

Israel's Economic Boom Outweighs Conflict, Corruption

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By David Rosenberg

March 6 (Bloomberg) -- Assaf Dahan, a 31-year-old Israeli mutual-funds analyst, is angry at the generals and politicians who sent his infantry unit unprepared into last year's war in Lebanon. He says corruption and incompetence are so widespread in politicshe doesn't know whom to support.

That didn't stop him investing some of the pay increase he got for moving to Excellence Nessuah Ltd., a financial-services firm, in Israeli securities.

"I'm investing most of my money locally," Dahan said by telephone from his office in the Tel Aviv suburb of Ramat Gan.

"The economic situation is excellent. Political problems and corruption have only a short-term impact on the market; in the long run, everything will work out."

The simmering tensions along the Lebanese border and in the Gaza strip, disaffection with the political system and a mounting security threat from Iran -- nothing has derailed the Israeli economy. Foreign investors last year poured a record \$21 billion into the country, helping the economy grow by a preliminary estimate of 5 percent and unemployment fall to a 10-year low in the fourth quarter.

Not even criminal investigations against Prime Minister Ehud Olmert, 61, Finance Minister Avraham Hirschson, 66, and other politicians, as well as accusations of rape against 61-year-old President Moshe Katsav, have unsettled investors. The benchmark share index rose to a record on Feb. 19, while the shekel has rallied for almost a year.

Rocket Fire

Gross domestic product grew an annualized 8 percent in the fourth quarter, the fastest rate in seven years. Surging home construction led a rebound from a contraction caused by the Lebanon war, when rockets fired by Hezbollah forced hundreds of thousands to flee northern Israel in July and closed factories across the region.

Consumer spending rose 4.7 percent in the fourth quarter, even as Hezbollah refused to disarm and Iran pushed ahead with its nuclear program, with President Mahmoud Ahmadinejad calling for the Jewish state to be wiped off the map.

Israelis say the reason for their resilience is simple: they've been living with such concerns since the Jewish state was founded in 1948.

"The shaky geopolitical situation isn't new," said Gil Bufman, chief economist at Bank Leumi Le-Israel Ltd. "As long as things don't have a direct effect on day-to-day life in major urban centers, it's not much of a factor as far as the economy is concerned."

'A Tidy House'

Moreover, the government hasn't allowed the political malaise or the Lebanon war to spark a jump in spending. "Even though the political situation isn't in order, the government has kept a tidyhouse fiscally," Bufman said.

The government ended last year with a budget deficit equivalent to 0.9 percent of GDP, less than a third of the planned shortfall, as the expanding economy lifted tax revenues.

HSBC Holdings Plc raised its forecast for economic growth this year to 4.9 percent on Feb. 27 from 4.1 percent. The sale of state-owned companies and the deregulation of markets has helped lift productivity an average of 5 percent annually in the past three years, aiding the expansion and containing inflation, it said.

"High technology goods and services have developed beyond the wildest projections and now account for about one third of GDP and 75 percent of industrial exports," London-based Morgan Stanley economist Serhan Cevik said in a Feb. 13 report. Israel has "become one of the most competitive economies in the world."

Nice Sales

Sales at Nice Systems Ltd. grew by a third last year from the sale of digital-recording technology to customers such as the Beijing subway and the Eiffel Tower. Its U.S.-traded shares rose about 29 percent, three times the pace of the Nasdaq Composite index.

The economic boom hasn't aided Olmert, who faces police investigations in connection with the sale of state-owned Bank Leumi Ltd. and some private real estate, and appointments he

made at the Industry and Trade Ministry. His long-time aide, Shula Zaken, has been put on leave in connection with a probe of the Income Tax Authority.

The government is also facing a commission formed to determine who was at fault for Israel's failure to destroy Hezbollah's military capability in the fighting last year.

Olmert was criticized today by State Comptroller Micha Lindenstrauss for failing to cooperate in his probe of problems regarding the home front command during the war.

"The prime minister is seeking to answer our questions by the end of March," Lindenstrauss told a parliamentary panel broadcast live on television. "It doesn't require such a long period of time to answer 12 questions."

The High Court of Justice ruled yesterday that Lindenstrauss couldn't present his findings until Olmert had responded.

Training and Equipment

"We were in training one or two days instead of a full week we were supposed to get," Dahan said. "The equipment we needed had been taken for other uses or was out of date." The prime minister should follow the example of Chief of Staff Dan Halutz, 58, who quit in January after taking blame for the war's failures, he said.

Olmert's Kadima Party has sunk to fourth place in opinion polls less than a year after it won general elections, and the list of problems for the government continues to lengthen. President Katsav was forced to suspend himself from office in January. Haim Ramon quit as justice minister this month after being convicted of an indecent act for kissing a woman soldier. Ramon's predecessor, Tzahi Hanegbi, has been indicted for illicit appointments when he was environment minister.

Hirschson is being investigated for his possible role in embezzlement at a non-profit organization he once chaired.

Two Sectors

"It seems as if there are two separate sectors, the economy and politics, that are functioning almost independently of one another," said Reuven Hazan, a professor of political science at Hebrew University in Jerusalem. He predicts that the political malaise, if it continues, will eventually hurt the economy: "At some point, one's going to spill over into the other."

With 78 seats in Israel's 120-member parliament, Olmert doesn't face any immediate threat of his government's collapse. Still, Hazan said he doubts the prime minister can hold on until the end of his term in 2010.

The conclusions of the commission probing the Lebanon war may create pressure on him to resign; if not, some Kadima members will be tempted to bolt the party if its prospects don't improve, he said. Kadima was formed at the end of 2005 by Olmert's predecessor, Ariel Sharon, from politicians who left the Likud and Labor Parties. Sharon was felled by a stroke before he could lead the party into the 2006 elections.

Hazan says the booming economy won't help Olmert politically. "Israelis don't vote their pocketbooks," he said. "Anyone who wants to take credit for the economy is welcome to, but it won't put them in power or keep them there. Security policy is what does that."

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