יועצי השקעות ישראל | Israel Investment Advisors

Israel Investment Advisors, LLC
1670 Broadway, Suite 3000
Denver, Colorado 80202
(303) 861-3798

Prudent Budget Policy Helped Israel Navigate the Global Financial Crisis
Brian J. Friedman, CFA

Every year in early December Israel's top business newspaper – *Globes* – holds its Israel Business Conference. With approximately 3,000 participants, the Israel Business Conference is one of Israel's premier economic gatherings. In addition to its own content *Globes* collaborates with the World Economic Forum, MIT, INSEAD and the Milken Institute to provide conference panels and speakers. I spoke on a panel moderated by Glenn Yago, Senior Director of the Milken Institute Israel Center, about the impact of global capital markets on Israel. I invited our Israeli analyst, Gal Schwartz, to join me and we spent an additional ten days in Israel meeting with analysts, economists, regulators and leaders in the Israeli securities industry. Our goal, both during the conference as well as in our many meetings, was to deepen our knowledge of the Israeli capital markets and their role in the Israeli economy.

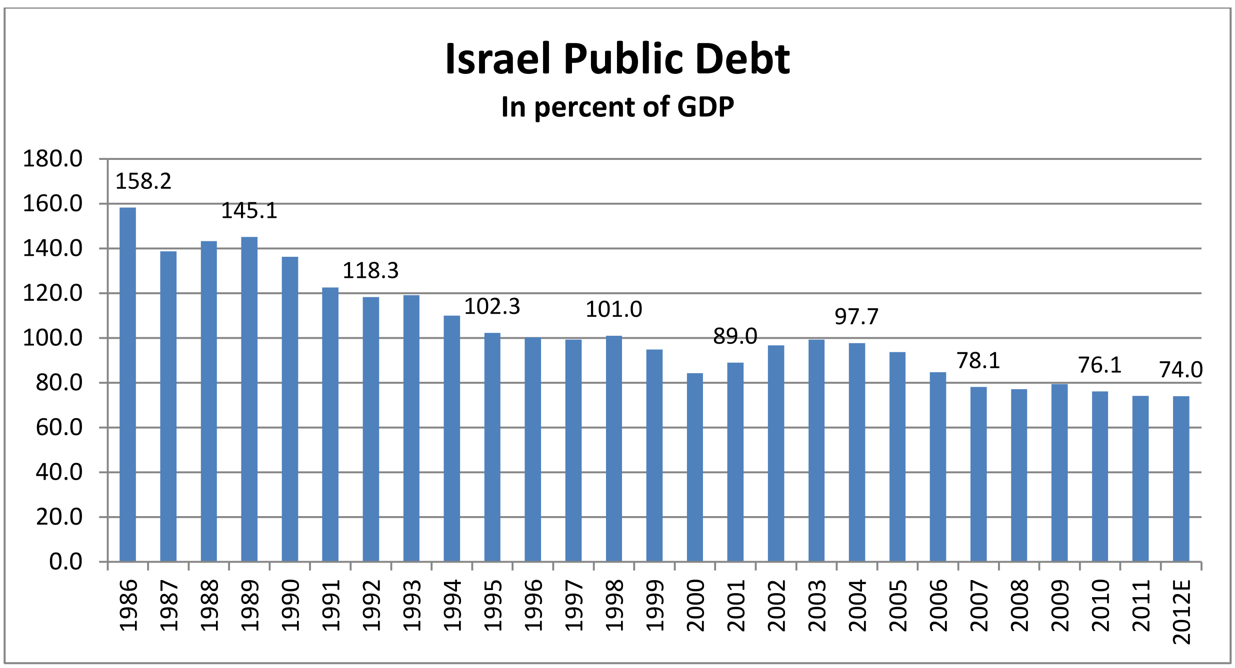
Israel has a small but dynamic securities industry. In typical Israeli fashion some good news ultimately proved bad and bad news good, for the Israeli securities markets. An example of the former was Israel's admission into the Organization for Economic Cooperation and Development (OECD). Entrance into the OECD confirmed Israel's acceptance into the family of wealthy developed economies. It was truly a moment of arrival for the start-up nation. As a consequence the Israeli stock market was removed from major emerging markets indexes and graduated onto developed economy indexes. In the transition trading volumes declined when emerging market index funds sold their holdings. We believe global investors will ultimately rediscover Israel's strong economic fundamentals.

Meanwhile, in the bad news proving good category Israel weathered the global financial crisis exceedingly well due to prudent management of its banking system and government finances. Government prudence is typically an oxymoron in Israel, so how did this come to be? We must remember that Israel experienced a financial crisis of its own in the 1980's proportionately much larger than even Greece's current debt problems. Policies adopted to stem the crisis in the 1980's and 1990's hover over Israeli politicians to this day.

Since the 1980's the Israeli government has adopted budget deficit and government debt targets. Last summer the government faced criticism for raising the 2013 deficit target to 3% of Gross Domestic Product from 2%. The government debt target is 60% of GDP by 2020, down from 74% at present. To put things into perspective, the United States' budget deficit is approximately 7% of GDP (down from 9% at its peak) and debt is also 74% of GDP, but rising rapidly rather than falling.

The chart below highlights the history of Israeli government debt. Although not always consistent or without acrimony, successive governments kept deficits and debt under relative control. Over time Israeli government debt declined from 158% of GDP. This history gives Israeli debt targets credibility in world financial markets, allowing Israel to maintain its AA credit rating (the second highest rating). Unlike the United States, Israel is a small country that must take global credit markets very seriously. As such, its history of fiscal prudence kept Israel clear of the sovereign debt crisis now sweeping Europe.

As I mentioned in my presentation to the Globes conference, the Israeli government adopts formal targets for the debt-to-GDP ratio and the deficit-to-GDP ratio. This process, which is largely absent in the United States, allows Israeli politicians to periodically enact unpopular budget policies. Hopefully, we will not need to experience the same degree of financial pain to make American politicians take mounting U.S. government debt more seriously.



Global capital markets pressured Israeli markets in recent years, but Israel weathered the storm well. The mortgage meltdown in the U.S. also sank the Israeli stock market for a period of time. Admission into the OECD caused foreign portfolio investment to shrivel while the European debt crisis wreaked havoc on Israeli financial markets and exports. Despite all of these global events the Israeli economy sustained growth and Israeli financial markets continued to function. We believe Israeli securities markets will emerge from mere survival to growing prosperity in coming years.