TODAY'S SHEKEL

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BoI: Israel will need NIS 20 billion in budget cuts, tax hikes for 2015

• By NIV ELIS

Finance Minister Yair Lapid will need to find NIS 12 billion in budget cuts and NIS 8b. more in new taxes in 2015 to stick to the country's fiscal targets, the Bank of Israel said in its annual report, released Monday.

The situation will only get tougher further down the line: 2016 will need NIS 20b. in cuts and NIS 12b. in tax increases, and 2017 will need NIS 27b. in cuts and NIS 13b. in tax increases. Because of the nature of the budgetary rules, which limit increased spending, any of those cases could see lower taxes, but only if they are accompanied by greater cuts. The deficit target shrinks from 3 percent of GDP in 2014 to 2.5% in 2015 and 2% in 2016.

In 2013, the report said, unexpectedly low costs and several one-time tax injections, such as taxes on major exits and a deal for big companies to release "trapped profits," helped bring the budget in significantly under its unambitious deficit target.

Bank of Israel Governor Karnit Flug explicitly mentioned Lapid's housing VAT exemption, which she opposed, as adding burden to the budget. The move was estimated to cost NIS 2b. a year, but will likely cost more as the limitations on the exemption erode.

The report showed that the price of housing increased 6% in real terms in 2013, bringing overall real growth since 2008 to approximately 60%. But flug saw a possible light at the end of the tunnel as well.

"Building starts remained elevated in 2013, and in each of the last three years their number was slightly higher than the incremental number of homes needed to supply the housing requirements deriving from demographic growth," Flug wrote in a letter to the government accompanying the report. "If the number of starts remains high and also includes areas in demand, this could contribute to a reduction in the pressure in the housing market and stabilize and even bring down prices."

BANK OF ISRAEL Governor Karnit Flug presents the central bank's annual report to Finance Minister Yair Lapid yesterday in Jerusalem. (Daphna Tal)

The economy grew at 3.3%, a slight slowdown over the previous year when natural-gas production was taken out of the picture, but significantly better than the OECD average of 1.2%, or the 0.4% economic contraction in the euro zone. Unemployment remained at a historic low, and the Bank of Israel characterized the economy "at full employment." The central bank projected growth for 2014 at 3.1%.

The slowdown was driven by a reduction in exports, a result both of floundering demand in the world and Israel's strong currency. Service exports, however, continued to grow.

"Looking ahead, over the long term, economic policy is faced with the dual challenge of ensuring that growth is sustainable and inclusive," Flug wrote. Improving education across all sectors and creating a more fully integrating labor market were key objectives that would also help bring down the cost of living and allow the government to continue providing a reasonable level of services, she added.

Another key, Flug wrote, was increasing productivity. New research in the report found that Israeli export-oriented industries had far higher productivity than non-export-oriented ones, likely because of the increased competition they face.

Another of the report's highlights, which were released ahead of its full publication on Monday, included an analysis that the share of Israel's exports to China's may double from the current 5% to 10% in 2035.

Emerging markets, and China in particular, are slated to shift global growth's center of gravity, the report said.

It also touched on Israel's taxation system, noting that creating a system for mandatory filing should not proceed unless easy, efficient technology were laid out first.

Russia sell-off spurs hunt for bargains

ANALYSIS

• By GERTRUDE CHAVEZ-DREYFUSS and DANIEL BASES

NEW YORK (Reuters) – Rising tension between Russia and the West has rattled the country's stock and bond markets, but some big money managers see the turbulence as an opportunity.

Russia's equity market has plummeted 18 percent so far this year. Foreigners dumped the country's stocks, bonds and the ruble following the early March invasion of Crimea, a territory of Ukraine. It now faces economic sanctions that could worsen if the crisis escalates.

Investors have reacted with their feet. The ruble is down nearly 9% on the year, and investors have pulled about $4.4 billion from stocks and $4.1b. from bonds between September 2013 to the middle of March, according to the latest data from EPFR Global.

"Russia's stock market right now is one of the cheapest in the world – and probably one of the most hated," said investor and commodities guru Jim Rogers, chairman of Rogers Holdings, in Singapore. "This is the time to buy Russia."

Those betting on Russia now should have a long-term horizon. After citizens in the Crimean peninsula voted for annexation by Russia, the United States and European Union reacted by issuing sanctions that, while limited in scope, could be broadened.

Russia's economy has weakened as inflation has risen and investments have stalled. IMF data shows the country's reserve assets declined to $493.3b. in February from $509.6b. in December as it has defended its currency. The central bank raised interest rates by 1.5 percentage points to stem the ruble's fall.

Rogers, who has been investing in Russia for the last one and a half years, said he bought Russian stocks last week. He said if more sanctions are imposed and the equities market declines further, there would be more buying opportunities in Russia.

Rogers said he is looking for non-energy companies – a tall order considering the RTS Index of 51 leading Russian companies is heavily skewed toward energy (58% of the index) and basic materials (13%).

Estimates from emerging- and frontier-market specialists FMG Funds, based in Malta, show that Russian stocks are trading at a price-earnings multiple of about four times 2014 earnings, with an annual dividend yield of 5%.

By comparison, the US trades with a P/E ratio of nearly 16 times earnings and a dividend yield of just 2%, FMG data show.

FMG, which has $150 million in emerging- and frontier-market assets, is looking to scoop up more Russian stocks.

"We believe that Russian equities are at levels which make them a compelling buy and that patience will be rewarded," FMG chief investment officer Joe Portelli said.

The largest equities in the RTS Index are Gazprom OAO and NK Lukoil OAO, each of which make up about 13% of the index. Gazprom's forward price-to-earnings ratio is just 2.6, far lower than most other BRIC-nation energy companies, according to Thomson Reuters data.

"Russian stock prices could triple and they would still be at a valuation discount," said Chris Darbyshire, chief investment officer at Seven Investment Management in London, which overseas assets of about $10b. "But Russian companies are not nearing bankruptcy. In fact, expectations for Russian earnings this year have remained relatively steady, whereas expectations for most developed markets, including the United States, have fallen."

Seven Investment invests in a broad range of emerging-market stock and bond benchmarks, in which Russia represents about 6% and 10% of the total indexes.

"We would add [to positions] at some point," Darbyshire said.

NO ESCALATION SEEN

The wild card is whether the saber-rattling between Russia and Ukraine will intensify and how much it hurts the Russian economy. Growth there has slowed to less than 2%, inflation has risen and capital outflows have escalated.

Some investors are in a defensive mode. Standish Mellon Asset Management, which manages more than $180b. in fixed-income assets, pared its Russian dollar-denominated and local bond holdings during the recent crisis.

"We thought that whatever valuations we have in Russia, it's better to exercise some caution," said Cathy Elmore, emerging-market portfolio manager and senior sovereign-debt analyst at Standish in Boston. "We need to be aware of this political layer that has been driving valuations."

Crimeans voted to secede from Ukraine and join Russia in a March 16 referendum. The US and EU, worried that Russia could seek to take control of parts of eastern and southern Ukraine, have warned they could impose broader sanctions affecting entire sectors of Russia's economy.

"It's probably fair to say that the crisis will take its toll on [Russian] GDP [growth]," said Yakov Arnopolin, vice president and portfolio manager at Goldman Sachs Asset Management in New York.

At the peak of the Russian crisis in early March, the spread on Russian sovereign debt relative to Treasuries had widened to about 350 basis points on the J.P. Morgan EMBI+ benchmark debt index. It has since narrowed to about 260 basis points.

Yields on 10-year sovereign Russia debt climbed to 9.63%

Mekorot, UK firm Arup sign water deal

• By SHARON UDASIN

During British Prime Minister David Cameron's visit to Israel last month, the Mekorot national water company signed a memorandum of understanding to foster collaboration with a British counterpart, the Israeli firm announced on Sunday.

Mekorot and engineering and infrastructural design firm Arup have agreed to jointly facilitate research and development in the fields of water and wastewater treatment around the world. The decision to cooperate occurred following a number of events organized by the UK-Israel Tech Hub, the companies said.

"Water is a valuable resource worldwide," Mekorot CEO Shlomo Ben Hamo said. "We welcome the beginning of cooperation between the two companies, which will enable the cultivation of new ideas in the global water sector."

This collaboration joins dozens of other similar agreements that Mekorot has committed to internationally, with the intention of promoting water projects around the world to cope with the global water crisis, the company said.

US Supreme Court agrees to hear Teva Copaxone appeal

• By NADAV NEUMAN

GLOBES

The US Supreme Court has agreed to hear an appeal by Teva Pharmaceutical Industries Ltd. over the expiry of its patents for Copaxone, its treatment for multiple sclerosis. The hearing could delay the expiration of the drug's US patents until September 2015. The patents are due to expire in May.

The Supreme Court's decision is a blow to companies that have been planning to offer generic versions of Copaxone, such as Momenta Pharmaceuticals Inc., which has developed a version with Novartis AG unit Sandoz, and Mylan Inc. If they launch generic Copaxone and Teva wins its case, the companies could have to compensate Teva for lost revenue.

A delay in the launch of generic Copaxone would be a windfall for Teva. In its guidance last December, the company forecast an operating profit of $4.8 billion-$5.1b. and earnings per share of $4.50-$4.80 on $19.3b.-$20.3b. revenue if generic Copaxone is launched this year. It forecast an operating profit of $5.35b.-$5.65b. and earnings per share of $4.80-$5.10 on $19.8b.-$20.8b. revenue if there is no generic launch.

Last month, Dutch drug company Synthon BV announced a successful Phase III clinical trial of glatiramer acetate, to test its equivalence to Copaxone.

Cupcake machine opens to satisfy 24-hour cravings

• By ELLEN WULFHORST

NEW YORK (Reuters) – New Yorkers, who live in the city that famously never sleeps, now can satisfy their craving for cupcakes in any of those endless waking hours.

A 24-hour vending machine that dispenses gourmet cupcakes opened for business last week on Manhattan's Upper East Side, and locals were lining up for a taste despite the wintry temperatures.

"It's so fun," said Melissa Martelli, a schoolteacher and neighborhood resident as she

red velvet, vanilla and lemon meringue.

"It's cool, especially if you live around here and it's like the middle of the night and you really want a cupcake. I would so do that," said Margarita Mazur, who works at a local tech startup.

The nine-year-old company behind the machine, Sprinkles, also has installed cupcake machines in Las Vegas, Dallas, Chicago, Atlanta and Beverly Hills, California, where the company is based, and plans to expand into Houston and Washington,