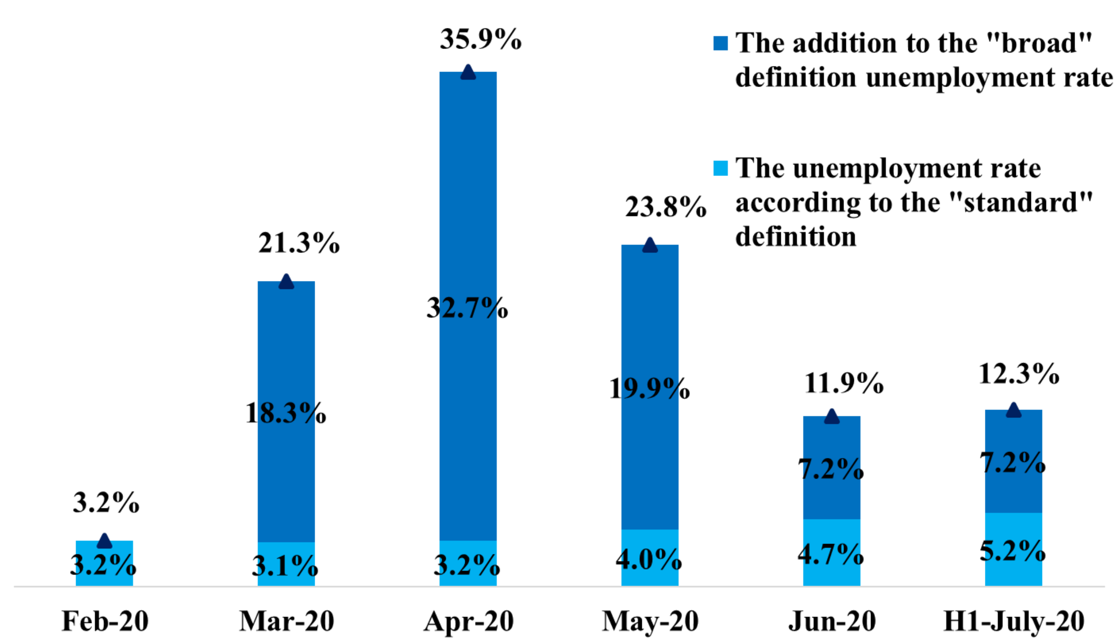
Leumi Economic Weekly

August 05, 2020

The unemployment rate according to the "regular" definition is biased downward and does not accurately reflect the scope of non-employment due to technical reasons of the definitions used; the broad definition currently reflects a double-digit unemployment rate

The Central Bureau of Statistics (CBS) released the employment data (based on workforce surveys) for the first half of July. As we noted in previous weekly surveys, due to the disruption in the data series as a result of the coronavirus crisis, the analysis presented in this section relies on the original data and not on the seasonally adjusted data, which we generally use.



** Unemployed persons, temporarily absent from work all week due to reasons related to the Coronavirus pandemic and stopped working due to dismissal or closure of the workplace in March-July 2020.*

An indication of the current unemployment rate is found within the detailed tables published by the CBS. These data show that the unemployment rate according to the standard definition does not fully reflect the scope of non-employment currently in the economy due to technical reasons related to the definitions used. This rate does not take into consideration a substantial portion of workers whose employment was disrupted due to the crisis, headed by: employees temporarily absent from their places of work due to the coronavirus crisis (primarily furloughed employees) and workers dismissed in March-July and who do not currently participate in the workforce.

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As can be seen in the accompanying chart, the "standard" unemployment rate indeed increased slightly starting from May, and in the first half of July it stood at 5.2% (original data), compared to its pre-crisis level of 3.2% in February 2020. However, the unemployment rate based on the broad definition indicates an immeasurably substantial increase in the level of unemployment in the economy, already in March, during which time the coronavirus started to spread throughout the country, and led to broad active measures by the government, which included a closure and shutdown of activity.

The "broad" unemployment rate, which reached a peak of more than 30% (which is equivalent to 1.5m workers) in April, remained above 20% through May (inclusive), and in June, with the opening of the economy to a relatively broad level of activity, fell to 12%. In the first half of July, with the renewed breakout of the coronavirus across the country, and the implementation of somewhat stricter restrictions on activity, the unemployment rate increased moderately to 12.3%, which is equivalent to 511,000 workers. This is to say, the unemployment rate indeed has stabilized recently, yet at a level substantially above the pre-crisis level (approximately 150,000 unemployed persons).

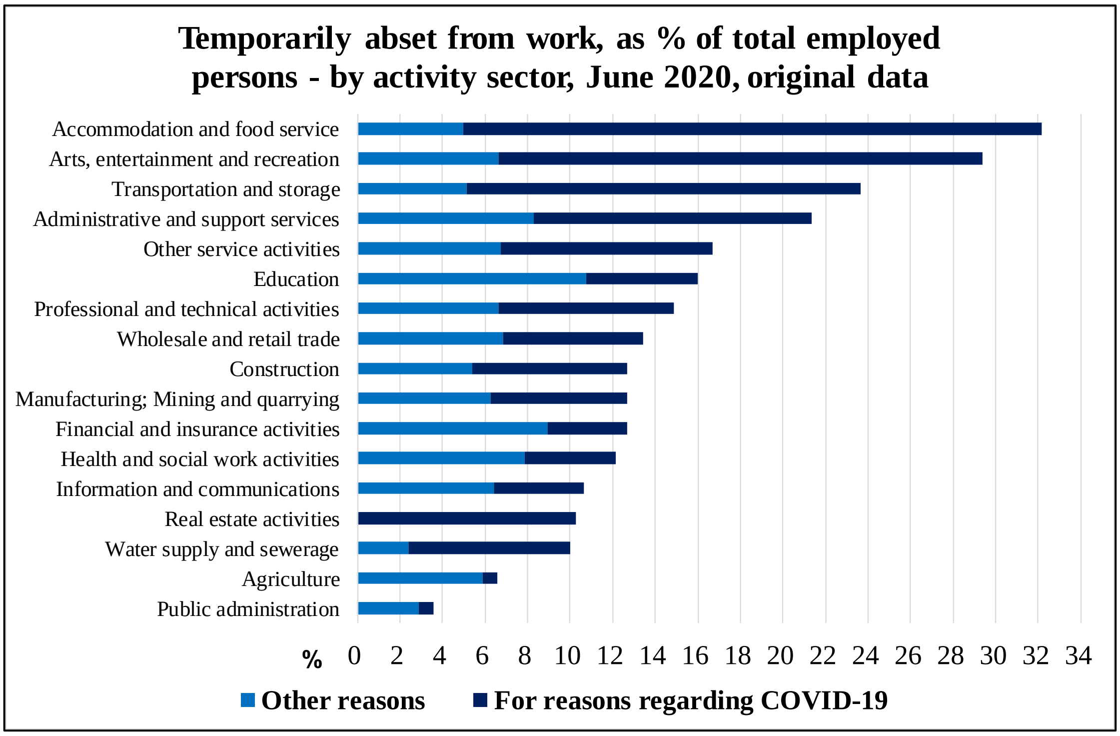
Looking ahead, as long as the current wave of morbidity continues, coupled with some of the restrictions on activity in the economy, this in parallel with the extension of unemployment benefits to furloughed employees, then the gap between the "standard" unemployment rate and the "broad" unemployment rate is expected to remain relatively wide. The gaps are expected to narrow only after a return to full economic activity, whenever this will occur. In light of what has been said, we estimate the standard unemployment rate for the general economy (persons aged 15 and above) in 2020 will equal 7%-8% (annual average) and it is likely to be even higher than this in a scenario involving a continuation of restrictions on the economy throughout all of 2021.

The rate of employed persons temporarily absent from their places of employment is especially notable in the services sectors

The most substantial portion of the addition to the "broad" unemployment rate derives from employed persons, salaried and independent, who have been temporarily absent from their place of employment due to the coronavirus crisis. As mentioned, this is primarily referring to furloughed employees.

Analysis of this portion according to sector shows that the highest percentage of workers who were temporarily absent (out of total employed persons in the sector) in June, following the decline in absent workers compared to May, was in the sectors that have still not returned to full operational activity. These sectors are affected to a large degree by restrictions on congregating and from the need to maintain social distancing. This is mainly referring to sectors such as food and hospitality services, art, entertainment and leisure, as well as additional sectors such as transportation, administration and support, and more.

However, it is important to note that some of the notable sectors are characterized by a relatively low number of employees, and therefore despite the high percentage of absent workers, their absolute numbers are not so high. On this regard, we note that from our estimates it arises that the leading sectors in terms of the number of temporarily absent workers include: food and hospitality services, transportation services, retail and wholesale trade, industry, and education. This is to say, despite the lower percentage of temporarily absent workers in the trade, industry, and education sectors, their absolute numbers are substantial, simply because these are employee intensive sectors.



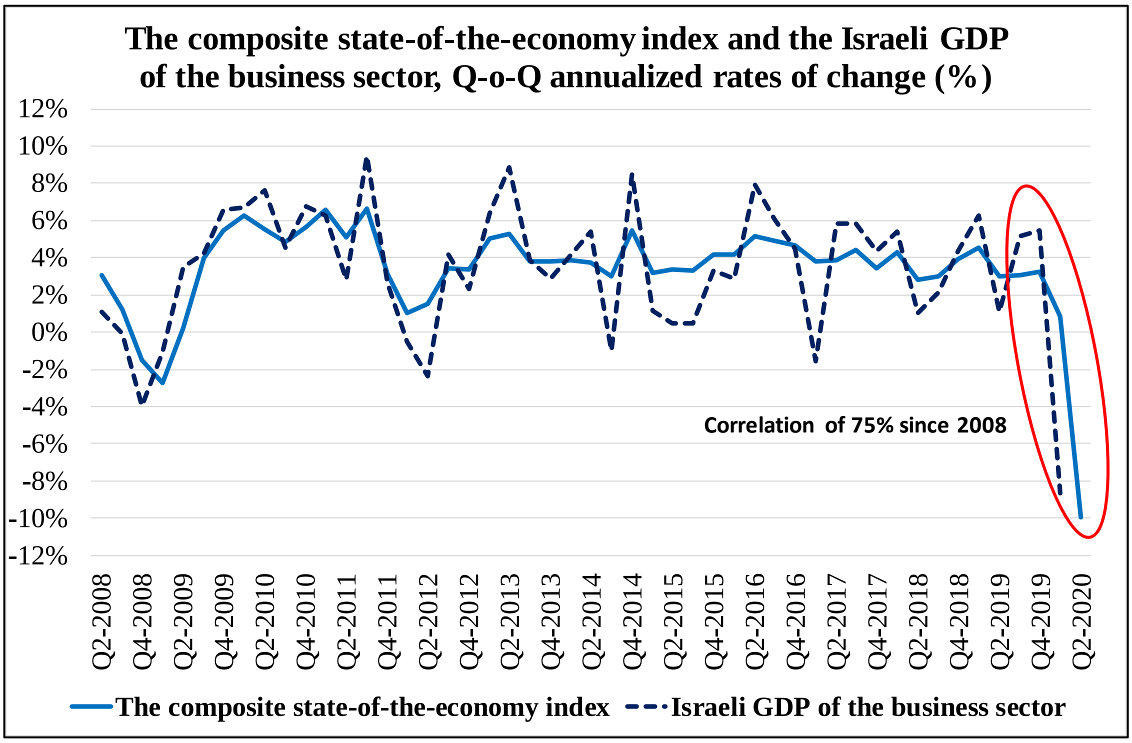
In addition, analysis of a breakdown of employed persons temporarily absent from their places of work in June according to their working age shows that the return of workers to employment is slower among those who are at the edges of the age range, that is to say the youngest and the most elderly (which is likely to weigh in the future more on elderly employees compared with younger workers). On the other hand, for the main working ages (25-54), the rates of absence are lower.

In summary, these data, together with surveys released on the same topic by the department of the chief economist at the Ministry of Finance (MoF), the Bank of Israel (BoI), and the government Employment Services, show that the damage from the coronavirus crisis in the labor market is not equal. Those who suffered the most include younger workers and those at the higher end of the age spectrum; furthermore, there has also been substantial damage felt by low-wage earners, that is to say, workers who do not hold the required skills in the labor market. A sectoral breakdown shows the most heavily damaged sectors include the entertainment and leisure, tourism, and food services sectors, and others.

At the current point of time, during the height of the additional wave of disease prevailing across Israel, it appears the number of businesses compelled to dismiss workers and to cease operations is in an uptrend. This is causing damage that is concentrated especially in specific sectors, and it has the potential to increase in other sectors as well as economic difficulties broaden into additional areas of activity. This development, in parallel with the continued decline in consumer confidence in the first half of July, underscores the renewed rise in uncertainty surrounding economic activity, a development that is likely to delay the country's exit from its economic crisis down the road, this in the absence of a clear, consistent, and immediate response on the part of economic policy makers.

The growth data for the second quarter of the year are expected to indicate a more substantial decline compared to the first quarter

In June the composite state-of-the-economy index remained unchanged compared to May, this according to BoI data. This comes following an especially sharp decline registered in April and a moderate decline in May, during which time economic activity gradually returned.



June's composite index was affected by increases in most of the index components, most of which appear in the index with a lag of one or more months, which reflect the beginning of the local economy's return to activity. However, it is important to note that at the current moment economic activity has still not returned to 'normal', and the breakout of a morbidity wave in the beginning of July is delaying the orderly return to activity, a development that is likely to be reflected in the composite index data in the coming months.

On a quarterly basis, we note that the composite index declined 10% in the second quarter of the year (in annualized terms) compared to the first quarter (see accompanying chart), after it had increased by a moderate 0.9% in the first quarter of the year. This is in contrast to the sharp 8.5% drop (in annualized terms) in the first quarter business sector product, which was indicated in the national accounts data. Against this backdrop, and in light of the relatively high positive correlation (75%) between the quarterly rates of change of the composite index and the business sector product, it can be expected that the second quarter national accounts data, which are scheduled to be released later this month, will indicate a sharper drop in the business sector product in the second quarter of this year compared with the decline registered in the first quarter.

The BoI repeated and emphasized that in view of the uniqueness of this crisis, one cannot draw conclusions from the severity of the decline in the composite index regarding the exact severity of the decline in activity. On this regard, we note that the fall in second quarter activity this year, which is reflected in the composite index data, is moderate in our opinion, and it does not reflect the full decline that arises from an analysis of other indicators, such as: credit card activity, the consumer confidence index, the employment data, and more. We estimate that in the second quarter of this year, which represents the peak of the crisis until now, GDP contracted more sharply.

Looking ahead, in our opinion, in the scenario in which the restrictions on economic activity will continue, and may even become stricter in the remainder of the year, 2020 is expected to conclude with a sharp real term decline of 7.9% in GDP, and a decline in the business sector product which will be at a double-digit rate.

Regarding 2021, under the assumption of a return to activity in most of the sectors of the economy during 2021, we forecast 5.5% growth; however, in the event the restrictions on activity will continue into the coming year, then we forecast only 3.2% growth of GDP.

On this regard, we note that in early August, the Chief Economist of the MoF updated the growth forecast toward a more pessimistic path. Currently, the forecast range for the <u>decline</u> in 2020 GDP us within a relatively broad range of minus 5.9% to minus 7.2%, depending on the degree of severity of the current wave of illness, and therefore the MoF placed greater emphasis on the more negative range of the forecast. These developments are expected to also impact 2021 GDP growth; the forecast range for which is also broad, ranging between plus 2.2% and plus 5.7%, this depending on the degree of severity of the restrictions on activity in the economy.

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