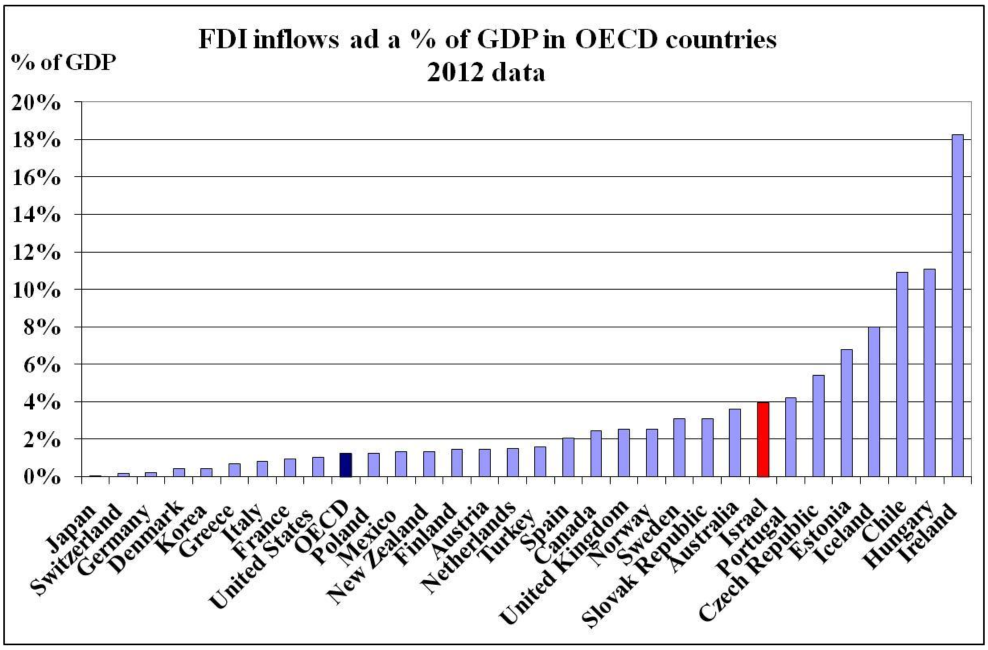
Leumi Economic Weekly

January 8, 2014

Foreign direct investment in Israel is in an upward trend

Foreign direct investment[1] in Israel by non-residents (FDI), channeled through the local banking system, amounted to a net US$550m in November 2013. In total during the period January – November 2013 FDI in Israel amounted to US$11.5bn, equivalent to 4% of GDP (a rate similar to that registered in 2012). This is the highest level of such investments in the economy since 2007, this despite the fact the data from the October-November period are only partial (the monthly data is from the local banking system only, whereas the quarterly data that will be published in the next month will also include data from additional sources), and December data have not been published yet.



In an international comparison of 2012 (see accompanying graph) it can be seen that FDI in the Israeli economy as a percentage of GDP was high compared to most OECD countries (average: 1.2%). The countries leading with the highest FDI as a percentage of GDP include (in descending order from highest to lowest): Ireland (more than 18%), Hungary, Chile, Iceland, Estonia, Czech Republic, and Portugal.

FDI in Israel throughout 2013 included strategic acquisitions of local companies from various sectors, but primarily from the technology sector, which stood out with a large number of acquisitions, among them being Waze (acquired by Google) and Trusteer (acquired by IBM).

[1] An investment is defined as direct when, among other things, 10% or more of the outstanding shares of a company are acquired.

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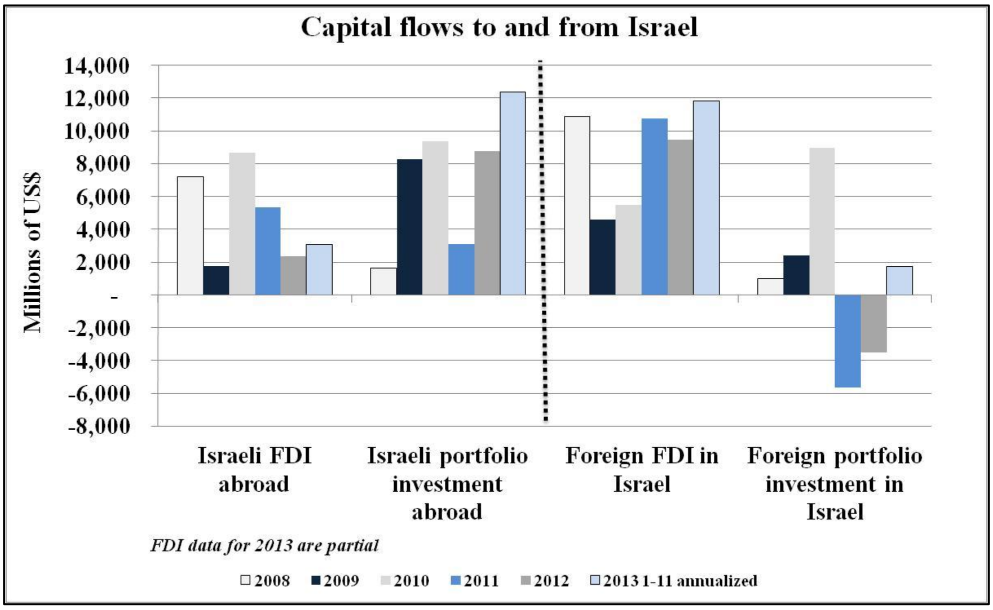
The increasing presence of R&D centers of international technology companies in Israel (for example Google, Apple, Samsung, Facebook, and more) and of investors and private equity investment funds from the US, Europe, and more recently also from Asia, will apparently support a continued upward trend in this activity. In addition, in light of a continued increase in optimism among investors around the world, as can be seen in international surveys (State Street Index, A.T. Kearny, ZEW, and more), this against the backdrop of expectations for a certain acceleration in the rate of global growth and a comfortable interest rate environment, the positive trend in FDI activity is likely to continue also in 2014.

Positive global economic developments, investor expectations, and limited alternative investments will support a continued positive trend in foreign investment

Parallel to the positive trend in FDI activity, foreign investors also increased their financial investments in the local market in November. Net investments in the local stock market amounted to US$100m, and in total year-to-date through November 2013 investments in stocks amounted to US$1.4bn. This represents a three-year high on an annualized basis. Recently there has also been an increase in investments by foreigners in the local bond market.

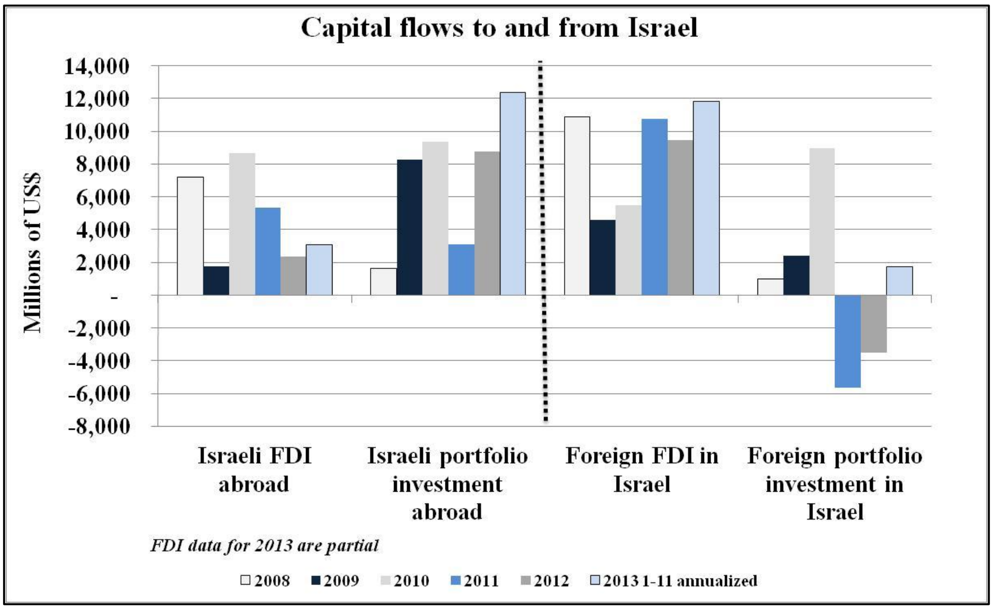


In the October-November 2013 period foreign investors invested a net US$397m in Israeli government bonds, and this after a net sell-off of bonds amounting to US$2.8bn in the May-September 2013 period. The "return" of foreign investors to the local capital market stems apparently from a range of reasons, including: an improvement in the geo-political realm (from the point of view of foreign investors) and also relative to the situation that prevailed in the third quarter of last year; a decline in the Israeli government budget deficit compared to the original budget framework; the positive interest rate differential between Israel and most of the developed countries (which contributes to carry-trade activity); and the basic strength of the shekel compared to the basket of currencies.

The positive trend in FDI activity, together with the recent increase in financial investments, and the surplus in the current account of Israel's balance of payments, which amounted to a cumulative US$3bn in the first three quarters of 2013 (1.2% of GDP), are all likely to continue to support a strengthening of the shekel.

A multi-year peak in financial capital outflows, the proportion of foreign equities owned by Israelis is increasing; nonetheless, the impact of financial capital outflows on the exchange rate of the shekel is moderate

Overseas financial investments (stocks and bonds) in foreign markets by Israeli residents amounted to US$940m in November 2013. Overall, in January-November 2013 investments amounted to US$12.4bn in annualized terms. This is the highest level since 1998, when the Bank of Israel (BoI) began publishing this data. It is notable that 70% of overseas financial investments in November were invested in equities, with the remainder in bonds.



An analysis of the data over time shows an increasing trend of shifting the financial investments of Israeli residents towards overseas equities. This trend started in 2003, following the high-tech crisis and the recession in the Israeli economy. In addition, the accompanying diagram shows that during periods of international crises a sharp decline occurred in overseas investments by Israelis in financial securities, despite the highly positive correlation between the Israeli capital market and foreign markets. Conversely, during periods of economic recovery around the world, a reverse trend occurs of capital exiting Israel and flows abroad.

According to data on the portfolio of financial assets held by the Israeli public, the holding rate of the Israeli public in foreign stocks stands at 7.7% of the overall portfolio, and representing 32% of the total stocks' portfolio, compared to an average of 20% in the past decade. These developments likely attest to a moderation in the “home bias” phenomenon (what this means is a weakening in the preference of local investors to invest in domestic equities despite the advantage of diversifying risk, primarily for investors from small, open economies such as Israel).

However, it is notable that despite the substantial increase in financial outflows (which are supposed to moderate the pressures supporting appreciation of the shekel) it is not evident that a substantial effect exists on the exchange rates. Consequently, it is estimated that a significant portion of the investments in tradable securities overseas are hedged in order to cancel out the exposure to exchange rate movements.

Salaried positions increased by a negligible rate last year

There was a decline of 9,000 in the number of salaried positions in the economy in October 2013 (excluding seasonality), due to declines in the industrial, construction, and education sectors. This was the second consecutive month in which a decline was registered. As of October, the number of salaried positions in the economy stands at 3.17m, reflecting a near-zero (0.4%) change compared to November 2012. These data, which are based primarily on monthly calculations of employer reports to the National Insurance Institute (NII), and partially on other administrative sources, attest to a weakness in the employment market. It should be noted that a gap exists between the NII-based data, and the data of the Central Bureau of Statistics (CBS), which are based on a survey among households (see our *Leumi Economic Weekly* from January 1st, 2014). According to the CBS survey, the number of employed increased 3.2% in November.

Based on the local economic developments in recent months, which include a certain improvement in industrial manufacturing and export activity, and also an improvement in the expectations of employers against the backdrop of the rise in global economic activity, we estimate the number of salaried positions in the economy will continue to climb. However, the rate of increase is likely to be moderate in light of the trend among Israeli companies to downsize their workforces. This development is being seen in the industrial sectors, and especially among the sectors that have been hurt from the continuing erosion in profitability caused by the trend of appreciation of the shekel over the past year.

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