

**COUNTRY PROFILE:****STATE OF ISRAEL****DATED:****AUGUST 2008****CREDIT GUARANTEE:**

IES/02: ATTACHMENT A

	<i>Country Rating</i>	<i>U/W Method</i>
<i>Short-term</i>	2A	No Restrictions

*Recent Political Highlights*

- ❑ Chief of state since July 2007 has been President Shimon Peres with head of Government Prime Minister Ehud Olmert since May 2006. The president is largely a ceremonial role and is elected by the Knesset for a seven-year term.
- ❑ The Economist does not expect the coalition Government to survive until the next scheduled election in 2010. This is due to numerous small parties being represented in Government, which means that ideologically diverse and fractious coalitions will continue to be the norm, militating against meaningful progress in the peace process with the Palestinians which would require strong leadership on the Israeli side and a more united Palestinian administration.
- ❑ Israel's prime minister has announced that he will step down next month, struggling under a spate of investigations into alleged corruption. The two front-runners to succeed him are foreign minister Tzipi Livni and transport minister Shaul Mofaz. Mr Olmert's reputation was irreparably eroded by the recent lengthy courtroom testimony of a New York businessman said to have made improper cash contributions to him for a decade before he became prime minister.
- ❑ Eight months into its difficult negotiations with the Palestinians, Israel recently drew up a detailed proposal for a peace agreement offering to withdraw from 93% of the West Bank. The proposal includes arrangements on three bottleneck issues of the decades-old Israeli-Palestinian conflict: borders, the Palestinian refugee problem and security. Olmert offered the Palestinians land in the southern Israeli Negev desert, adjacent to the Gaza Strip, compensating for 5.5% of the 7% of the West Bank that Israel wants to annex.

*Recent Economic Highlights*

- ❑ Israel has a population of 7m people with an expected population growth rate of 1.7% in 2008.
- ❑ Despite expected Government instability, there is a broad consensus on key issues of economic policy, including the importance of maintaining a general Government budget deficit of below 3% of GDP, restricting inflation between 1%-3% target band (although this has been breached) and attracting high levels of foreign investment. The fiscal deficit is forecast to remain well below 2% of GDP until 2012.
- ❑ Although slowing, GDP growth will average 4.1% between 2008-12, supported by domestic demand and investment. GDP growth will reach 4% in 2008 and 3.2% in 2009 from 5.3% in 2007. The economy performed strongly in early 2008 but weaker than expected OECD growth and the prolonged strength of the shekel. According to figures released by the Central Bureau of Statistics (CBS), Israel's GDP grew 5.4% in the first three months of 2008, after growing 5.3% in 2007. Business-sector GDP grew by 6.1%, while exports of goods and services increased by a huge 12.6%.
- ❑ Inflation is forecast at 4.3% in 2008 and 3.4% in 2009 from 0.5% in 2007.
- ❑ Direct investment in the first half of 2008 totalled \$4.3bn – lower than the \$5bn during the first half of 2007.
- ❑ The tourism sector has performed surprisingly well with visitor numbers up 45% in the first half of 2008 compared with the same period of 2007, boosted by easier visa procedures for groups on short visits. According to the Ministry of Tourism, Israel hosted 1.5m tourists in the first quarter of 2008 and is on course to reach its goal of 2.8m visitors by the end of the year.
- ❑ The Manufacturing Association of Israel has repeated its warning that Israel's textile industry could be facing closure owing to a slowdown in the economy. About 850 textile employees have lost their jobs during the first half of the year. While textile exports fell 3.3% to \$520m during this period, textile imports (especially from Asia) rose 18.6% to \$656m. The Association has repeated its call for Government to provide an emergency program to rescue the industries which affords a livelihood for 16,000 families.
- ❑ The Ministry of Finance Accountant General Shuki Oren has hedged a total of \$1.5bn in external debt since April, bringing the total value of foreign currency hedges since the beginning of 2008 to \$2.5bn. The hedges are part of accountant general's multi-year programme to reduce foreign currency exposure. Government's foreign currency-denominated debt stood at \$31.1bn at the end of 2007 of which the dollar component amounted to \$27.4bn.

*Latest Trade Developments*

- ❑ Major exports: machinery and equipment, software, cut diamonds, agricultural products, chemicals, textiles and apparel.
- ❑ Major imports: raw materials, military equipment, investment goods, rough diamonds, fuels, grain and consumer goods.
- ❑ Main trading partners: US, Belgium, Hong Kong, Germany, China, Switzerland, UK and Italy.
- ❑ British Prime Minister Gordon Brown emphasised the UK's long-term economic commitment to Israel and his target of boosting bilateral trade to £3 billion by 2012 during his visit to Israel last month. Over the past decade UK-Israel bilateral trade grew by 40% to more than £2.3b per year. The UK is Israel's third largest trading partners after the US and Germany. Brown noted that with over 250 Israeli companies located in the UK and 47 Israeli companies listed on London stock exchanges, Israel was one of Britain's top business partners.
- ❑ South African exports to Israel totalled R5.5bn in 2007 from R4.5bn in 2006 and R1.7bn in the year to March 2008.