



DEFYING GRAVITY

Israel's economy is booming despite a strong shekel and stagnant export markets

THE APPLE that fell from a tree and bonked young Isaac Newton on the head led him to contemplate the laws of gravity. Some 350 years later, and despite the recent detection of Albert Einstein's gravitational waves, gravity is still not well understood.

Yet, everything obeys Newton's law, which says things fall to the earth – except perhaps the economy of Israel – which continues to thrive despite all the odds and obstacles, when many other Western economies remain stagnant and shackled.

On a sunny winter day in February, Prime Minister Benjamin Netanyahu and Finance Minister Moshe Kahlon doffed their neckties and ventured out into the streets of Jerusalem to celebrate, in Netanyahu's words, "an excellent year for the economy."

They stopped at a hummus stand and had hummus, pita, bean soup, *ful* (fava beans) and Turkish coffee, and the scene was streamed on Facebook Live. The idyllic friendship between the two would soon deteriorate into a nasty spat over the fate of the Israel Broadcasting Authority that, before a deal was finally reached, threatened to bring national elections.

Was 2016 truly an excellent year for the economy? Actually, it was, compared to the US and OECD (the club of 35 developed nations).

Now that all the numbers have been tallied and we can see the big picture, Israel's 4% economic growth compares favorably with that of the United States (1.6%), OECD (1.7%) and the world

(2.9%). So, in many ways, Israel's economy is, indeed, defying gravity.

The question is how and for how long? How can Israel's export-driven economy thrive when global trade is stagnating, Israel's main export markets (US and Europe) are far from robust and the strong shekel makes it very expensive for foreigners to buy goods and services here?

Gross Domestic Product (GDP) grew 4% in 2016, spurred by torrid 6.2% growth (annual rate) in the fourth quarter. Business-sector GDP climbed 4.7%. The engines of growth were consumer spending, which rose about 6%, and a spurt in investment (gross fixed capital formation), both in residential building and industry.

Economic growth created jobs. In May 2016, the rate of unemployment fell to 4.8%, its lowest level in 33 years, and then dropped even further to 4.3% in December, a level regarded by many as full employment.

The Tel Aviv Stock Exchange's TA-25 stock index declined 3.8% in 2016, after rising 4.4% in 2015 and 10.2% in 2014. This was misleading, however, because three major pharma stocks – Teva, Mylan and Perrigo – with disproportionate weight in the TA-25 dragged the index down while other stock indexes rose sharply – the TA-75 Index jumped 17.3%, and the TA MidCap-50 Index (medium-sized companies) soared 24.4%. The TA-25 Index has now been revised, and the new TA-35 will reduce the impact of pharma stocks.



ISRAELI HI-TECH start-ups continued to rack up major exits and initial public offerings in 2016, totaling \$10 billion, up 12% from 2015. However, 44% of that sum came from one deal – the \$4.4b. takeover of Playtika in July by a Chinese online gaming company – one of Israel's largest all-time exits. All in all, there were 93 mergers and acquisitions last year.

Experts noted that the pace of exits and IPOs slowed noticeably in 2016, and then came Mobileye's record \$15b. exit this March.

At the end of 2016, Israel had 73 companies



NOAM REVKIN/FENTONY/FLASH90

listed on NASDAQ; more than 300 global companies had R&D centers in Israel; and, according to the Bank of Israel, there were more than 5,000 start-ups, of which 430 were in cyber security.

In 2016, Israel ranked 21st in the IMD's World Competitiveness rankings and 21st in the Global Innovation Index, but only 52nd (out of 190 countries) in the World Bank's Ease of Doing Business rankings.

Aliya to Israel slowed markedly. Declining immigration from France and Ukraine resulted in some 27,400 immigrants during

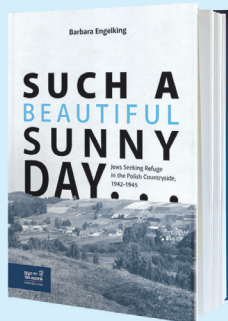
2016, down 12% from 2015. About 5,700 immigrants came from Ukraine, and just over 5,000 from France, or around 38% of the total. Immigration from the US remained stable at about 3,000.

Israel's trade deficit – the gap between imports and exports – surged 78% from \$7.8b. in 2015 to \$13.6b. in 2016, resulting from a 3% drop in exports and 6% increase in total imports. One cause was the appreciation of the shekel, which made exports more expensive and imports cheaper. If it were not for the trade deficit, economic

Before Finance Minister Moshe Kahlon (left) and Prime Minister Benjamin Netanyahu had a falling out, the two visited a Jerusalem hummus stand in February to celebrate 2016 as a great year for the economy

growth would have been higher.

Even though the dollar rose strongly relative to other currencies in 2016, the shekel strengthened by 2.5% relative to the US currency, and is, by some measures, at its



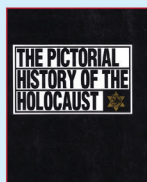
SUCH A BEAUTIFUL SUNNY DAY...

Jews Seeking Refuge in the Polish Countryside, 1942-1945

Barbara Engelking

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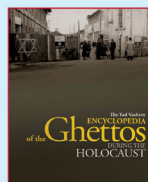


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This extraordinary compilation of photos, maps, and explanatory text is one of the most informative reference works on the Holocaust. After outlining the antisemitic and racist sentiment present in Eastern Europe, Dr. Arad discusses the foundations for Hitler's beliefs, and then recounts the escalation of Hitler's ideas.



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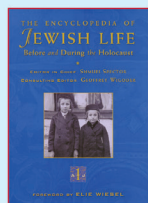
THE AUSCHWITZ ALBUM

The Story of a Transport

Editors: Israel Gutman and Bella Guterman

This unique album documents the process of arrival, selection, confiscation of property and preparation for murder of a Jewish transport from Carpatho-Ruthenia, which arrived at the ramp of Auschwitz-Birkenau in May 1944. This edition includes a picture that had been missing for years and the identity of the deportees.

In association with the Auschwitz Museum, Poland

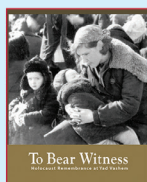


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Editors: Shmuel Spector and Geoffrey Wigoder

The encyclopedia features more than 6,500 communities, clarifies precise locations of settlements, traces their development, and shares small details of everyday life; 600 photographs and illustrations; 17 pages of maps; chronology; glossary; complete bibliography; indexes of communities and personalities. In association with New York University Press



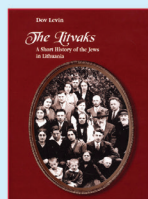
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TO BEAR WITNESS

Holocaust Remembrance at Yad Vashem

Editors: Bella Guterman and Avner Shalev

The new museum complex in Yad Vashem was designed to meet the changing needs of each generation and to serve as a bridge between the world that was destroyed and the life that resumed. This album leads the reader through the events of the Holocaust as depicted in Yad Vashem's Holocaust History Museum.



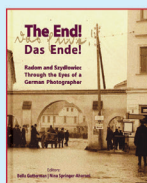
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THE LITVAKS

A Short History of the Jews in Lithuania

Dov Levin

Lithuania's vibrant Jewish community has always held a unique place in Jewish history as the outstanding cultural center for Jewish scholarship. The book describes the Jews in Lithuania from medieval times to the postwar period, highlighting periods of Jewish self-rule, the great yeshivot, the Gaon of Vilna, the Jewish nationalist movements, and other facets of Lithuanian Jewry.



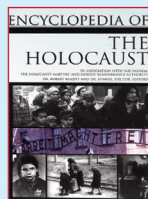
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THE END!

Radom and Szydlowiec Through the Eyes of a German Photographer

Editors: Bella Guterman and Nina Springer-Aharoni

This album is the work of an unknown German photographer who documented the events he had witnessed – the street scenes; the Jewish cemetery; the figures of the women, children and men; and the Jewish victims' deportation as well as the looting of the property.



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ENCYCLOPEDIA OF THE HOLOCAUST

Editors: Robert Rozett and Shmuel Spector

The encyclopedia features eight essays on the history of the Holocaust and its antecedents, as well as coverage of such topics as the history of European Jewry, Jewish contributions to European culture, and the rise of antisemitism and Nazism. The essays are followed by more than 300 photographs and approximately 650 entries on significant aspects of the Holocaust. In association with the Jerusalem Publishing House

highest level since 1984. The Bank of Israel continued to buy dollars to keep the strong shekel from rising excessively and hurting exports, purchasing \$8b. in 2016, and bringing Israel's foreign exchange reserves to an all-time high of more than \$100b. The shekel-euro exchange rate, too, is now at a 14-year high.

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A fierce debate has broken out over the wisdom and effectiveness of the Bank of Israel's dollar purchases; some free-marketers think the shekel should be allowed to find its own level through supply and demand, while exporters continue to press for a weaker shekel.

The Bank of Israel continued to expand money and credit in 2016, and the amount of cash and demand deposits, known as M1, rose 17.3%, while the broader monetary aggregate, M2, rose 8%. Despite the expanding money supply, inflation remained very low in 2016, with the consumer price index actually declining 0.2% – the second straight year of negative inflation. The Bank of Israel seeks to raise inflation to 2% by year end to spur the economy.

Housing prices continued to rise in 2016, increasing 8%, though some measures showed prices fell slightly in December, the first decline in years, before rising again early this year.

Government debt continued its seven-year decline in 2016 and has now fallen from 75.3% of GDP in 2009 to about 62% in 2016. This is in part because government budget deficits have been modest, 2.2% of GDP in 2016, the same as in 2015, due to higher than expected tax revenues.

Summing up 2016 to the Jerusalem Press Club, Bank of Israel Governor Karnit Flug said, "Our macroeconomic situation is very good and I think the economy has great potential, but we only utilize a portion of our strengths and our resources."

On many occasions, Flug has noted Israel's lagging productivity (output per hour) – labor productivity is only 76% of the OECD average – and the gap is not closing.

Income inequality in Israel remains high, among the highest of all OECD nations. Measured by those below the poverty line and spendable income, Israel ranks below all 35 OECD nations in equality except Mexico. However, a Finance Ministry report in February by chief economist Yoel Naveh claims Israel was one of only two OECD countries in which poor families' income grew between 2007 and 2015 at a faster pace than the increase in income among rich families. Real wages rose about 2.5% in 2016, even though labor supply rose and more Israelis joined the labor force. In 2016, labor force participation rose to 80.7% of the working-age population, higher than the OECD average

The outlook for 2017 is quite bright.

ACCORDING TO OECD economists, "Despite the appreciation of the currency and ongoing weakness of foreign demand, growth is projected to be robust in 2017 and 2018. The accommodative monetary stance and higher wages for the low-paid will bolster consumption, while investment will benefit from the launch of projects by major hi-tech firms and government measures to promote housing and transport. The current account surplus should shrink, unemployment remain low and inflation increase steadily within the targeted range of 1-3%, driven by pay rises."

In the US, the Trump administration is fashioning its new budget, based on an economic forecast that calls for 4% GDP growth – equal to Israel's 2016 growth rate. In his New York Times column, Nobel Laureate Paul Krugman lambasted this prediction as fanciful because, since 2012, only in the third quarter of 2012 did the US economy grow this fast, in the face of an aging

population, decline in immigration, low investment and low productivity growth. Can the US economy too defeat gravity like that of Israel? Few experts think it can.

In presenting the Bank of Israel's Annual Report on March 29, Flug praised the strong growth and low inflation, but drew attention to some drawbacks: "Home prices continued to escalate," "expenditure per student is not sufficient" and "[there is] low investment in public infrastructure." She strongly urged investing in these areas rather than passing back surplus tax revenue as tax cuts.

Will Israel's economy continue to defy gravity as it did in 2016? It probably will, as long as consumer optimism and business confidence remain high, as long as people continue to spend, and businesses and government continue to invest.

Business confidence, as measured by CEIC Data (a global database), reached an all-time high in December 2016, and consumer confidence has risen steadily since September 2015.

In the end, economies soar when spirits soar. And despite the political chaos in the world, in Israel, spirits seem high. In the 2016 World Happiness Report, Israel ranked as the 11th most happy (of some 157 countries), up from 14th in 2012, two places above the US and just behind New Zealand, Australia and Sweden, countries whose neighborhoods are far friendlier than Israel's.

Postscript: Those surplus tax revenues? On Tuesday, April 18, Finance Minister Moshe Kahlon called a snap news conference and announced a four-point "Family Net" program aimed at benefiting low- and middle-income families. It included higher tax credits, grants for working families, lower tariffs on clothing and cell phones, and cheaper day care. Kahlon did not clear his plan in advance with Prime Minister Netanyahu. But opposition leaders said they would offer Kahlon a Knesset "safety net" to pass his plan – a rare instance where a Finance Minister has opposition support. ■

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