

July 19, 2018

SURVEY OF INDUSTRY EXPECTATIONS FOR JULY – SEPTEMBER 2018 Final Findings

Based on the answers of ~181 industrial companies which responded to the survey from mid-June 2018 through to mid-July 2018

Manufacturers' reports on the second quarter of 2018:

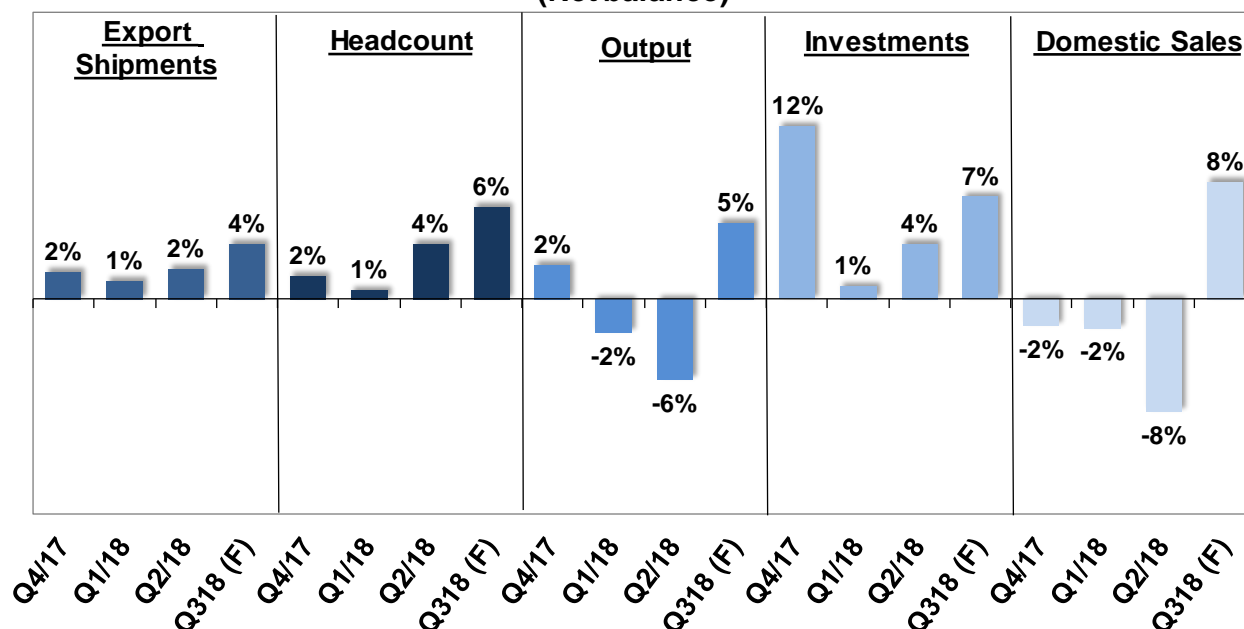
- ❖ The decline in industrial output deepened.
- ❖ Industry sales to the domestic market continued to drop.
- ❖ Growth in export shipments continued.
- ❖ A further increase in employee headcount in industry.
- ❖ Growth in industry investments in fixed assets continued.
- ❖ Expansion of the operations of multinational industrial companies abroad.

Manufacturers' forecasts for the third quarter of 2018¹:

- ❖ Forecasts for an increase in industrial output, most likely as a result of seasonal factors.
- ❖ Domestic market sales are expected to soar.
- ❖ Forecasts for further growth in export shipments.
- ❖ Forecasts for accelerated growth in hiring in the industry sectors.
- ❖ The growth pace of industry investments is expected to continue to accelerate.
- ❖ Forecasts for growth in the operations of multinational industrial companies abroad.

¹ Since 2014 the Division of Economic Research has deducted a bias coefficient from the net balances obtained from the manufacturers' forecasts, since over a lengthy period a bias has been observed in manufacturers' forecasts in the Survey of Industry Expectations versus their actual reports. This analysis refers to the manufacturers' forecasts less the bias coefficient found for each parameter. For further information, see the explanation in the Methodological Appendix.

Manufacturers' Forecasts for the Third Quarter of 2017 (Net balance)



Net balance = the percentage of those reporting an increase less the percentage of those reporting a decrease, adjusted for the reported intensity of the change.

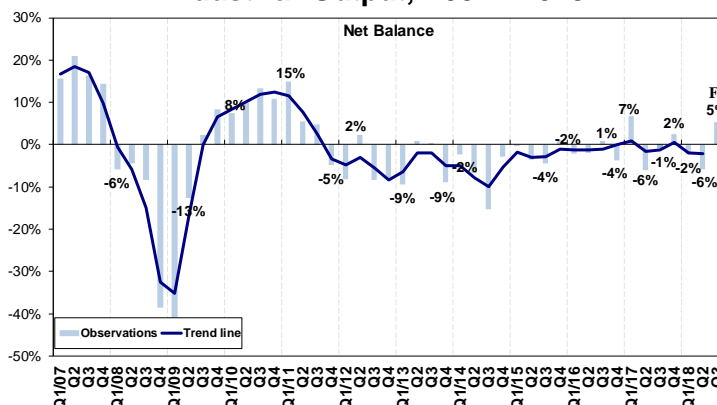
SURVEY OF INDUSTRY EXPECTATIONS FOR JULY – SEPTEMBER 2018

Industrial Output

In the second quarter of 2018 the decline in industrial output deepened, with manufacturers' reports indicating a negative net balance² of around 6%, further to a decrease of approximately 2% in the first quarter of the year.

In parallel to the decline in industrial output, equipment utilization in industry decreased, with a negative net balance of around 2% subsequent to a decrease of around 3.5% in the previous survey. By contrast, a positive net balance of around 6% was recorded in raw materials inventory, and of 5% in finished goods inventory

Industrial Output, 2007 - 2018



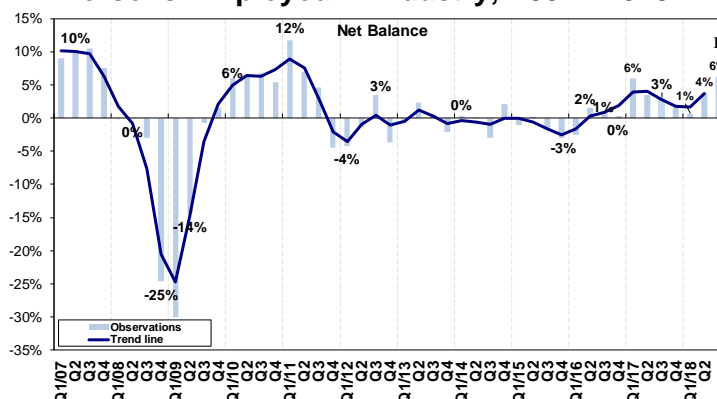
In the third quarter of 2018 manufacturers foresee a rise in the pace of growth in their output, with a positive projected net balance³ of around 5%. We estimate that the forecast for this increase is most likely influenced by a high seasonal impact in view of Rosh Hashanah and the Jewish festivals, which fall in September 2018.

Persons Employed in Industry

In the second quarter of the year a further increase was reported in industry headcount: Manufacturers' reports indicate a positive net balance of approximately 4% further to reports of an increase in headcount (1% positive net balance) in the first quarter of 2018.

However, the difficulty in recruiting professionals for the industry sectors continued, with 88% of manufacturers reporting such difficulty in the second quarter of 2018 further to 85% in the two prior quarters.

Persons Employed in Industry, 2007 - 2018



Manufacturers estimate that in the third quarter of 2018 the pace of hiring in industry is expected to pick up, with a positive projected net balance of around 6%.

² Net balance = the percentage of those reporting an increase less the percentage of those reporting a decrease, weighted according to the intensity of the change.

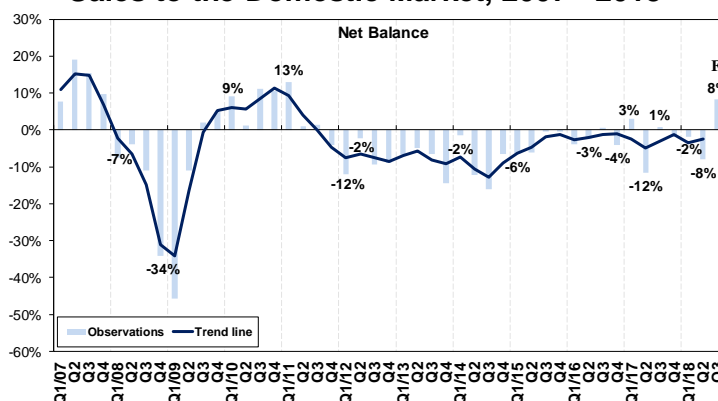
³ Projected net balance, less the bias coefficient, derived from the average differences in the past decade (2004-2013) between the manufacturers' forecasts and their actual reports. For an explanation of the bias coefficient, see the Methodological Appendix.

Sales to the Domestic Market

In the second quarter of 2018 the drop in industry sales to the domestic market continued as the pace of decline deepened: A negative net balance of 8% following 2% negative net balance in the previous survey.

In the third quarter, manufacturers expect a sharp increase in domestic sales with a positive projected net balance of around 8%, which reflects optimism regarding the development of local market sales. We note that the forecast for the dramatic rise in domestic sales may be due, among other things, to a high seasonal effect as Rosh Hashanah and the Jewish festivals, which fall in early September 2018, draw near.

Sales to the Domestic Market, 2007 - 2018

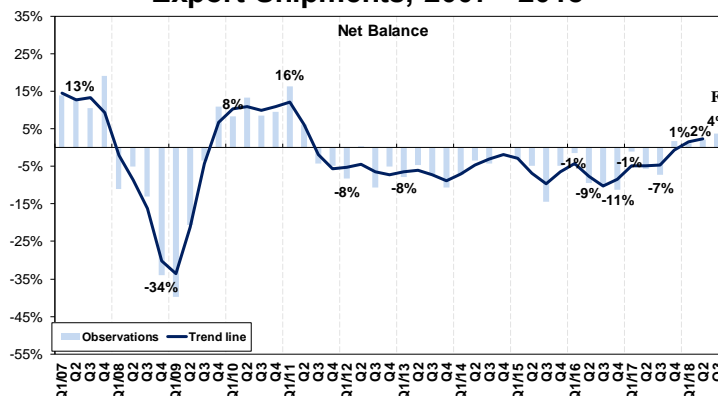


Export Shipments

In the second quarter of 2018 export shipments continued to increase, with a positive net balance of around 2% further to a positive net balance of 1% in the prior quarter.

Nevertheless, the dramatic erosion of export profit margins continued, with a negative net balance of about 14% in export profitability further to a negative net balance of 19% in the first quarter of 2018. We note that in all probability, the erosion of profit margins is due to the cumulative impact of the revaluation of the Shekel against the U.S. Dollar.

Export Shipments, 2007 - 2018



Additionally, a further drop in export prices in foreign currency was recorded in the second quarter: A negative net balance of 4% further to 5% negative net balance in the previous survey. The decrease in prices is the result, among other things, of the revaluation of the Shekel against the Dollar, combined with the difficulties encountered by exporters due to the harsh global competition, which has forced them to continuously lower their prices in foreign currency.

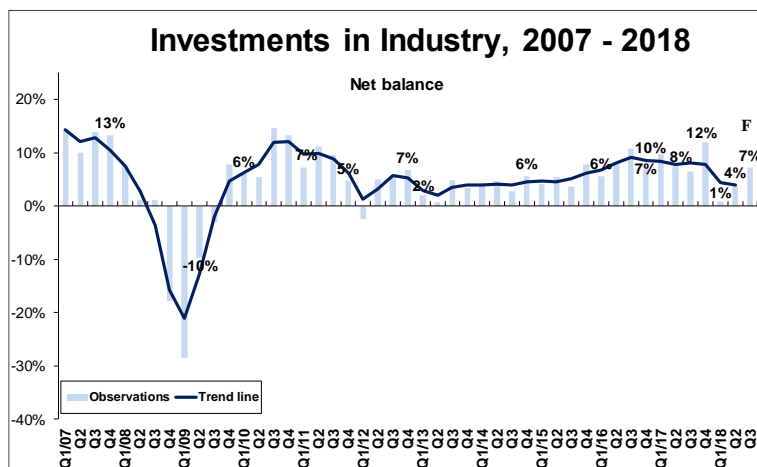
In the third quarter of 2018 manufacturers foresee further growth in export shipments with a positive projected net balance of around 4%, together with a further drop in export prices in foreign currency (3% negative projected net balance).

The major factors inhibiting export growth as ranked by exporters are domestic manufacturing costs, foreign exchange rates, international prices and local demand.

Investments in Industry

In the second quarter of 2018 industry investments in fixed assets continued to grow: A positive net balance of around 4% further to 1% positive net balance in the prior quarter.

Manufacturers also reported an increase in real financing costs, with around 7% positive net balance in the quarter under review, perpetrating a trend of rising expenses, which has persisted for over seven years⁴.



Methodological Appendix – The Bias Coefficient

Since 2014 the Division of Economic Research has deducted a bias coefficient from the net balances obtained from the manufacturers' forecasts, since over a lengthy period a bias has been observed in manufacturers' forecasts in the Industry Expectations Survey versus their actual reports. For most parameters this bias was found to be positive, meaning a tendency to over-optimism, while in a small number of parameters a tendency to pessimism was observed.

Bias coefficient: The average difference in the past decade⁵ between the net balance of the manufacturers' forecasts⁶ and the net balance of their actual reports for that quarter.

Bias Coefficients (%)

(Positive coefficient = tendency to over-optimism; negative coefficient = tendency to pessimism)

Parameter	Output	Export	Domestic market	Headcount	Investments
Total industry	4.0	4.0	2.1	-1.6	0.5

⁵ Commencing in the first quarter of 2004 through to the last quarter of 2013.

⁶ The percentage of manufacturers reporting growth less the percentage of those reporting a downturn, weighted for the reported intensity of the change.