26 October 2017

1/7 COUNTRY RISK CATEGORY

COUNTRY RISK ANALYSIS

Israel

0 1 2 3 4 5 6 7

The country risk categories range from 0 to 7. The lower the number, the better the credit rating of the country.

CONTACT

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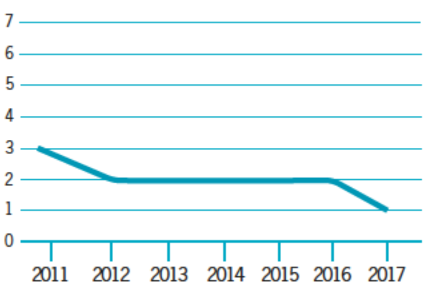
BASIC FACTS

Population	8.5 million
GDP, nominal	USD 319 billion
GDP/capita	USD 37,293

COUNTRY CLASSIFICATION HISTORY



Source: EKN

Low payment risk despite political uncertainty

Israel is a hi-tech economy and market economy with stable public finances, a favourable business climate and strong institutions. The political situation is difficult. The peace process with the Palestinians has come to a standstill and new armed conflict is threatening to flare up. The divide between Israelis and Palestinians appears to be unbridgeable. The security threat against Israel will continue, however despite this environment the economy has shown a positive trend. A small domestic market and poor relations with the neighbouring countries has made the economy dependent on exports, above all to the EU and USA. Israel's economic vulnerability will be reduced in the long term given its recent discovery of gas reserves and more diversified exports.

EKN has guaranteed a number of major export transactions with Israel in recent years. In August 2017, the country was upgraded to country risk category 1 from category 2, based on the strength and positive development of its economy, as well as on EKN's positive experience.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

STRENGTHS

\+ A developed economy with strong institutions.
\+ Sustainable public finances and balance of payments.
\+ Favourable business climate.

WEAKNESSES

\- A complex and at times turbulent security situation.
\- A peace accord with Palestine unlikely in the foreseeable future.
\- Small domestic market and export-dependent.

SWEDISH EXPORTS TO ISRAEL, MSEK

Israel	MSEK
2016	2 547
2015	2 449
2014	2 415
2013	2 952
2012	3 260

Source: The National Board of Trade

EKN'S EXPOSURE

	MSEK
Guarantees	1 831
Offers	1 239

EKN'S POLICY

Israel has been classed as a high-income country since 2010, which means that the OECD does not place the country in a country risk category. Until this year EKN chose to keep Israel in country risk category 2. However, given the strength of the Israeli economy and the good experience EKN has had, EKN upgraded Israel to country risk category 1 in August 2017. The upgrade means low premiums, above all in transactions involving short-term credits. As before, normal risk assessment applies to all transactions. The Israeli shekel may be considered by EKN in local currency transactions. No types of risk are covered in transactions with the occupied areas of Palestine.

EKN'S EXPOSURE AND EXPERIENCE

During the 2012-2016 period, EKN issued guarantees for 67 transactions to a total amount of SEK 4.6 billion for Swedish companies exporting to Israel. The exports have gone to sectors such as power generation, transport and construction. Experience is good, with only a few problem transactions.

WHAT MIGHT CAUSE A CHANGE IN THE COVER POLICY?

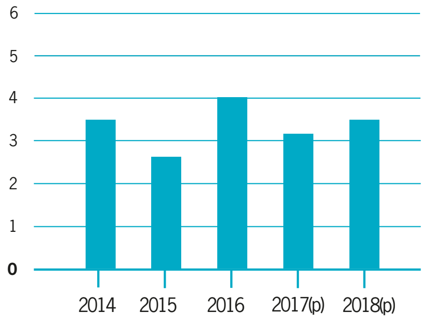
THE EASING OF RESTRICTIONS, IN THE EVENT OF:

- Improved relations with the Palestinians with a reduced risk of new conflict.
- A lower budget deficit, meaning further reduction of government debt.

THE TIGHTENING OF RESTRICTIONS, IN THE EVENT OF:

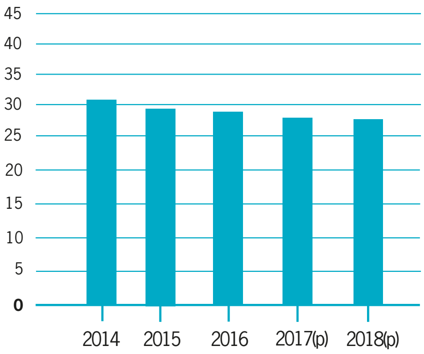
- New military conflict which has a negative impact on the economy.
- Poorer budget discipline resulting in mounting debt.

GDP GROWTH (% PER ANNUM)



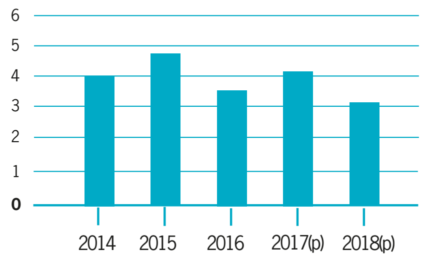
Source: IMF WEO 2017

EXTERNAL DEBT (% OF GDP)



Source: IMF Article IV 2017

CURRENT ACCOUNT (% OF GDP)



Source: IMF WEO 2017

COUNTRY ANALYSIS

BACKGROUND

Israel has few natural resources and not much water. No country in the world, however, has invested as large a share of its GDP to research and development, which has made Israel a hi-tech economy. A small domestic market and poor relations with the neighbouring countries has resulted in an economy dependent on exports, above all to the EU and USA. Israel has seen strong economic growth despite political turbulence and the surrounding military conflict. A strong labour market and low interest rates have driven consumption and investment. During the past decade the economy has grown by almost four per cent each year, which is well above the average for an advanced economy.

Israel's relationship with the Palestinians overshadows all other political issues. The current composition of the government, which includes several nationalist and pro-settler parties, has not brought the parties closer to each other - rather the opposite. The political system allows parties with only two percent of the votes to enter Parliament, which means weak coalition governments where small parties often have the casting vote. No Israeli government has lasted the whole mandate period since 1988, which has had a negative impact on reform. If Prime Minister Netanyahu succeeds in keeping his government of six parties intact and refuting the on-going accusations of corruption, by 2019 he will have held office as prime minister longer than anyone else in Israel's history.

THE MOST RECENT TREND

Israel's growth shows relatively large swings as a result of the economy's dependence on exports and exposure to political factors. Growth was four percent in 2016 thanks to a recovery in exports and domestic consumption together with a strong labour market. Forecasts point to a three-per cent growth over the coming years. Israel's involvement in conflict has historically hampered growth. The political instability in the region has therefore made growth prospects rather less certain. Property prices in Israel have seen a sharp rise over a number of years, and this may be corrected, which would further add to the uncertainty in the growth forecast.

Reducing government debt has been a priority for a number of governments. The debt has been reduced from 90 per cent of GDP at the start of this century to 60 per cent today, which makes Israel one of only a few developed countries with a lower debt today than before the global financial crisis. The present government is expected to stick to its conservative macroeconomic policy. Despite this, the downtrend in debt will probably level off in the future. The reason is that the high level of defence expenditure is a constraint on budget flexibility and the ability to reduce the budget deficit further.

BUSINESS ENVIRONMENT

Ranking from 0 (worst) to 100 (best)

Source: The World Bank

External debt is low, and Israel will remain a net creditor against the rest of the world. The country's historically stable current account surplus has enabled an increase in international reserves to the equivalent one-year requirements. This buffer is reassuring, given the security risks faced by Israel and the country's limited export diversification. The Israeli shekel is a floating currency, although the central bank regularly intervenes in the currency market to prevent the shekel becoming too strong. The Israeli shekel may be considered by EKN in local currency transactions.

THE LONG-TERM TREND

The security threats faced by Israel will persist. A peace accord with the Palestinians is unlikely in the foreseeable future given the divisions both within the Palestinian leadership and Israeli society. Continued housing construction by Israel in occupied territory is heightening tensions. There is also the risk that military confrontation will again flare up with the political and military group Hezbollah in Lebanon. Both sides will probably try to avoid confrontation, but minor provocations can quickly escalate and lead to conflict. The civil war in Syria and Israel's increasingly obvious interventions there constitute a further security risk, although the consequences have so far been minimal.

Israel's public finances and balance of payments will be strengthened in the long term thanks to Israel's recent discovery of gas reserves in the Mediterranean Sea. The reserves are estimated to cover Israel's energy requirements over the coming 25 years, and will eventually make Israel a net exporter of energy. The trade balance will still see a deficit over the coming decade, but will improve as of 2021 when Israel is expected to start exporting gas. For several years the Israeli government has actively sought to diversify trade and reduce its export dependency on Europe and the US. This policy is expected to persist, and the government has entered into a free trade agreements with several Asian countries. Export diversification will take time to become a reality, but will in the long term reduce the vulnerability of the trade balance.

BUSINESS ENVIRONMENT

The Israeli business climate is favourable given its strong institutions, few restrictions to trade and investment, skilled workforce and well-developed infrastructure. This is reflected in the World Bank's Doing Business Index, where Israel is in 40th place out of 189, in line with many other OECD countries. Israel is given a particularly high ranking in terms of protection for investors and the absence of trade barriers. The World Bank Indicators also show a favourable regulatory environment, a sound judicial system and low levels of corruption. Political stability is less satisfactory, however, which may have unforeseen consequences for the corporate sector.

Israel's banking system is on a sound footing. The banks are generally well-capitalised and profitable. As in many other developed economies, the Israeli banking sector is concentrated. Five banking groups account for 95 per cent of the sector's assets, which inhibit competition and efficiency. In the long term this may be a drawback for financial stability. No new actors have emerged for almost half a century, and cost-effectiveness is low in relation to other OECD countries. Apart from this, the overheating of the housing market is the largest credit risk facing the Israeli banking system. The signs of cooling off and abatement in the rise in housing prices are welcome in this respect, and help mitigate the risk.