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Bulletin:

Israel's Medium-Term Fiscal Risks Are Rising After Yet Another Election Is Triggered

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PRIMARY CREDIT ANALYST

Maxim Rybnikov
London
+ 44 7824 478 225
maxim.rybnikov
@spglobal.com

SECONDARY CONTACT

Karen Vartapetov, PhD
Frankfurt
+ 49 693 399 9225
karen.vartapetov
@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF
@spglobal.com

This report does not constitute a rating action.

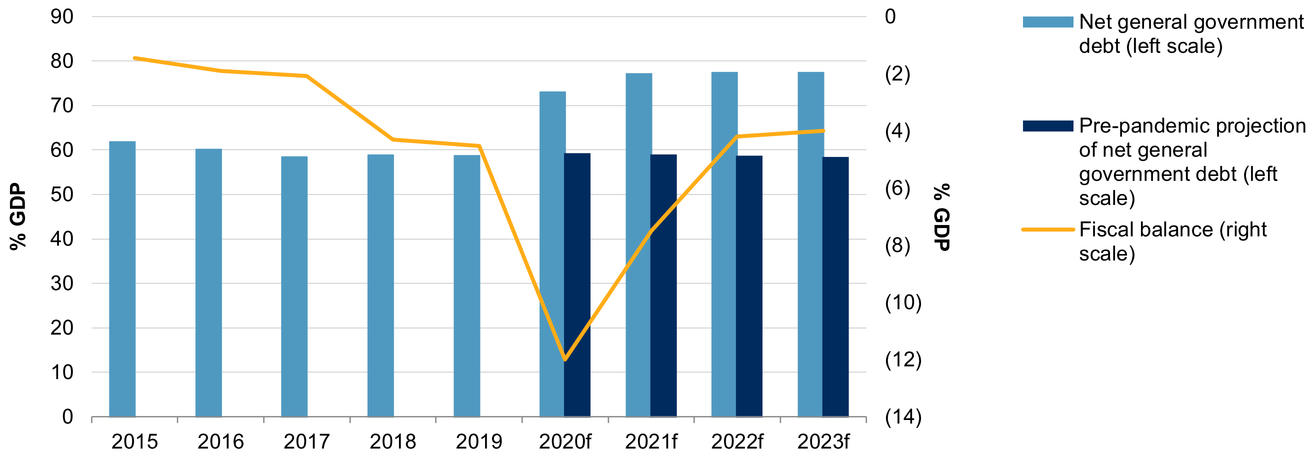
LONDON (S&P Global Ratings) Dec. 24, 2020--S&P Global Ratings does not expect any change in Israel's (AA-/Stable/A-1+) short-term policy direction after the announcement that the country will hold yet another out-of-cycle general election, currently scheduled for March 2021. However, we consider that the continued political brinkmanship and the possibility of another inconclusive election result could increase medium-term fiscal risks.

On Dec. 23, the latest government budget approval deadline elapsed, triggering dissolution of parliament and a fourth general election in two years. Israel has already gone through three inconclusive elections over the past 18 months. In April 2020, a coalition government was formed between the incumbent prime minister Benjamin Netanyahu's Likud and the center-right Blue and White Party led by Benny Gantz. Throughout this year, the coalition partners have been locked in frequent disputes with the deadline for passing the 2020 government budget (one of the backbones of the coalition agreement) repeatedly delayed.

An inconclusive electoral outcome could jeopardize formation of a stable government with a clear economic and fiscal policy agenda. Elevated political tensions are nothing new in Israel, given its highly polarized ideological and religious landscape. However, this time the degree of domestic political volatility is compounded by the COVID-19 pandemic as well as the legal trial against incumbent Prime Minister Netanyahu commencing in February next year. We therefore expect uncertainty to remain elevated in the coming months. The outcome of the upcoming ballot is difficult to predict, with a number of parties close in public opinion polls.

Our base case remains that public debt will stabilize at close to 77% of GDP in 2022-2023. Economic support measures to counter the impact of the pandemic, alongside the pandemic's impact on growth, will push up Israel's net general government debt in 2020. We estimate a rise to 73% of GDP by the end of 2020, from 59% at year-end 2019, effectively undoing the fiscal consolidation of the last decade in a single year. Nevertheless, our base-case scenario remains that the government will initiate efforts to consolidate fiscal accounts starting from the second half of 2021, with headline general government deficits declining to 4% in 2022-2023 and public debt stabilizing at close to 77% of GDP. For full details of our current base-case scenario, see "Israel Ratings Affirmed At 'AA-/A-1+'; Outlook Stable," published Nov. 13, 2020, on RatingsDirect.

The Pandemic Has Inflated Israel's Public Debt, But We Expect Gradual Fiscal Consolidation Over The Medium Term



f--S&P Global Ratings' forecast.

Pressure on the ratings could build if net general government debt continued to rise over the medium term. Delivering specific and effective budget consolidation measures will likely prove considerably more difficult politically compared with this year's stimulus. In our view, continued political fragmentation and a possible outcome of a hung parliament in March would act to reduce the likelihood of such measures being adopted.

Our ratings on Israel remain supported by its wealthy and resilient economy. We also view positively its net external creditor position, and the benefits that accrue to the state from flexible monetary settings and a relatively deep pool of domestic savings. The ratings are also supported by the structure of public debt, which is predominantly held domestically and denominated in local currency.