MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Israel's A1 government rating; outlook remains stable

Global Credit Research - 11 Aug 2016

New York, August 11, 2016 -- Moody's Investors Service ("Moody's") has today affirmed Israel's A1/(P)A1 issuer and government bond ratings with a stable outlook.

Moody's decision to affirm Israel's A1 rating with a stable outlook balances the following key rating factors:

1.) The country's economic resiliency, which derives from very high economic and institutional strengths, reflected in its strong and improving external position;

2.) The government's favorable fiscal dynamics in the recent past, although at risk in light of revisions to the budget rules; and

3.) Israel's susceptibility to geopolitical risk, which requires substantial budget allocations to defense on an ongoing basis.

Outlook Actions:

..Issuer: Israel, Government of

...Outlook, Remains Stable

Affirmations:

..Issuer: Israel, Government of

...Issuer Rating, Affirmed A1

...Senior Unsecured Medium-Term Note Program, Affirmed (P)A1

...Senior Unsecured Regular Bond/Debenture, Affirmed A1

...Senior Unsecured Shelf, Affirmed (P)A1

Moody's has also maintained Israel's Aa3/P-1 country ceilings for foreign and domestic currency debt, its Aa3/P-1 country ceiling for domestic currency deposits and its A1/P-1 country ceilings for foreign currency bank deposits. These ceilings represent the highest possible rating that an issuer domiciled in Israel can achieve.

RATINGS RATIONALE

FIRST FACTOR: THE RESILIENT ECONOMY AND ROBUST EXTERNAL POSITION DRAWS ON VERY HIGH ECONOMIC STRENGTH

Israel's A1 rating is supported by its durable economy and robust institutions, which have enabled the country to successfully weather global and domestic shocks as well as geopolitical challenges with limited disruption to its economic stability. The country benefits from a resilient dynamism and tight security structures. Furthermore, Israel can also depend upon financial support from the global Jewish community, mainly via the Israel Bonds program, and the US government, especially in an emergency.

Already a wealthy advanced economy, Israel's growth has averaged 4% over more than a decade, exceeding that of its OECD and rating peers, with low volatility. Exports however, an important contributor to this past growth, have slackened in recent years, in part due to a strong shekel. Still, the current account remains in surplus and the economy continues to grow close to its estimated 3% potential, led by private consumption. Productivity is lagging though, mainly due to the lack of competition between low value-added industries in the non-tradeables sector of the economy, a stark contrast to the highly competitive high-tech niche.

The economy's resilience derives in large part from its diversification and innovation, comprising established and start-up industries ranging from agriculture to pharmaceuticals, electronics and other high-technology products and services. Israel ranks third, behind Switzerland and Finland, in the World Economic Forum's latest Global Competitiveness rankings, driven by its research institutions and the labor force's capacity for innovation.

The recent discovery and exploitation of sizeable offshore gas reserves provide Israel with enhanced energy security, meanwhile its development of additional gas fields presages exports of gas to several markets in the region as well as to the EU. Israel's current account and balance of payments have already been in surplus for more than a decade, shifting the country's net external debt position into a surplus of 40% of GDP last year. The central bank's foreign currency reserves are at an all-time high of nearly $100 billion, i.e. roughly one third of GDP. This strong external position is yet another reflection of the economy's resiliency.

SECOND FACTOR: FAVORABLE FISCAL DYNAMICS PUT AT RISK DUE TO REPEATED REVISIONS TO FISCAL RULES

Israel's domestic politics are noisy, especially surrounding government budget formation, and the government's medium-term fiscal rules have been repeatedly revised for various reasons, most notably to increase spending beyond previously agreed ceilings. Still, the fiscal dynamics have been favorable almost without interruption over the past 13 years in spite these constant revisions. Once again in 2016, the budget deficit outcome is likely to be lower than the targeted 2.9% of GDP, due to the more tax-intensive nature of domestic demand-led growth, which is bolstering revenues above expected levels.

Whereas the unfunded spending concessions that were made last year to meet the demands of

individual coalition parties did not endanger the 2016 outcome because of the better than expected revenue picture, they have complicated the formation of the 2017 budget. New changes to fiscal rules set only last November will be required again this year if the two-year budget proposal for 2017-18 announced on 8 August is made into law.

In addition to higher expenditure in various areas such as defense than would be allowed under the current spending ceiling, the proposal also specifies individual and corporate tax cuts that are likely to undermine the revenue buoyancy that has contributed to lower than budgeted deficits in recent years. The combination of higher spending and tax cuts also means that the budget proposal could compromise the long-held political consensus around reducing government debt: Moody's estimates that deficits of the size now proposed in the budget proposal would lead the debt-to-GDP ratio to rise slightly between the end of 2016 and the end of 2018.

THIRD FACTOR: SUSCEPTIBILITY TO GEOPOLITICAL RISK IS A RATING CONSTRAINT

Israel's credit profile is susceptible to geopolitical risk, representing a constraint to the sovereign's A1 rating. That said, and despite the present conflicts in the Middle East, Israel's security situation has rather improved in the recent past. Security threats are contained owing to the strength and determination of the Israeli body politic (including the defense forces) as well as the financial and material support of the United States. Furthermore, its considerable military apparatus and technological advantages have led to a significant capacity for deterrence, particularly against traditional militaries.

However, whereas the proliferation of conflicts in Israel's immediate neighborhood (Syria and Iraq in particular) as well as those that have traditionally been conducted by proxy (Hezbollah, Iran, Lebanon) may not have more than an intermittent impact on Israeli economic activity, they do result in a diversion of government resources to the security effort. Although defense spending has been steadily decreasing in relative terms, it remains the largest single item in the government's budget, absorbing resources that could otherwise go to growth-enhancing spending such as education and infrastructure. Israel's outlays on defense totaled 5.4% of GDP in 2015, placing the country as the sixth largest military spender (relative to GDP) in the world.

WHAT COULD RESULT IN AN UPGRADE/DOWNGRADE

Israel's A1 government bond ratings would come under positive rating pressure if government budget deficits continued to be contained enough to lower the government gross debt-to-GDP ratio significantly. Also credit positive would be an easing of regional tensions or progress on a peace agreement with the Palestinians that reduced local antagonisms. Finally, a meaningful improvement in Israel's regulatory framework that boosted investment and productivity would support Israel's creditworthiness.

Downward pressures on Israel's government bond ratings would develop if geopolitical developments disrupted Israel's economic stability or if the government's commitment to fiscal discipline, in particular the consensus around reducing the government's debt to GDP ratio, was

to wane.

GDP per capita (PPP basis, US$): 33,656 (2015 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 2.5% (2015 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): -1% (2015 Actual)

Gen. Gov. Financial Balance/GDP: -2.1% (2015 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: 4.9% (2015 Actual) (also known as External Balance)

External debt/GDP: 30.2% (2015 Actual)

Level of economic development: Very High level of economic resilience

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 9 August 2016, a rating committee was called to discuss the rating of the Israel, Government of. The main points raised during the discussion were: The issuer's economic fundamentals, including its economic strength, have not materially changed. The issuer's institutional strength/ framework, have not materially changed. The issuer's fiscal or financial strength, including its debt profile, has not materially changed. The issuer has become less susceptible to event risks.

The principal methodology used in these ratings was Sovereign Bond Ratings published in December 2015. Please see the Ratings Methodologies page on www.moodys.com for a copy of this methodology.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the

issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Kristin Lindow
Senior Vice President
Sovereign Risk Group
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

Yves Lemay
MD - Sovereign Risk
Sovereign Risk Group
JOURNALISTS: 44 20 7772 5456
SUBSCRIBERS: 44 20 7772 5454

Releasing Office:
Moody's Investors Service, Inc.
250 Greenwich Street
New York, NY 10007
U.S.A.
JOURNALISTS: 212-553-0376
SUBSCRIBERS: 212-553-1653

MOODY'S
INVESTORS SERVICE

© 2016 Moody’s Corporation, Moody’s Investors Service, Inc., Moody’s Analytics, Inc. and/or their licensors and affiliates (collectively, “MOODY’S”). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS

AFFILIATES (“MIS”) ARE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY’S (“MOODY’S PUBLICATIONS”) MAY INCLUDE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY’S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY’S OPINIONS INCLUDED IN MOODY’S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY’S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY’S ANALYTICS, INC. CREDIT RATINGS AND MOODY’S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY’S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY’S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY’S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE. MOODY’S CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY’S CREDIT RATINGS OR MOODY’S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY’S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY’S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided “AS IS” without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third- party sources. However, MOODY’S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody’s Publications.

To the extent permitted by law, MOODY’S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY’S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY’S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from $1,500 to approximately $2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moodys.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or

MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000. MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.