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Statement by the Hon. **YUVAL STEINITZ**,
Governor of the Fund for **ISRAEL**,
at the Joint Annual Discussion

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Dear colleagues and friends,

Last year governments around the world were alarmed by a threatening global crisis. Today we stand here with cautious optimism.

It is widely agreed that the IMF and the WB have reacted promptly, and with proportionate measures, to the global financial and economic crisis. It should be noted that the IMF, with its strong analytic capacity, should play a key role in the future development of international standards for financial surveillance.

Remarks on the Essence of the Crisis

Mr. Chairman, I believe that the *very essence* of the recent economic crisis is yet to be understood; until then, it would be quite premature to draw final conclusions.

Although we might identify the *causal sequence* of the extraordinary events that led us into the crisis - starting a year and a half ago with the bursting sub-prime bubble, through the collapse of Lehman-Brothers, and until today's early signs of recovery—we shouldn't ignore the fact that *this causal sequence looks inevitable only in retrospective*. We have to admit that this unique kind of encompassing global recession was unpredictable just two years ago; and the best testimony for this is that nobody predicted it.

True, few experts have managed to predict some elements of the forthcoming crisis, but none of them did foresee that these elements would have culminated into such a global economic earthquake.

From a philosophical point of view, one should consider the possibility that unlike the natural sciences, the science of economy is immanently imperfect. This is due to the high gravity of the psychological aspects of the field, which means that a widely accepted theory might change our behavior to the extent of refuting the underlying theory, and so on and so forth.

Even the immediate effects of the current crises on recent consumer and corporate behavior and leaders' decisions, in case of encountering future global challenges or possible aftershocks of the current crisis, are extremely hard to predict.

Indeed, economic and financial crisis of *that magnitude* provides us with a rare opportunity to further development of the economic theory, and we should not be surprised to see some shifts in the economic paradigm in the very near future.

Some Remarks with Regard to Israel

The current crisis has found Israel's economy holding steady in a turbulent environment: high growth rates, public debt on a downtrend, budget deficit lower than planned, and thriving hi-tech industry abundant with start-up companies and venture capital activities.

Most relevant were the conditions of the Israeli real estate market and the financial system: the first proved to be realistically priced, and hence not subject to the bursting bubble phenomenon. The financial system showed resilience, strong enough to avoid the risk of collapsing banks, insurance companies, and other financial institutions.

Despite the strong fundamentals mentioned above, the crisis did have serious negative effects on our economy, due to the global nature of our real economy and financial institutions: export figures have sharply declined, risk premiums soared, the well-known credit crunch occurred, thus influencing the real economy and investments, suppressing the stock exchange and the growth rates.

These negative implications, which in turn started to diminish state revenues and to raise unemployment rates, motivated the government to act in three major directions:

- An inclusive *economic stimulus plan*
- Unprecedented *biennial budget*
- A *package deal* with the employers and the unions

Additional measures are being taken nowadays on the regulatory level of the capital market. They include, increasing capital requirements from insurance companies, and re-organizing capital markets regulations in order to prevent aggressive destabilizing marketing of pension funds and other long term savings vehicles.

The government has taken steps to ease the credit crunch by providing guarantees for exporters and banks, and by creating leverage funds and credit funds for businesses. Government actions have also included billions of shekels injected into Research and Development programs, in order to support the hi-tech industries.

We can say with satisfaction, that the last three months have finally shown clear signs of recovery, as most macro-economic indicators have shifted direction: exports have risen 25%, tax revenues expanded again, and the Composite State-of-the-Economy-Index rose significantly. For the first time in 15 months manufacturing production and trade and services revenues significantly increased, while some improvement in the labor market was also indicated.

We believe that the latest developments resulted mainly from:

- A. The government initiatives in the real market: expanding public expenditure and support for the credit market while cautiously keeping a *declining trajectory of the fiscal balance* for the medium and long term.
- B. The positive psychological effect of consolidating a comprehensive economic plan, the responsible and coherent monetary policy of the Bank of Israel, the approval of a unique biennial budget, and the successful resolution of the tri-party package deal.

The expansionary monetary policy was another important component of the overall reaction to the crisis.

The Bank of Israel, under the leadership of governor Stanly Fischer, reduced interest rates and conducted an expansionary monetary policy as well as acting in the foreign exchange market by discretionary purchases. Its policy reflects the need to return inflation to the target range of price stability, to support the recovery in economic activity, and to maintain financial stability.

Despite the positive developments mentioned above, I strongly suggest that caution is still essential in this time of uncertainties. I want to emphasize that while the increase in unemployment in Israel seems to be currently contained, employment will remain one of the most challenging issues.

Israel and the IMF

Finally, I would like to confirm Israel's support of the recent G20 initiative to increase the resources available to the IMF in order to support emerging markets and developing countries.

Israel is willing to play its part in contributing to the IMF's resources and will participate in the two main funding programs—the NAB (New Arrangement to Borrow) and the Voluntary SDR Allocation—that were recently announced. Upon demand, the IMF would be able to get a loan, up to 500 million SDR, that would be paid from Israel's foreign exchange reserves.

In addition, Israel will be committed to purchase its allocated SDR. This will be implemented as an investment from our foreign exchange reserves.

Israel is proud to be part of the global effort to strengthen the global financial and economic system, and recognizes the importance of coherent policies to support growth in developing countries.

To conclude, I would like to express my deep appreciation to our hosts, the Republic of Turkey and the local authorities of the beautiful city of Istanbul, for the well planned and executed Annual Meeting and the warm welcome we have all received.

Thank you

Dr. Yuval Steinitz
Minister of Finance, Israel