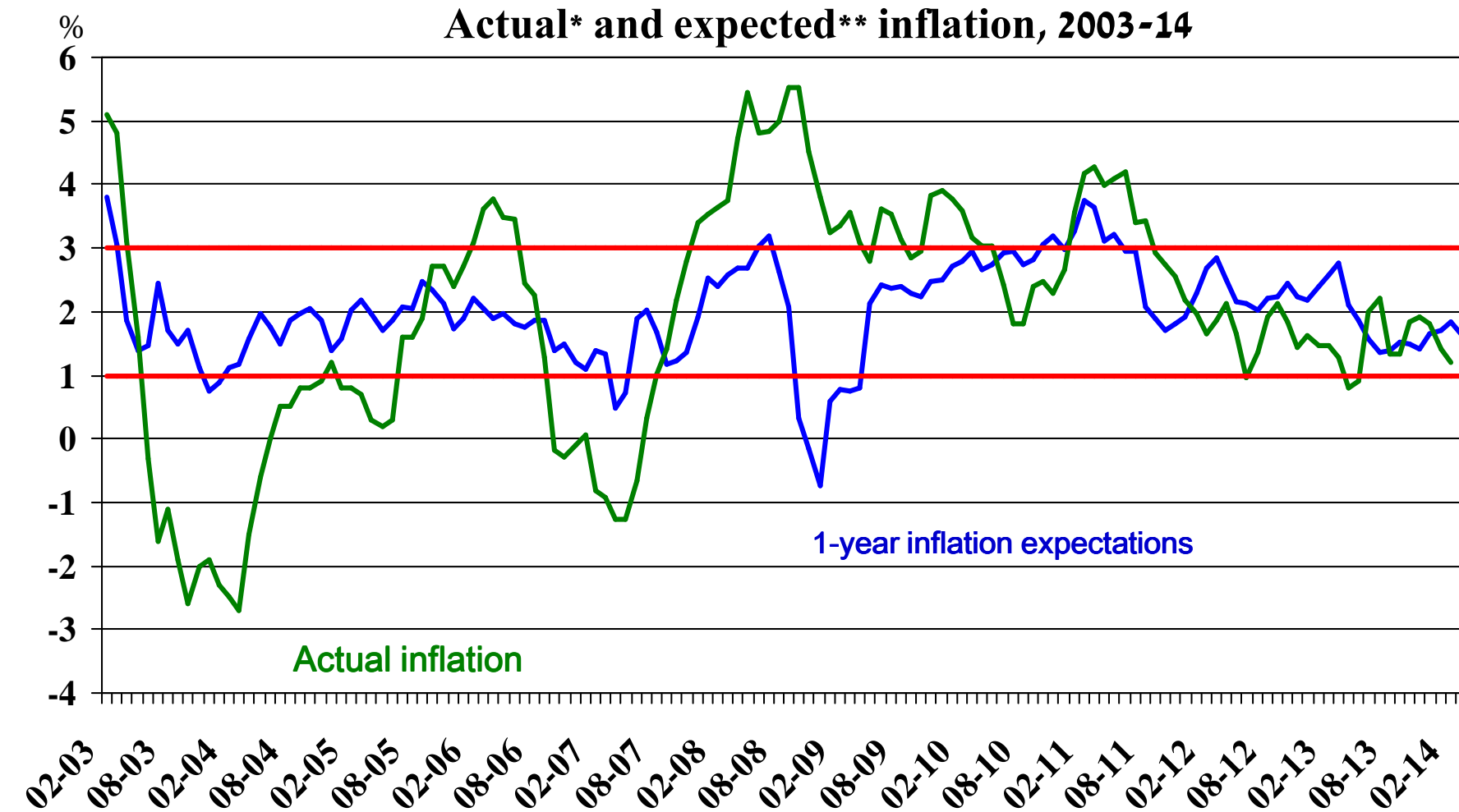
	Israel	OECD	Eurozone
Growth rate*	3.3	1.2	-0.4
GDP per capita growth rate*	1.4	***0.5	***-0.7
Growth forecast for 2014*	3.1	2.3	1
Unemployment rate (ages 15+)	6.3	8	12
Inflation rate (12-months)*	1.2 (February 2014)	1.7 (January 2014)	0.7 (February 2014)
Current account surplus**	2.5	-0.2	2.6
*Debt to GDP ratio**	67.4	110.3	106.4

- Rate of change
- **Percent of GDP
- *** 2013 estimate, assuming that the population growth rate in 2013 is the same as 2012.
- SOURCE: Based on Central Bureau of Statistics, Bank of Israel forecasts, and OECD.

The background of the slide features a large, light blue watermark of the Bank of Israel logo. The logo is circular, with the words "BANK OF ISRAEL" in English and Hebrew around the perimeter. In the center is a menorah. The text "The State of Monetary Policy" is overlaid on this background.

The State of Monetary Policy

Actual inflation and inflation expectations are below the midpoint of the target range

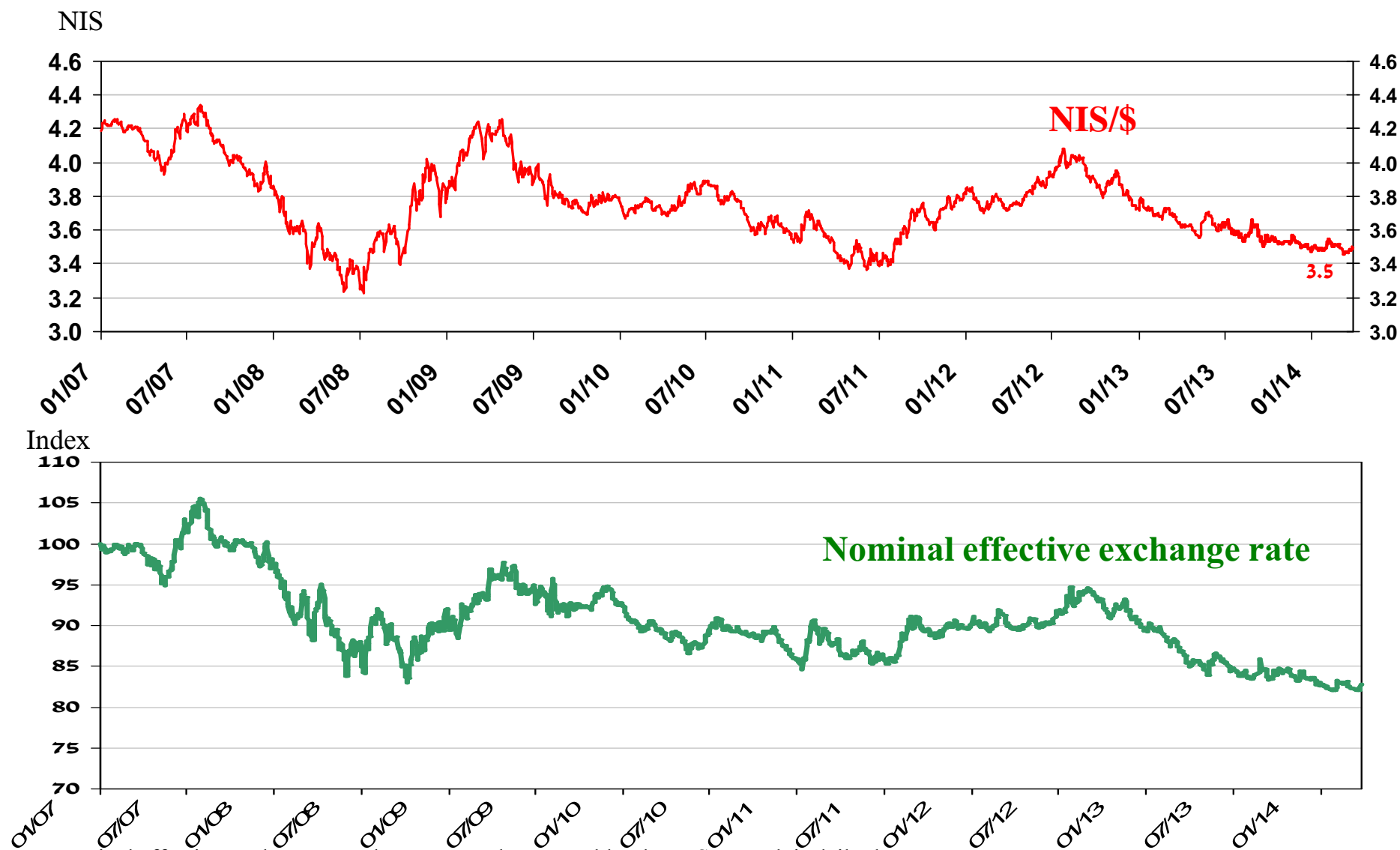


* In preceding 12 months.

** For 12 months, derived from capital markets.

SOURCE: Bank of Israel.

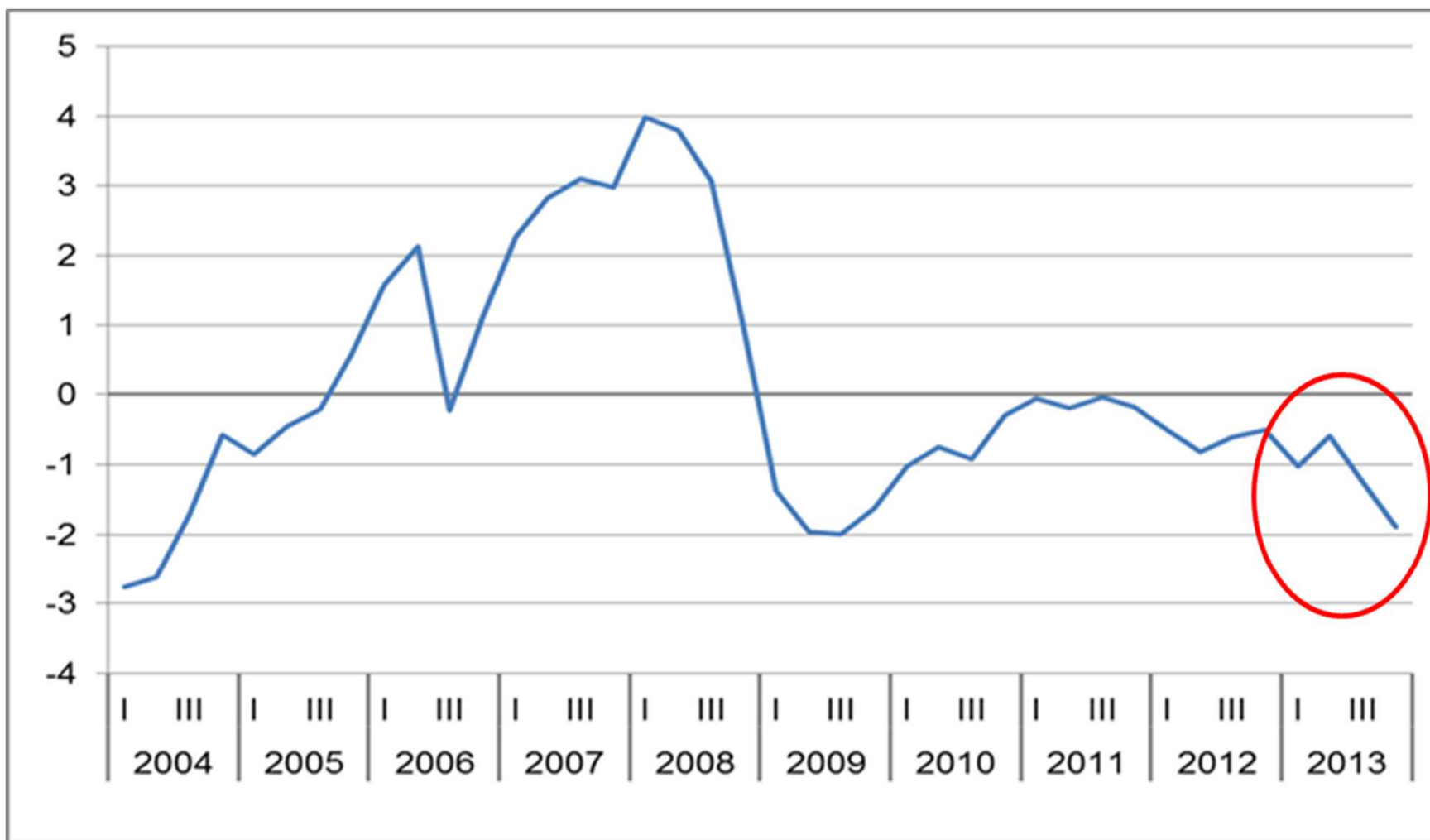
NIS/\$ and nominal effective exchange rates, 2007-2014



-Nominal effective exchange rate data presented are monthly, the NIS/\$ graph is daily data.

-SOURCE: Bank of Israel and IFS data.

Development of business product gap* (Quarterly, 2004-2013)



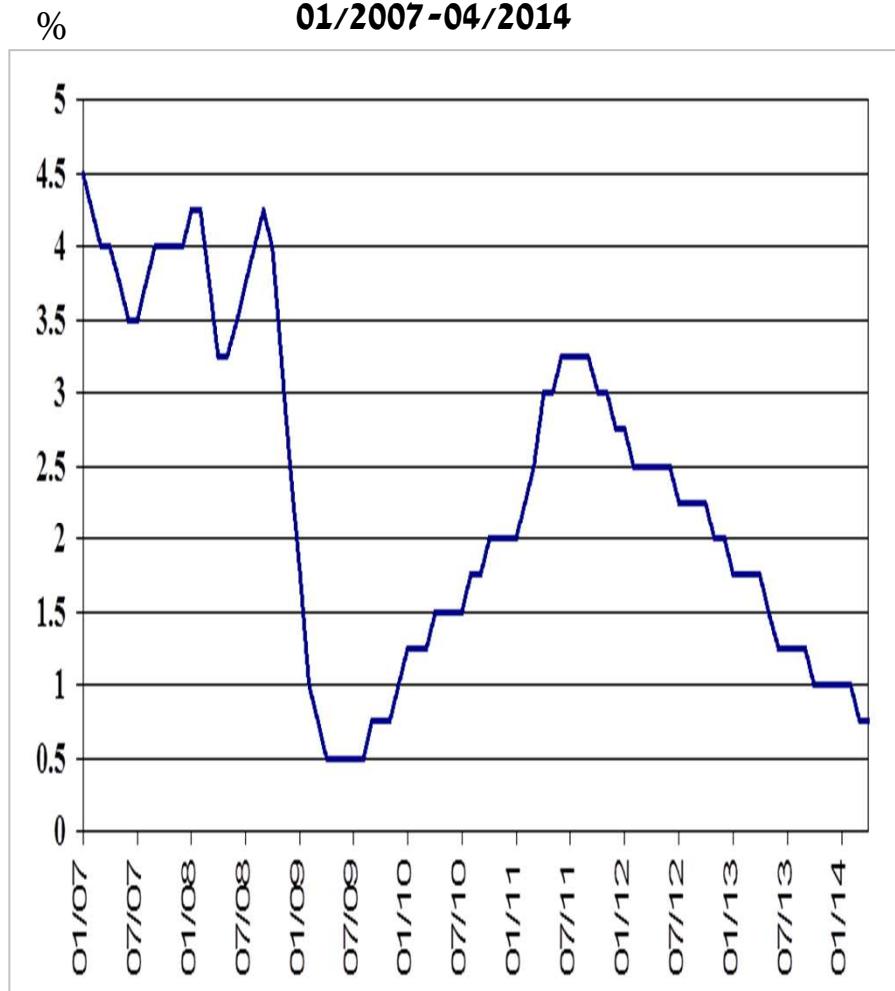
*Deviation (in %) of actual GDP from potential GDP. Potential GDP is based on production function approach.

SOURCE: Bank of Israel.

Main monetary policy tools

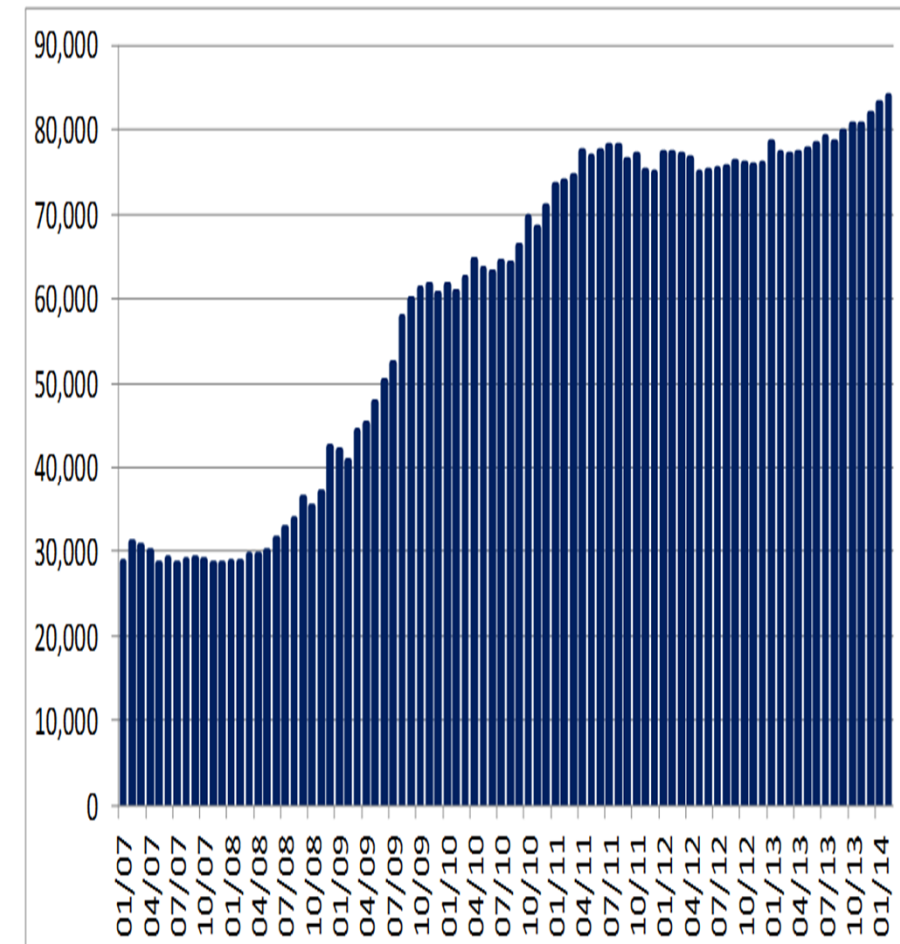
Bank of Israel interest rate

01/2007-04/2014



Bank of Israel foreign exchange reserves

\$M \$ million, 01/2007-02/2014



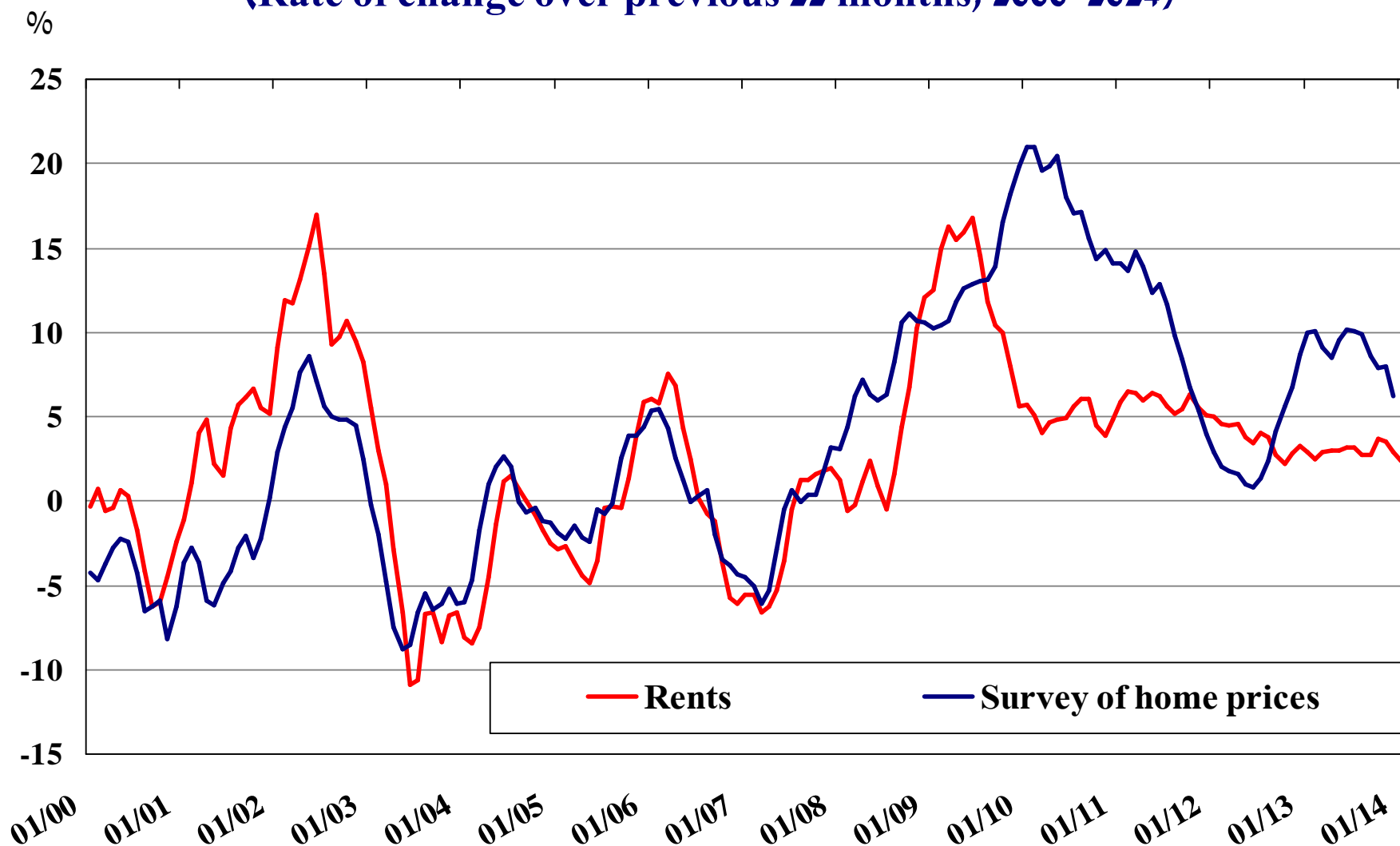
SOURCE: Bank of Israel.

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State of the Housing Market

Survey of home prices and housing index

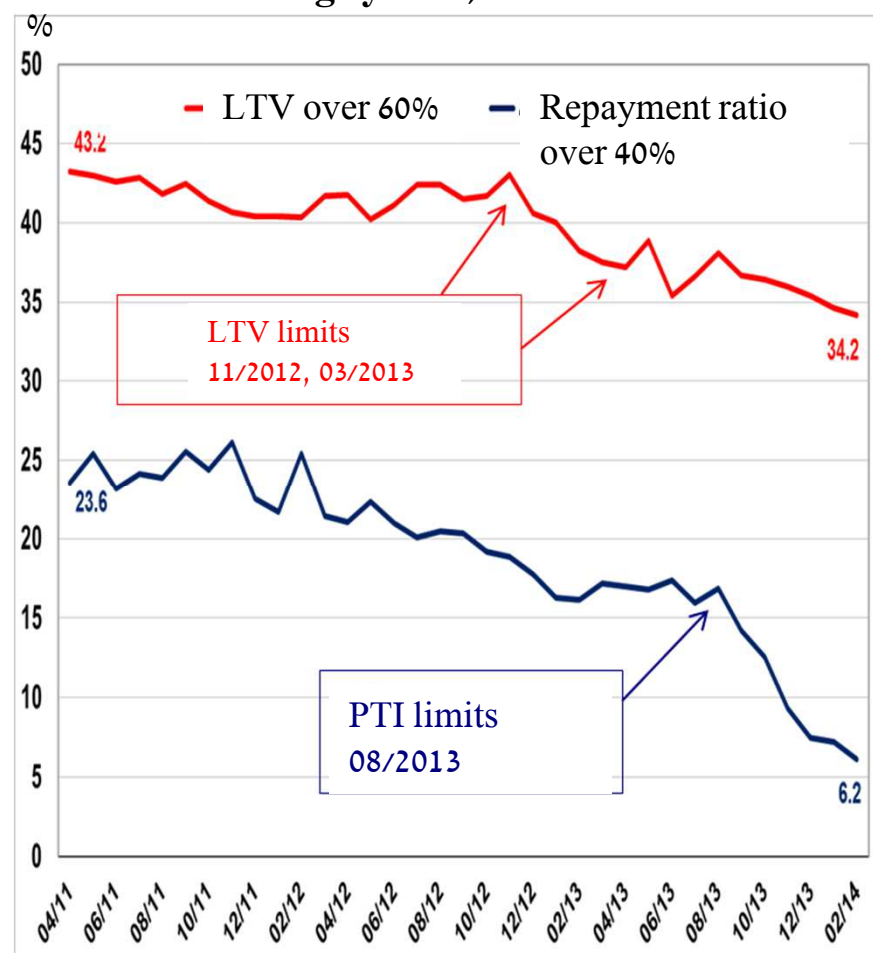
(Rate of change over previous 12 months, 2000-2014)



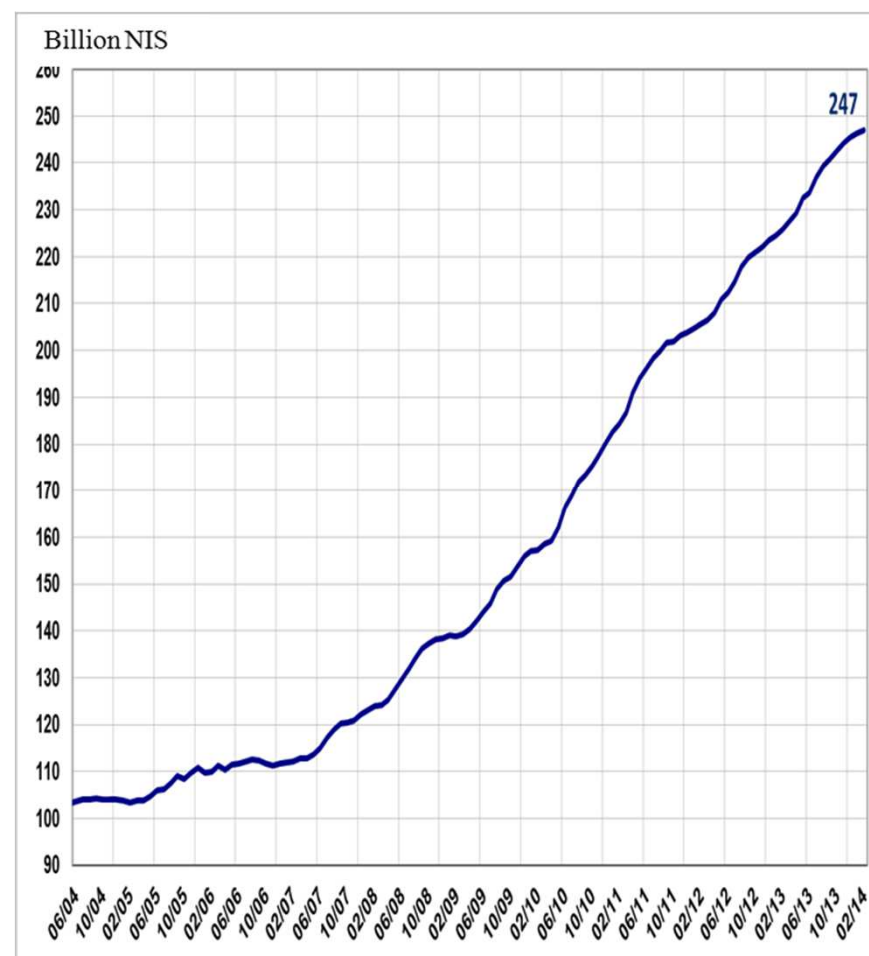
SOURCE: Bank of Israel.

Increase in balance of housing loans; decline in risk characteristics of mortgages

Share of mortgages granted with repayment ratio over 40% and LTV over 60%, Total banking system, 4/2011 – 2/2014



Balance of loans for residential purposes Total banking system, 6/2004 – 2/2014

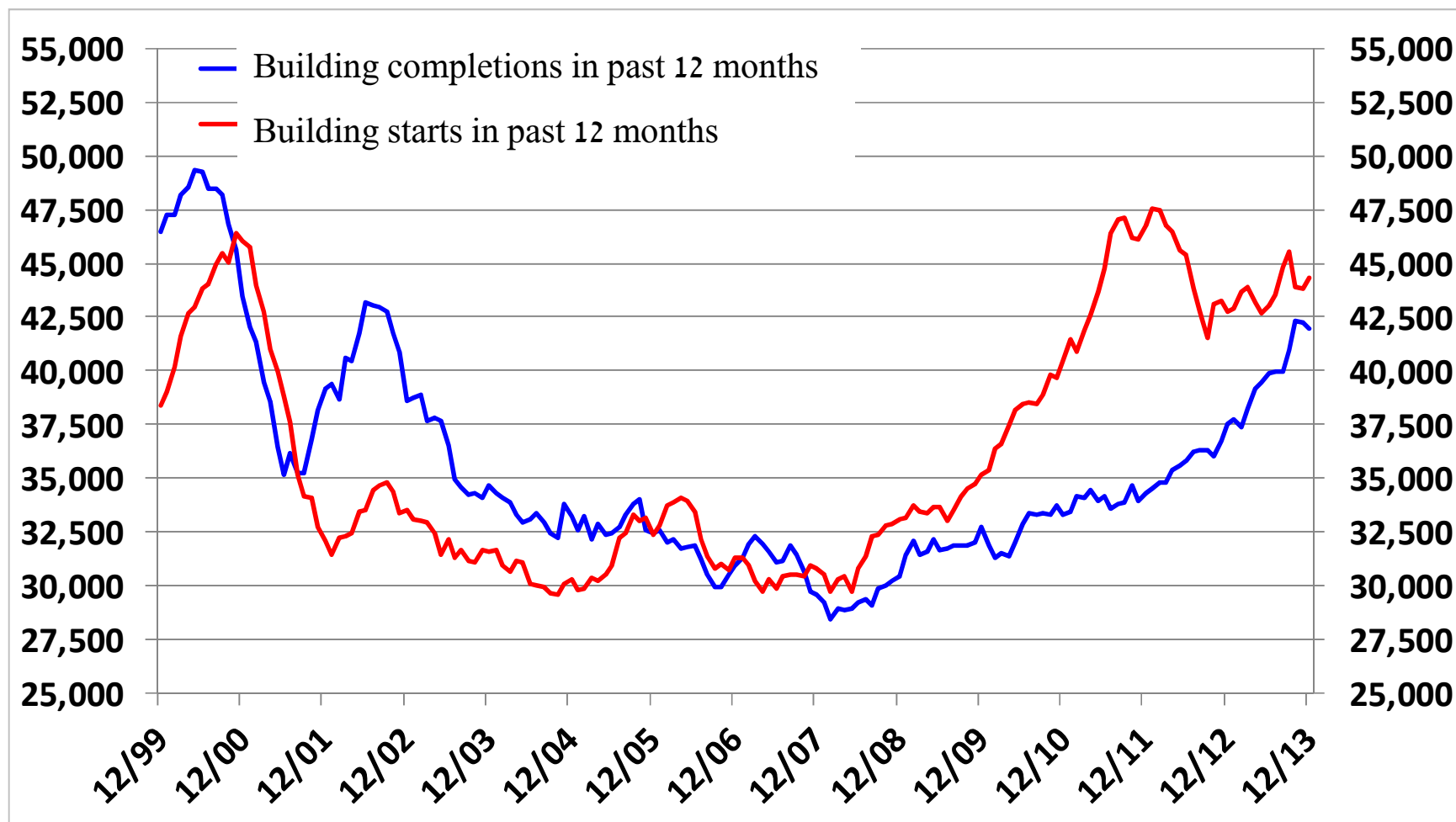


SOURCE: Bank of Israel.



Activity level

Building starts and completions in past 12 months, 2000-2013

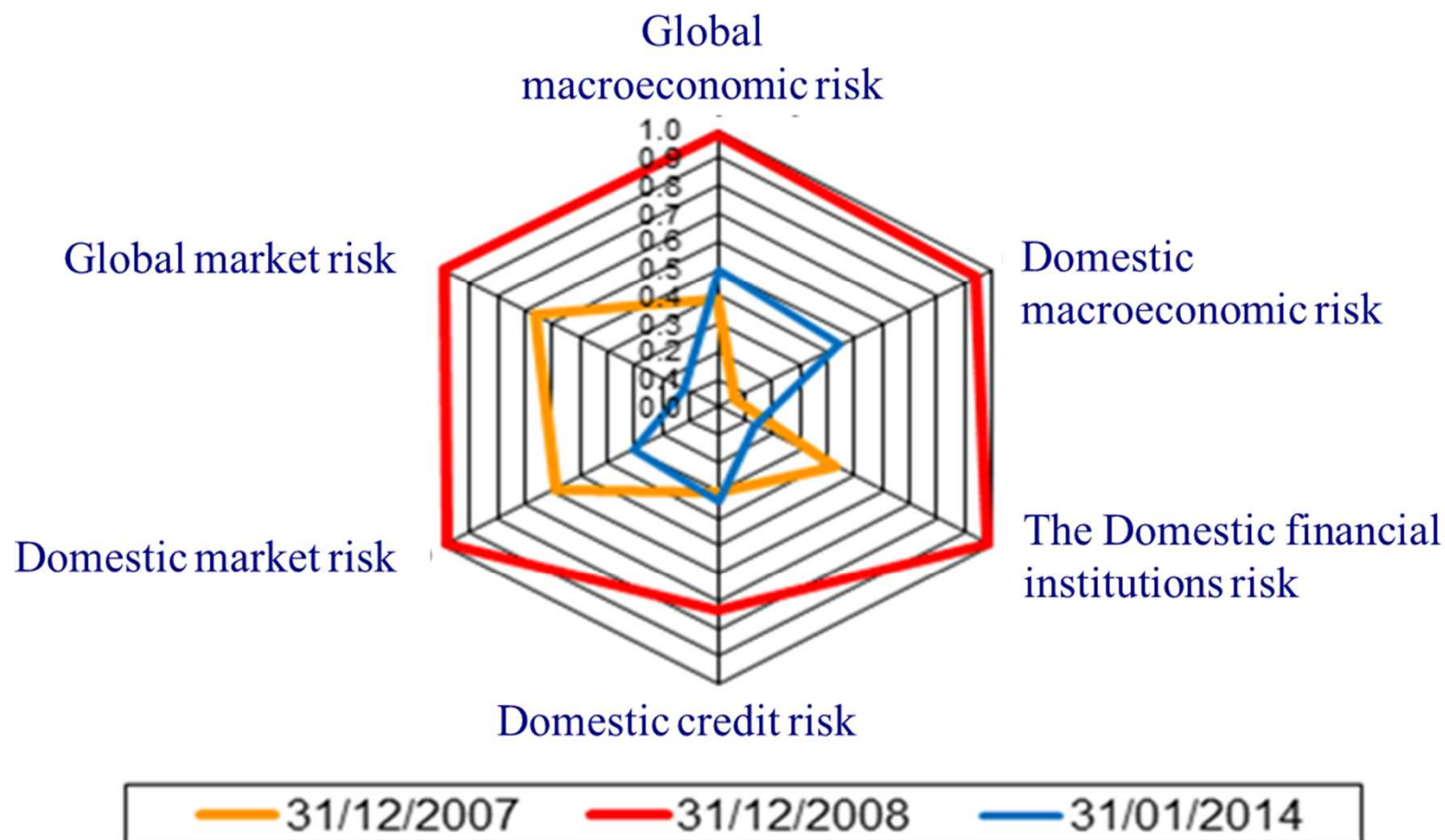


SOURCE: Bank of Israel.

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State of Financial Stability

There is a gap between economic activity and the impression of risk levels by investors



* Strength of risks calibrated so that the historical average value is 0.5.



Looking ahead: Establishing an inter-institutional financial stability committee

- **The Committee's objectives:**

Institutionalizing coordination and cooperation between all financial regulatory authorities (the Supervisor of Banks, the Commissioner of Capital Markets, Insurance and Savings, Payment and Settlement Systems Oversight, and the Israel Securities Authority) and stabilizing entities (the Bank of Israel and the Ministry of Finance) with the aim of **identifying, preventing and reducing** systemic risks.

- **The Committee's functions:**

Defining, analyzing, assessing and monitoring systemic risks.

Examining risks and exposures in the financial system in order to identify and assess systemic risks.

Promoting exchange of information among the financial regulatory authorities, and between them and the stabilizing entities.

Improving coordination and cooperation between the financial regulatory authorities and the stabilizing entities in analyzing, assessing, developing and operating tools and methods for preventing and reducing systemic risks.

Warning when a systemic risk is liable to constitute a material risk.

Recommending measures to prevent or reduce identified systemic risks.

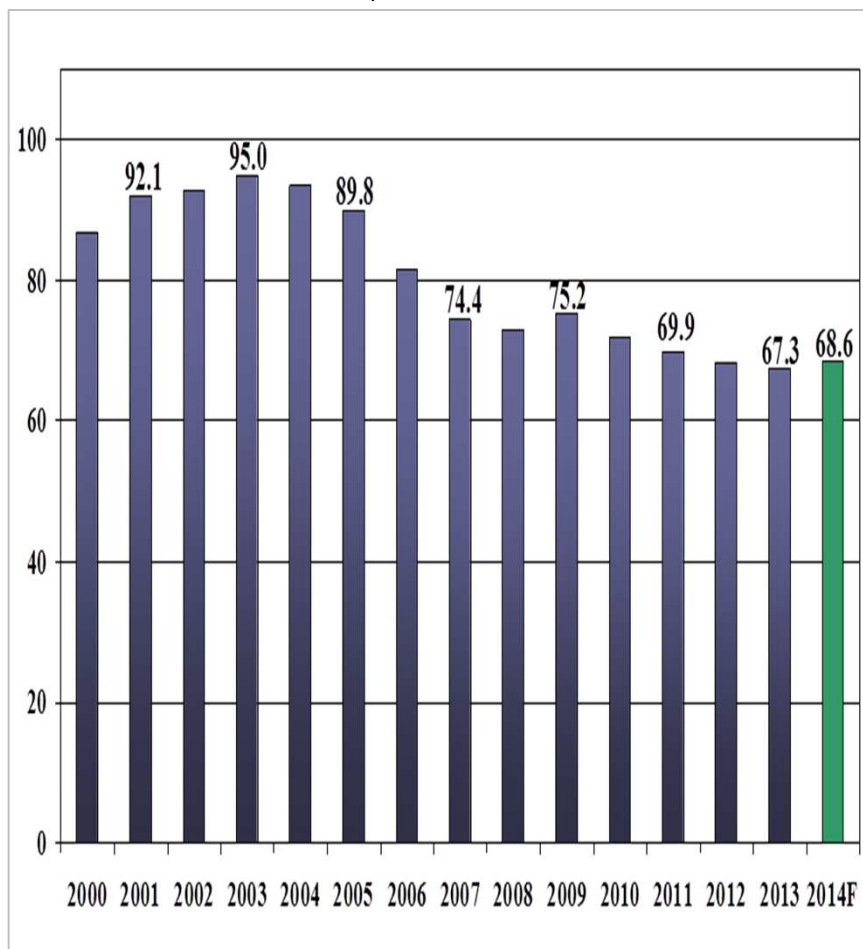
Monitoring the actions taken as a result of the warnings and the implementation of recommendations (“adopt or disclose”).

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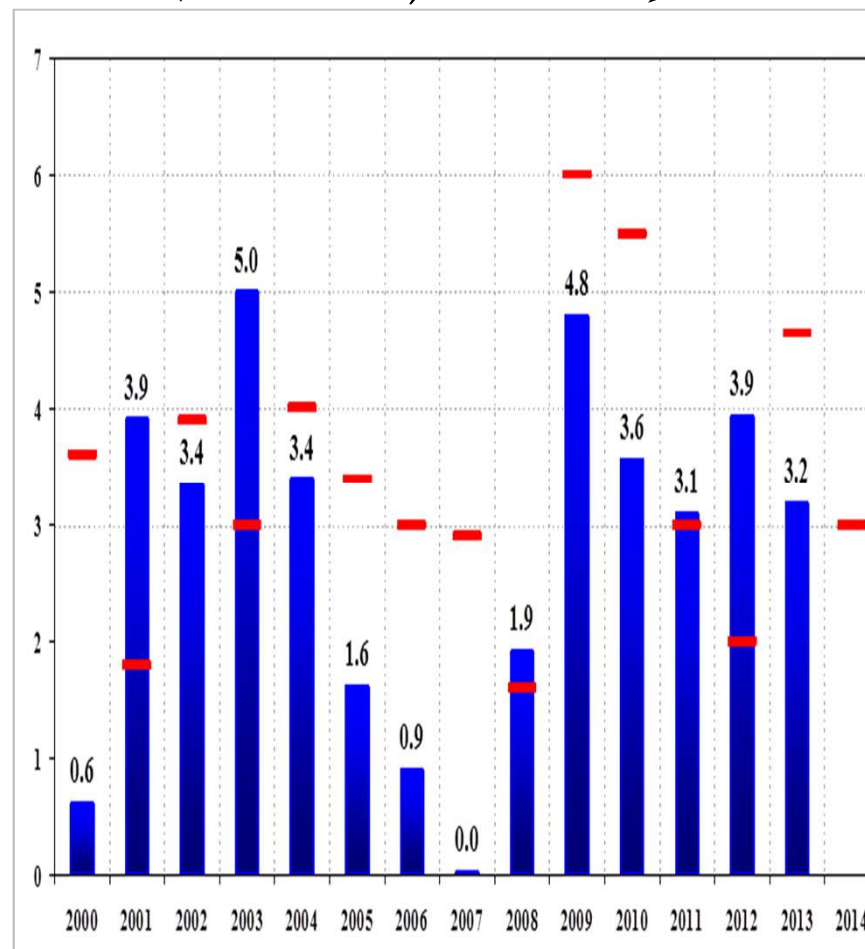
State of the Budget

As of now, budgetary control has been regained

**Gross public debt
(% of GDP, 2000-2014F)**



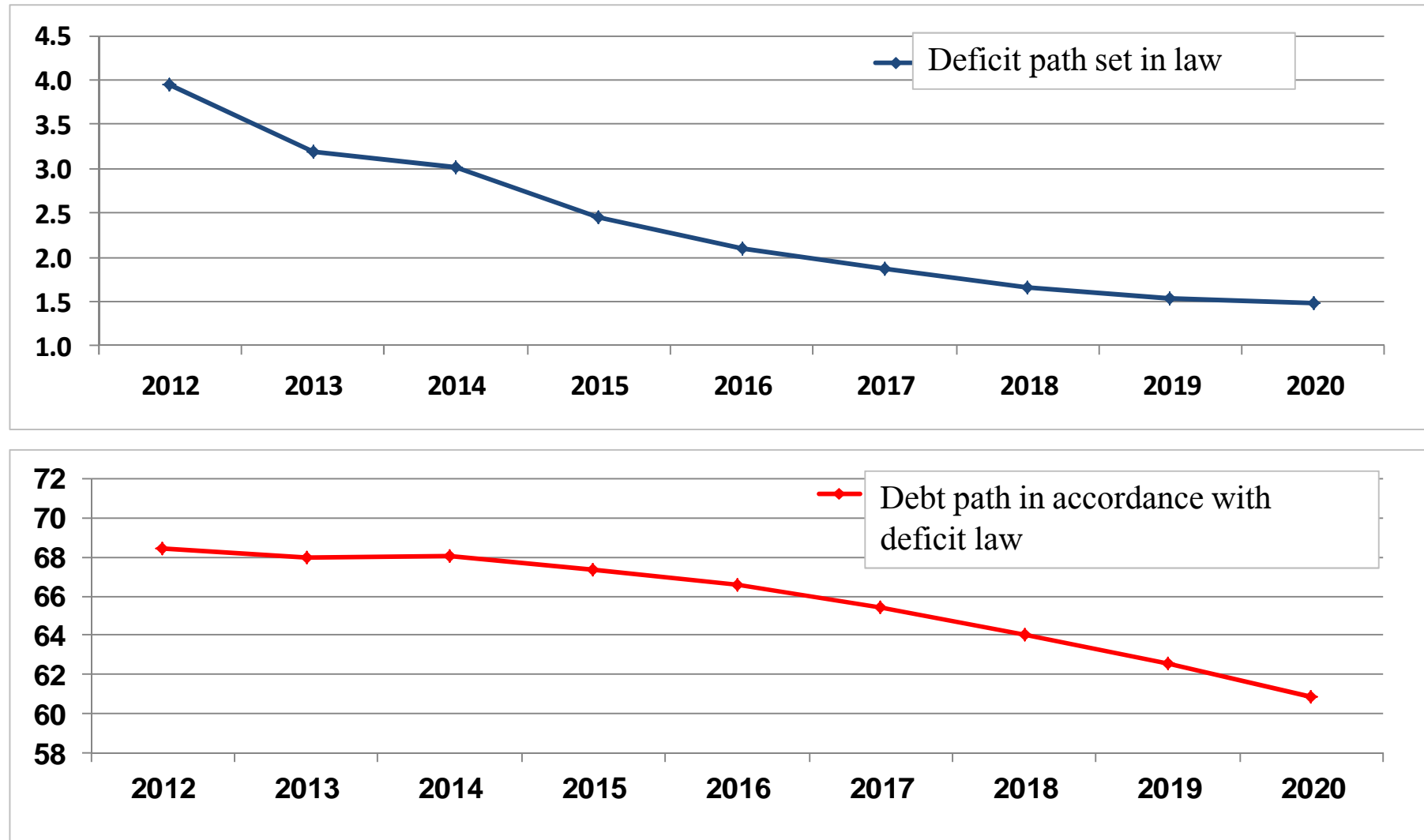
**Government deficit and deficit ceiling
(% of GDP, 2000-2014)**



SOURCE: Bank of Israel.

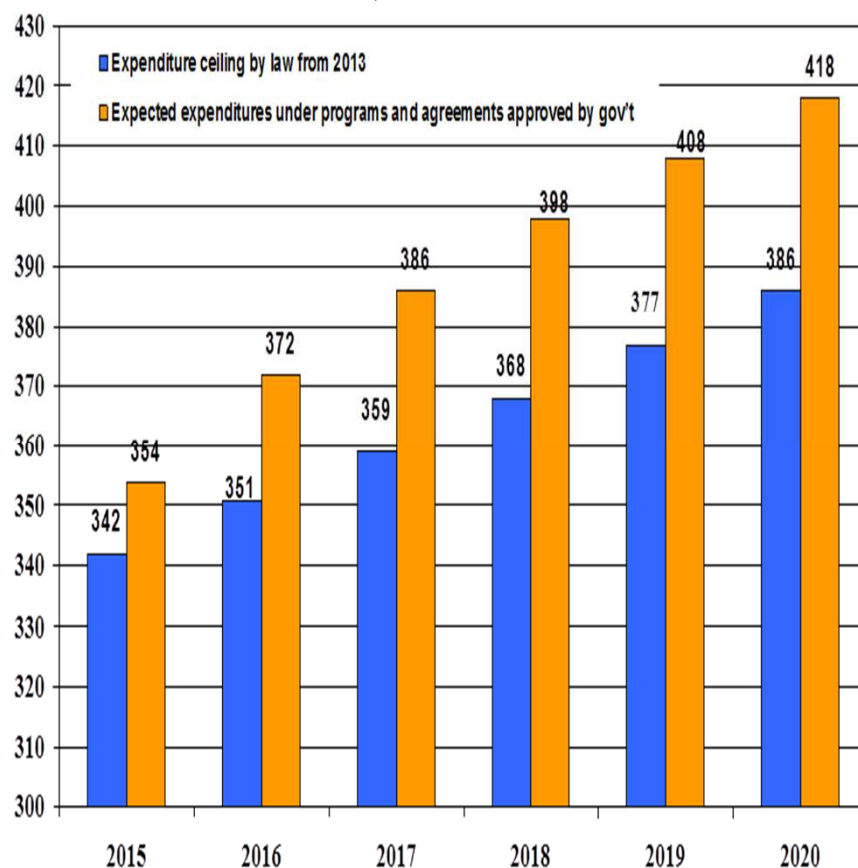
Debt and deficit paths

(as percent of GDP, 2012-20)

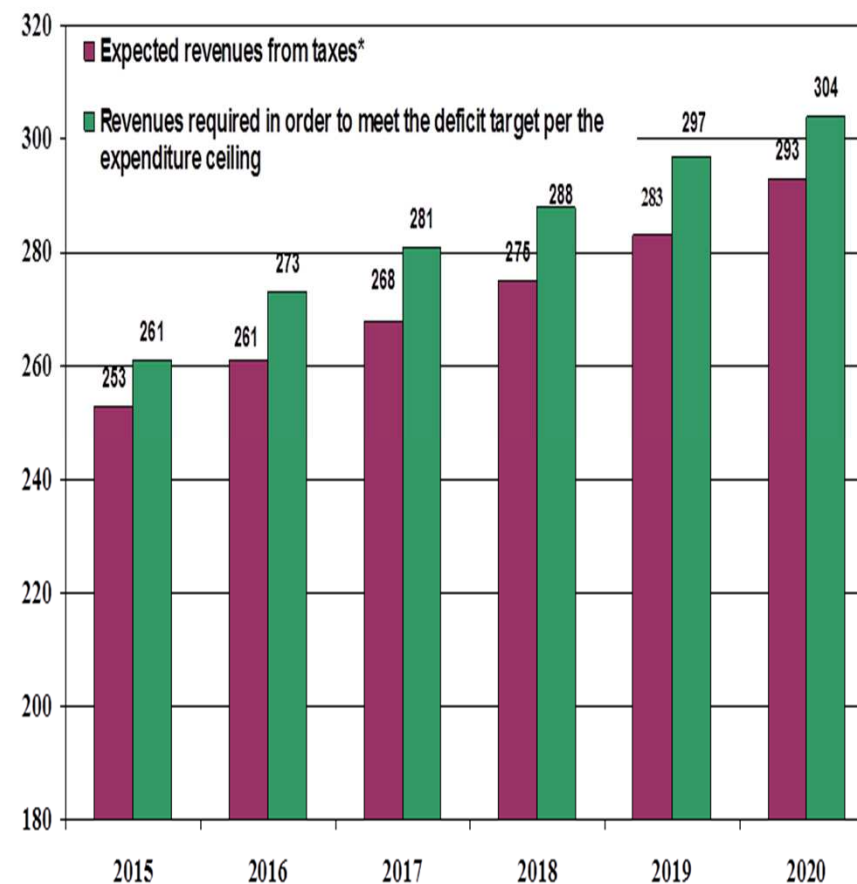


What adjustments are needed on the revenue side and expenditure side in order to meet the fiscal targets

Government expenditures ceiling,
by law and by gov't commitments,
(NIS billion, 2015-2020)



Expected revenues from taxes, and revenues needed in order
to meet the deficit target, given the expenditure ceiling is met*
(NIS billion, 2015-2020)



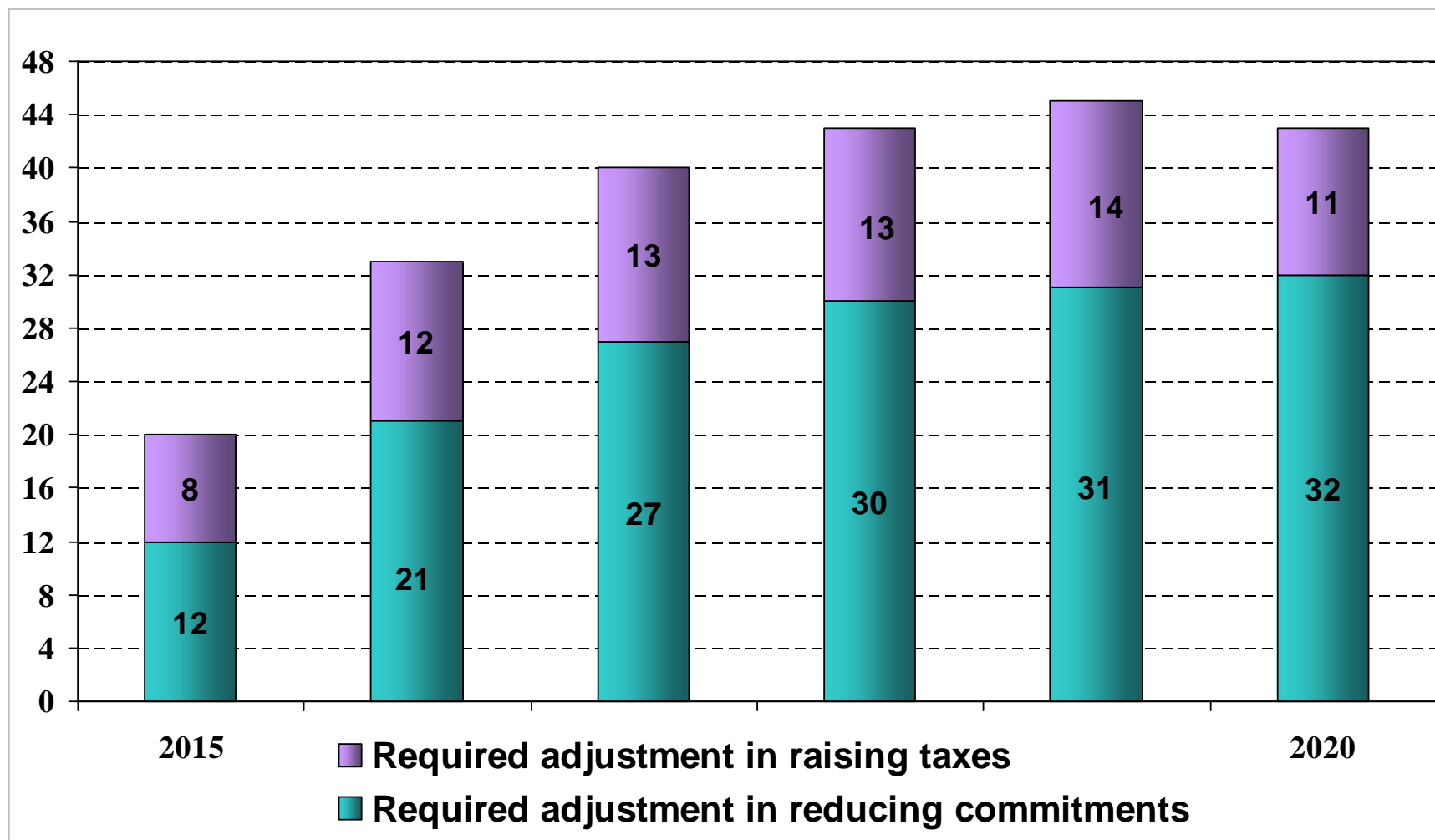
*Assuming zero VAT on homes, for first-time homebuyers who meet the criteria.

** 2014 prices.

SOURCE: Bank of Israel.

Total adjustments needed in order to meet the deficit ceiling, given full utilization of the expenditure ceiling (NIS billion, in 2014 prices)

NIS billion



SOURCE: Bank of Israel.



Reducing indexation mechanisms in an economy without inflation

- Against the background of price stability achieved in the past decade, and the credibility of its being maintained—as reflected in long-term inflation expectations, there is no advantage to the indexation mechanisms in the economy and they are even liable to create distortions. Thus it is recommended that the government continue to reduce the mechanisms in Israel:
- **State budget**
 - The fiscal rule for calculating the government expenditure limit is set in real terms and indexed to inflation.
 - This situation creates high variance in government expenditure and makes planning budget expenditure for future years difficult.
 - It is recommended to switch to a fiscal rule set in nominal terms and which is not contingent on yearly fluctuations in inflation.
- **The dual track (nominal and real) method of taxing capital gains in Israel**
 - The dual taxation methods distort the incentives to invest in certain assets and in certain periods and makes efficient diversification of investments in the economy more difficult.
 - The real taxation of capital gains is unique to Israel .
 - Calculating the real gain for tax purposes is one of the main technical problems
 - Moving to uniform nominal taxation will contribute to efficient diversification of the asset portfolio and to financial stability, and will increase transparency in tax collection.

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Thank you