ISRAEL'S FINANCIAL FIREPOWER – EXECUTIVE SUMMARY

How low debt, high savings, and strong growth provide Israel significant financial firepower to fight and win a war

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December 31, 2023

Three months after Israel suffered the worst terrorist atrocity in its 75-year modern history, the war continues and Israelis once again demonstrate that overcoming setbacks, addressing challenges, and moving forward despite tragedy are the secrets to Israel's ultimate success.

Israel, still in the midst of confronting enemies on multiple fronts, is showing resilience and determination. Our latest in-depth research report Israel's Financial Firepower digs into the details of how the economy plays a significant role during and after the war. Key points from our longer analysis are summarized in this newsletter.

War has come, but Israel is strong and resilient.

- Israel's economic growth is strong
- Israel's savings are high
- Israel's debt is low
- Israel can afford to fight the war and increase defense spending over the long run

Israel has significant financial firepower to fight and win this war.

Prosperity and Security are Inextricably Linked

- Due to rapid economic growth and fiscal discipline, Israel was one of the very few countries in the world to reduce its government debt burden during and after the Global Financial Crisis in 2008. The Israeli debt-to-GDP ratio is currently 60% (see Chart 1) compared to 94% in the United States.
- Israel spends about $23 billion per year, or roughly 4.5% of annual GDP, to support its military (see Chart 2).
- Israel maintains a standing army of 170,000 troops with estimated reserves of 465,000 (360,000 mobilized for this war; see Chart 3).
- Security expenditures will balloon temporarily as Israel fights this war.
- The attack revealed glaring security gaps that must be resolved. Israel can afford this conflict as well as the necessary upgrades to its defense profile.
- Manpower, weapons, and intelligence are critical military assets, but Israel also possesses significant untapped financial firepower.
- Economic growth is essential to Israel's security.

Israel's Financial Firepower – Executive Summary

Hindsight is 20/20: Defense Spending Lagged the Economy

- Israel's defense burden shrank substantially and continuously over the past 50 years (Chart 2).
- Since the 2008 Global Financial Crisis, Israeli defense spending grew by just 1.2% per year when adjusted for inflation as opposed to GDP growth which was 4% per year.
- Israel shrank the size of its active-duty armed forces by 7,000 troops since 2008. Although this number might seem negligible, it is striking when placed into a broader demographic context (see Chart 3).
- Between 1993 and 2023 Israel's populace grew by 2.1% per year, by far the fastest population growth in the developed world. In 1993 there were 5.2 million Israelis with 2.3 million of them in the labor force. Today there are 9.7 million Israelis with 4.8 million in the labor force. If Israel conscripted a similar proportion of the labor force today as it did in 1993, the IDF standing army would be more than double in size.

Chart 1

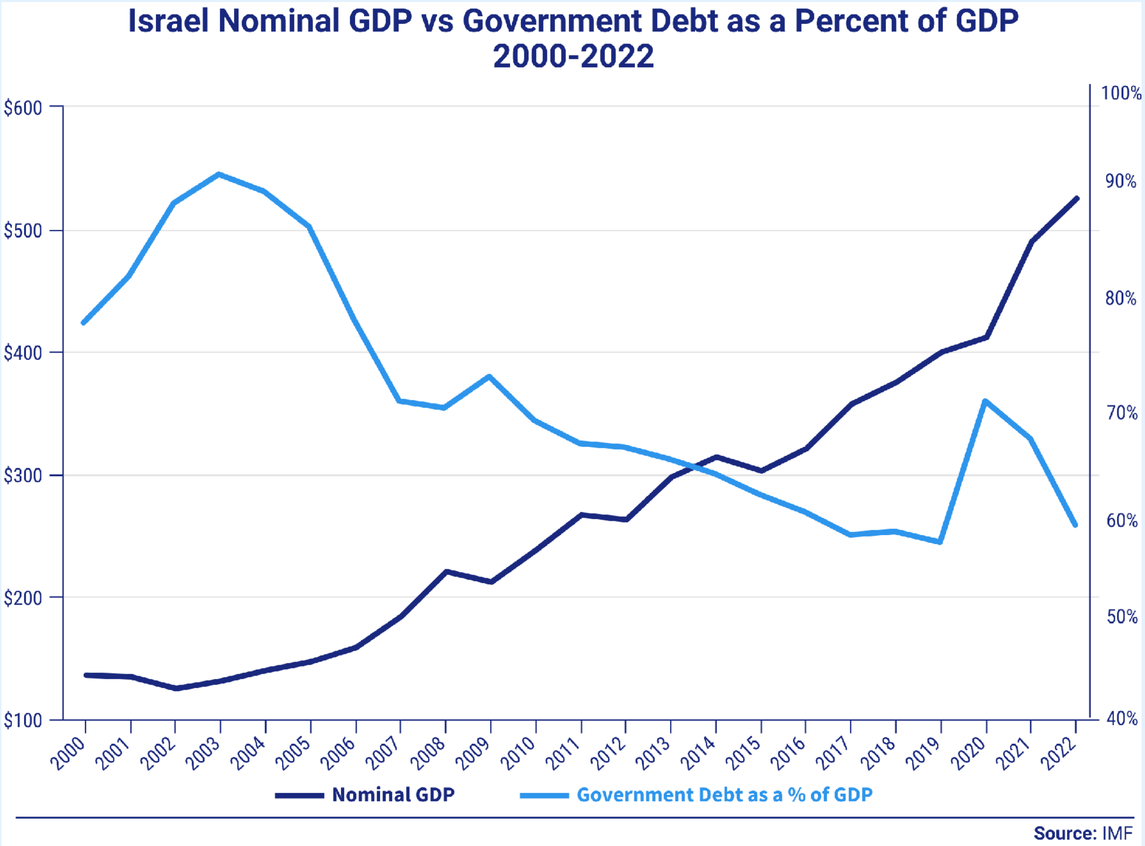


Chart 2

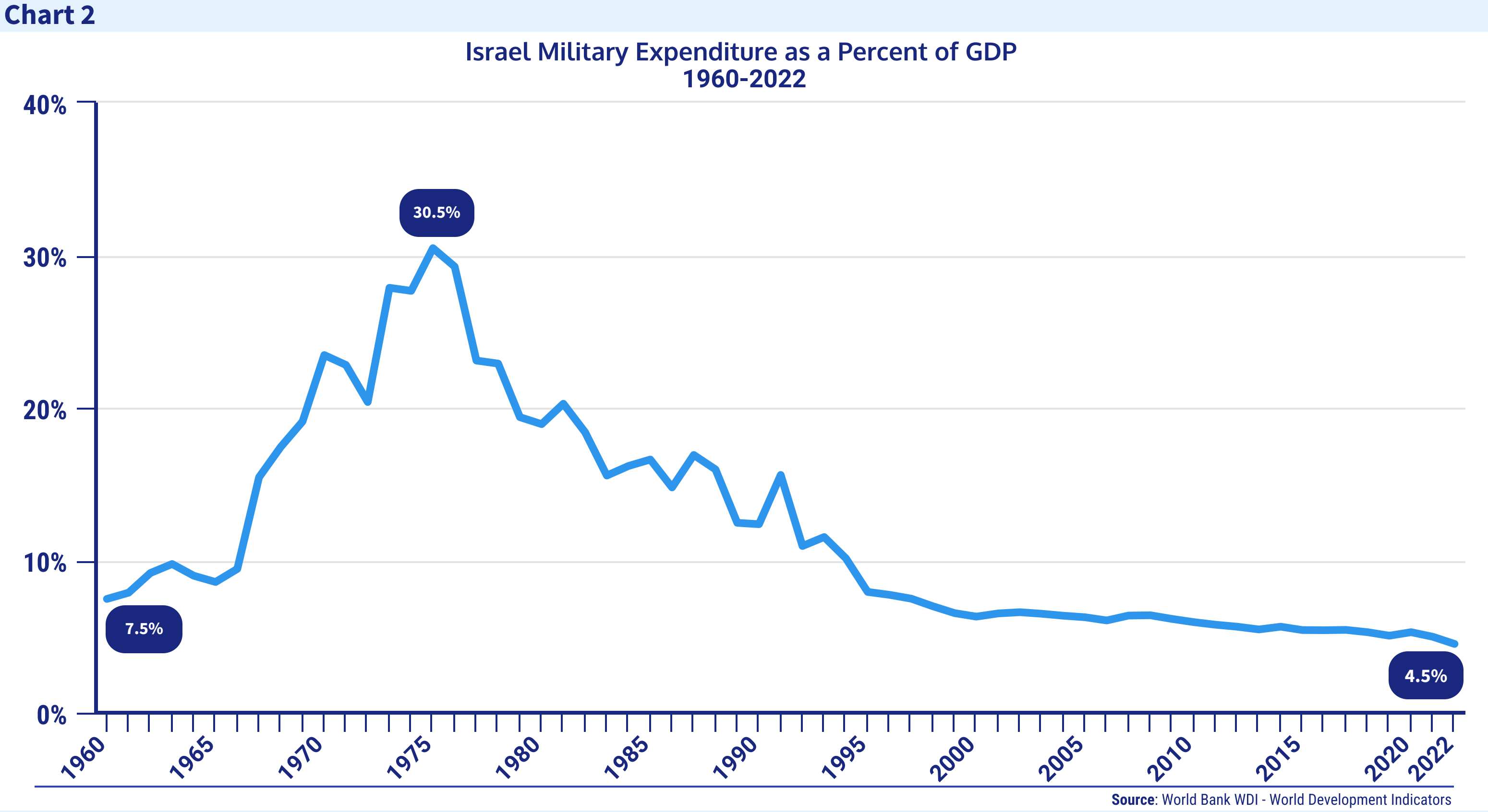
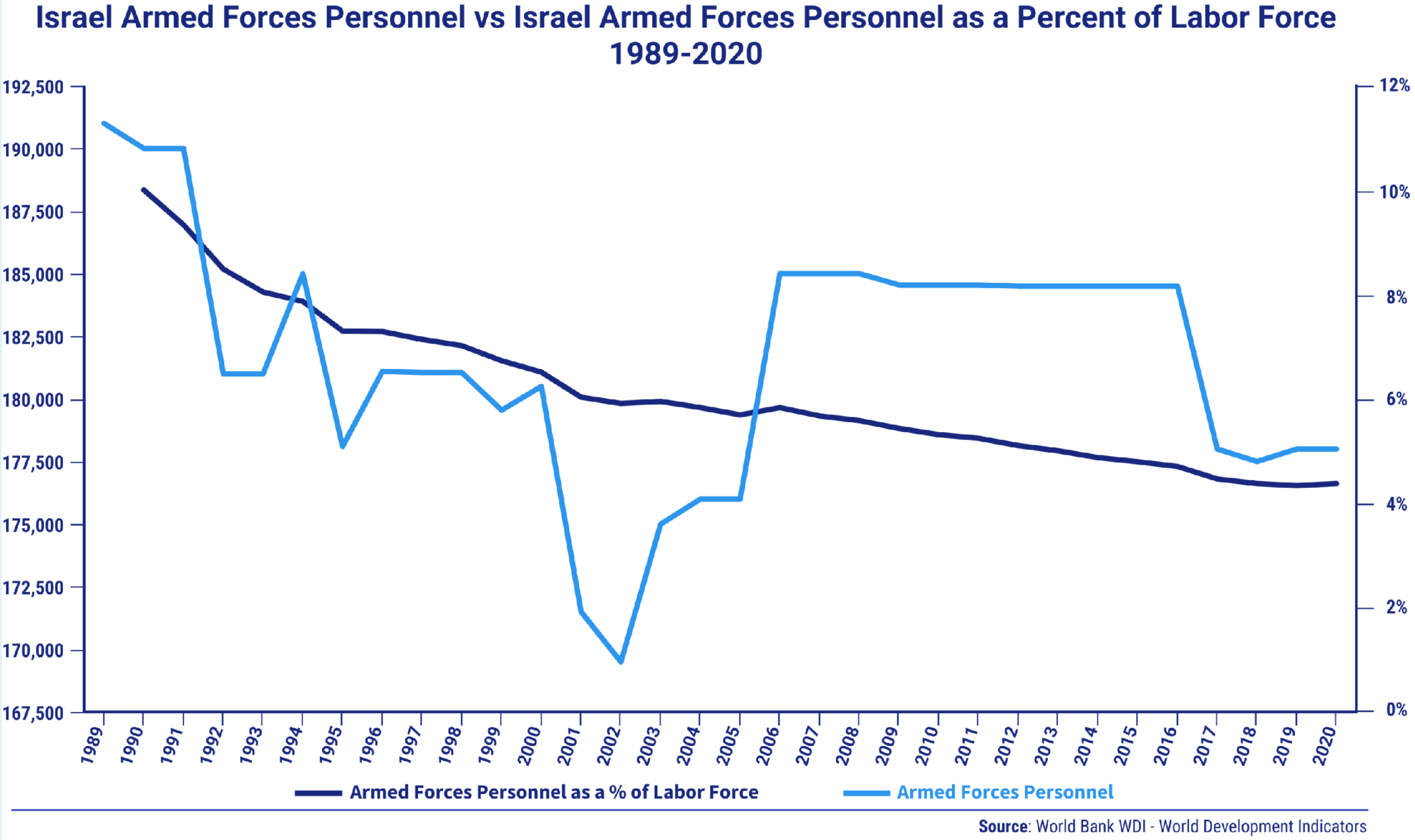


Chart 3



Wealth and Capital Growth in Israeli Society

- Israeli households are amassing wealth at a rapid clip due to their high savings rate. Net saving as a percentage of GDP stands at 16.2% in Israel vs. 2.4% in the United States, and the gap is widening (Chart 4).
- The Israeli savings system is based on tax-advantaged defined contribution plans similar to American 401(k) accounts, but with government mandated contribution requirements by employees and employers.
- The highest and best use of this capital is infrastructure and private sector investment, but it is also available for Israel's defense expenditures if required.
- If history serves as a lesson, in the depths of the Second Intifada, few observers would have predicted that the Israeli economy would flourish as it has over the past 23 years. Despite an inauspicious start to the 21st century filled with conflict, violence, and dashed hopes for peace, the Israeli economy boomed over the last two decades, while many wealthier countries, such as Japan, Italy and France, in less hostile neighborhoods, stagnated.
- Even if the economy suffers a recession similar in depth to the Second Intifada, Israelis should still comfortably save $3 billion to $4 billion each month. In the short-run the government may borrow this cash to fund the war.
- Unlike prior wars in 1948, 1967, 1973, and in Lebanon, Israel's financial firepower exceeds its needs. On top of this, American government assistance and donations from world Jewry will help alleviate fiscal pressures in the near-term.

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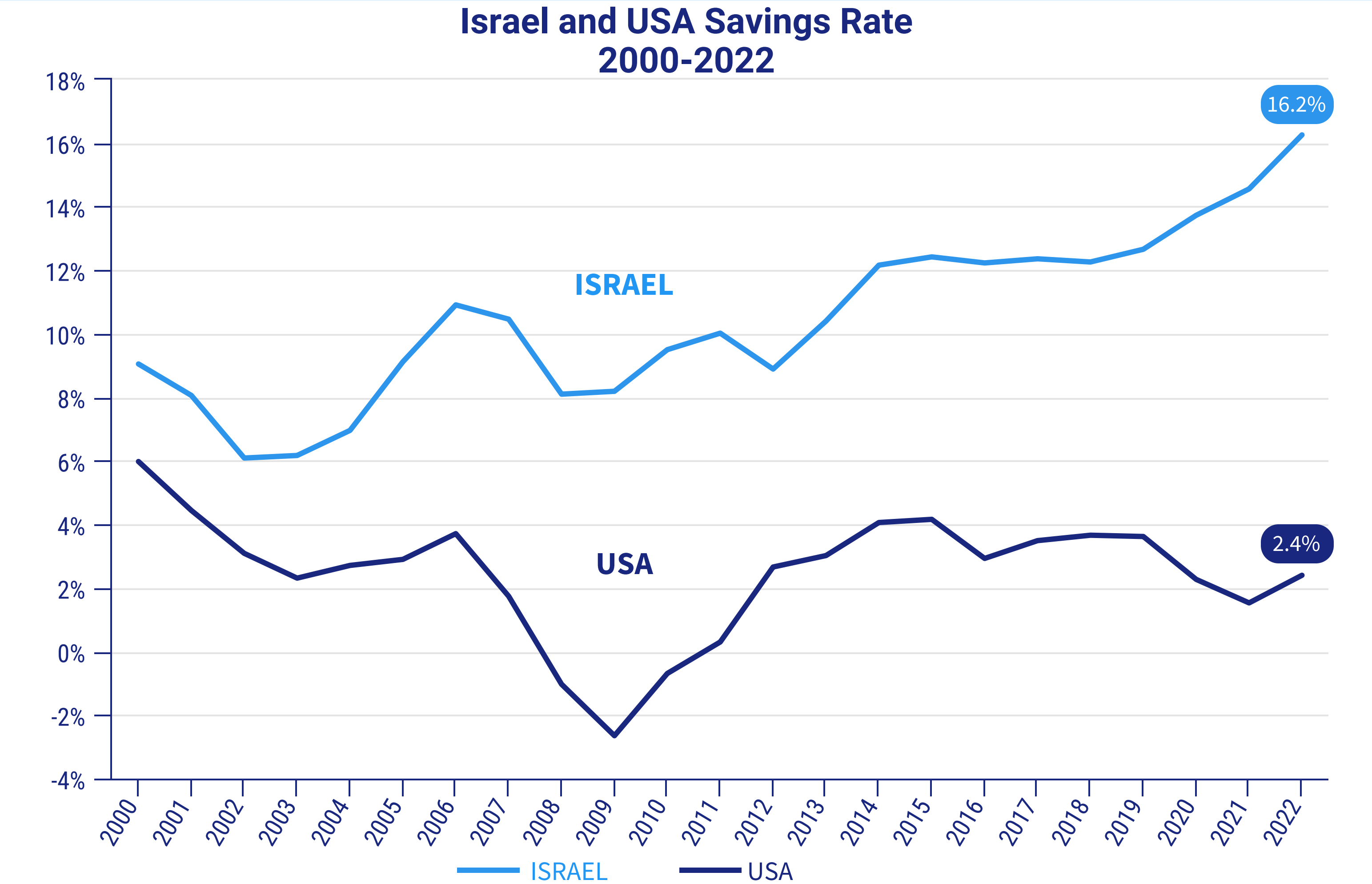
Chart 4



Source: OECD (2023), Saving rate (indicator). doi: 10.1787/ff2e64d4-en

Recession and Recovery – Lessons learned During the Covid Pandemic

- Israel mobilized 360,000 reservists which comprise 7.5% of the labor force. Another 200,000 people were evacuated from communities near the Gaza Strip and along the Northern border with Lebanon. This group removes about 100,000 people from the labor force. Another 180,000 Palestinians and other foreigners are no longer working in Israel amounting to an additional 3.6% of total employment. Added together, about 13% of the Israeli work force is dislocated by the current war.
- In the early months of the Covid pandemic the Israeli unemployment rate approached 22%. Current dislocations, plus the impact of a broader recession on the economy, will likely reach 15% to 17% of the labor force this time around. As a result, the pandemic experience serves as a fitting analogy for the economic costs of the current war. Direct costs to support the Israeli economy could approach a similar $30 billion, or perhaps as much as $50 billion depending on the scale and duration of the conflict.

Israel’s Growth Engines Remain Intact

- Israel’s long-term economic growth is powered by four engines: technological innovation, rapid population growth, increased labor force participation, and improved productivity.
- Of the four engines, productivity improvement is the most important albeit least appreciated by the broader public. Defined as the total economic output per hour worked, productivity is the key driver pushing living standards higher for the average Israeli. Productivity improves as Israeli companies achieve larger economies of scale and upgrade quality and efficiency in response to intensified business competition.
- Tough economic reforms have led the way in providing necessary measures to promote the strong economic growth of the last two decades.
- The job is far from finished, but economic reforms in Israel are gradually reducing competitive barriers. Of necessity, Israel will likely accelerate pro-competition economic reforms already under consideration to maintain robust economic growth after the war.

Israel's Financial Firepower – Executive Summary

War has come, but Israel is strong and resilient

- Israel is a rich country. Despite a potential war-related recession, Israel's growth engines remain intact.
- With 20/20 hindsight we now know Israel underinvested in defense.
- The good news is that Israel can afford to pay for this expensive conflict as well as permanently enlarged defense budgets.
- Low debt, high savings, and strong growth can provide Israel significant financial firepower to fight and win this war.

To read the complete report **Israel's Financial Firepower** **click here**

We extend our deepest condolences to the families who have lost loved ones; may their memory be for a blessing. We wish Refuah Shlema (complete recovery) for those who have been injured, and we pray for the safe return of every hostage and every soldier defending the State of Israel.

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