יועצי השקעות ישראל

Israel Investment Advisors

Fiscal Discipline and Falling Debt: Israel Gets a Credit Upgrade

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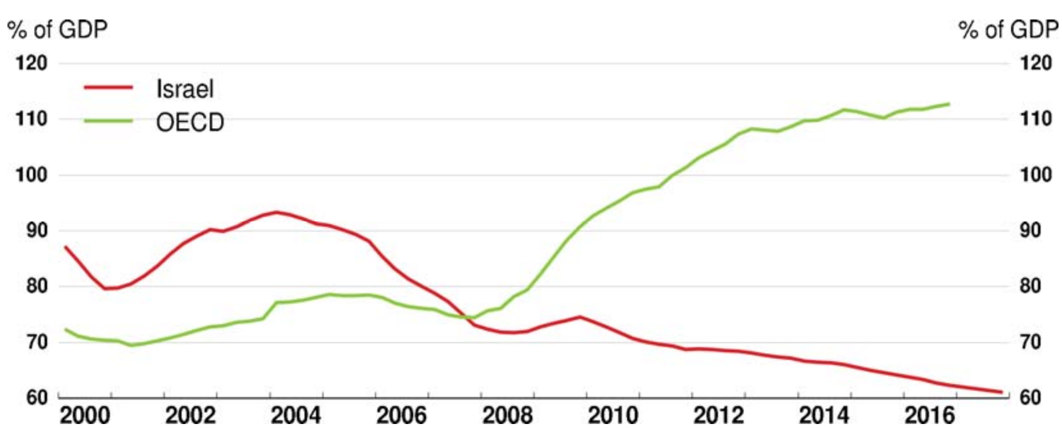
On August 4th Standard and Poor's (S & P) raised Israel's credit rating from A+ to AA-. Israel carries less government debt as a percentage of its gross domestic product (GDP) than several of the 11 countries currently rated AAA, including countries such as Canada and Germany. The American federal government's credit rating of AA+ is slightly higher than Israel's, even though we support a debt ratio of 76% versus Israel's 60%. S & P is unlikely to upgrade Israel to a AAA rating as long as its security situation could necessitate unexpected borrowing in the event of war or terrorism.

While popular opinions within Israel and abroad often characterize Israeli politics as chaotic, Israel has maintained fiscal discipline for 30 years. During and after the 2008 Global Financial Crisis, every advanced economy significantly increased its debt burden except Israel (see Chart 1). Israel's debt ratio is likely to fall further due to continued robust economic growth. This credit upgrade recognizes Israel's reduced financial risk and potential to boost infrastructure investment.

Public Debt is Declining



Source: OECD, Economic Outlook Database

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Low Debt Led to Inadequate Infrastructure Investment

Although Israel now ranks as one of the most fiscally disciplined advanced economies, its debt reduction policy constrained infrastructure investment. According to the Organization for Economic Cooperation and Development (OECD), Israel's underinvestment in transportation infrastructure such as roads, railroads and mass transit ranges between a 20% to 40% gap relative to other OECD member countries. The infrastructure gap contributes to Israel's productivity deficit compared to other advanced economies. GDP per hour worked is 45% lower than the United States and 25% less than the OECD average.

A $32 billion Plan to Improve Israel's Infrastructure

To rectify the infrastructure deficit, the Israeli government recently announced a very large $32 billion investment plan equivalent to 10% of current GDP. According to Prime Minister Netanyahu, "This program will allow the government to provide Israel's citizens with better service in transportation, energy, health, and many other fields." He also said "We'll continue bringing the periphery closer to the center for the benefit of all Israelis and build more roads, interchanges and train tracks." S & P was aware of this program prior to its analysis, and the extra expenditure is unlikely to imperil Israel's credit rating. The government will finance these infrastructure projects with a mix of debt, private investment, user fees, and annual tax revenue.

Building a faster, more efficient national transportation network that would leverage Israel's small size could yield significant productivity benefits and help reduce the exorbitant cost of housing in the Tel-Aviv metropolitan area. A number of these projects are already underway, such as the Tel-Aviv to Jerusalem high speed railroad and the new Tel-Aviv light rail system.

Closing the Productivity Gap with the Best Economies in the World

Boosting infrastructure investment is extremely important but only one contributing element to closing Israel's productivity gap. Another critical policy is continued implementation of the Anti-Concentration Law passed in 2013 to erode monopoly power and intensify business competition (see our December 2013 newsletter[1]). Other policies designed to accelerate productivity growth include improving workplace skills and labor force participation among Ultra-Orthodox men and Arab women.

While not always visible to the average Israeli citizen, these policies are gradually improving economic performance. If the government maintains policy momentum, Israel could close the productivity gap with the OECD average over the next 20 years. Of course, catching up to the world's most productive economies such as Germany or the United States will likely take longer.

In the 1980s Israel was a fiscal basket case with a government debt ratio exceeding 150%, hyperinflation and sluggish economic growth. Very few countries in world history made the leap from an emerging market to a high-income industrialized economy. Israel managed this feat while fighting wars and terrorism and reducing deficits, debt, and taxes. All this occurred despite periodic shifts in the ideological orientation of the political parties in power. In the coming generation Israel has the opportunity to move from the bottom of the industrialized productivity league tables to a respectable position closer to the top.

[1]*Unlocking Even More Value in the Israeli Stock Market*, available at: www.israelinvestmentadvisors.com