Leumi Economic Weekly

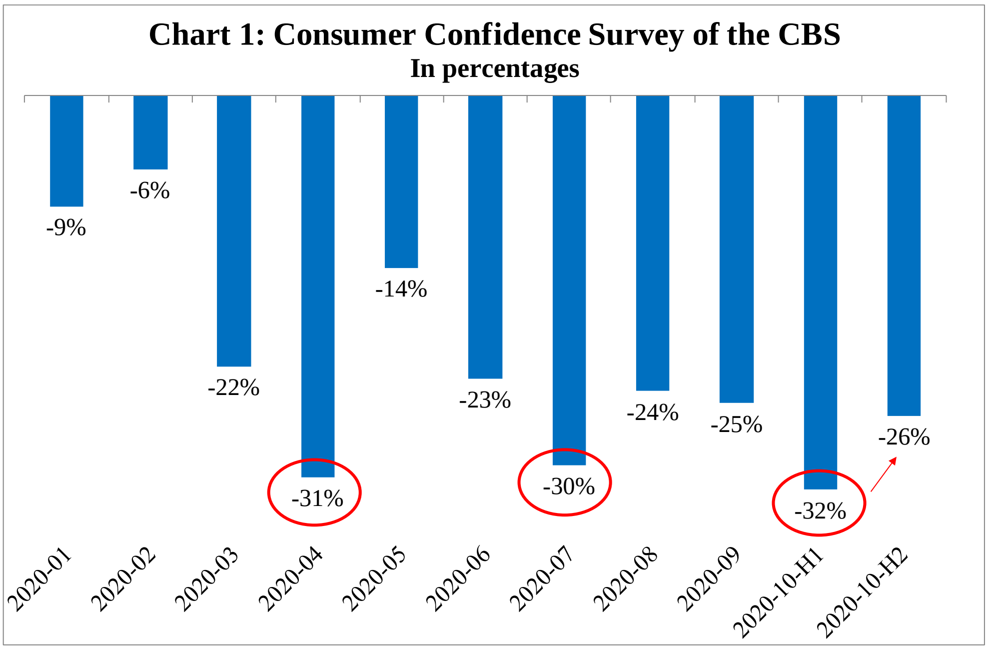
November 11, 2020

A slight improvement in the degree of optimism among households in the second half of October, as the country started a gradual exit from its second economic shutdown

Data from the Central Bureau of Statistics (CBS) show that consumer confidence increased in the second half of October, after it had fallen to a low in the first half of the month, against the backdrop of the second economic shutdown imposed in the country (see Chart 1).

The increase in consumer confidence started as the country initiated a process of exiting the shutdown, which supported a slight improvement in the degree of optimism of households. However, it is important to note that the main index component that contributed to the increase referred to an expected change in the economic situation of the country in the coming year, whereas in all the other components, which relate directly to the economic situation of households, no substantial change occurred.

In the event the process of exiting the economic shutdown will continue as planned, and particularly those aspects that relate directly to the economic situation of households, then it is likely this development will be expressed in a continued rise in private consumption.



Analysis of credit card expenditures, according to Bank of Israel (BoI) data (analysis of daily data without any adjustment for seasonality), indicates volatility in the volume of purchases (compared to the beginning of January 2020), close to the levels from just prior

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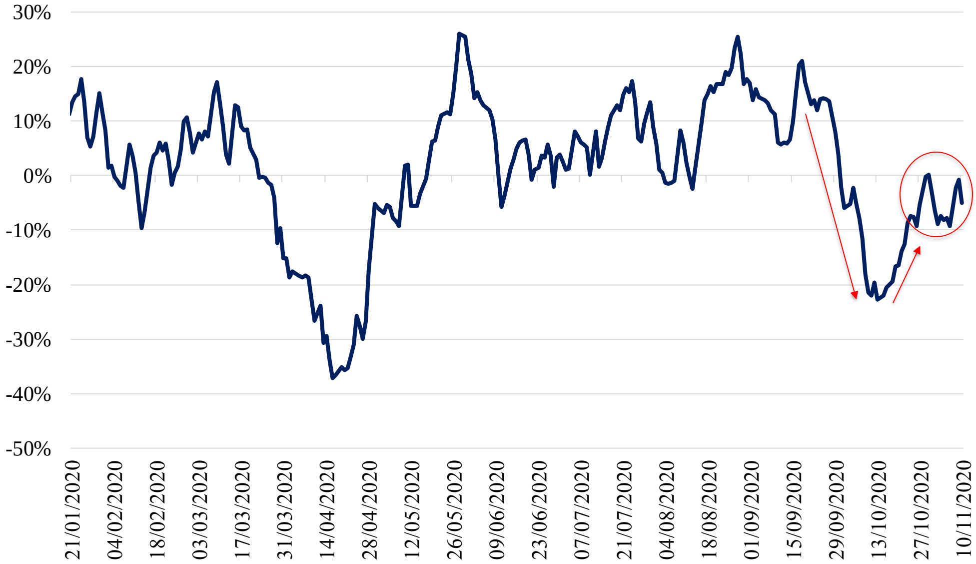
to the coronavirus crisis (see Chart 2). This comes after the volume of purchases was in an upward trend in the first days after the initial exit from the country's second economic shutdown. It is important to note that the volume of purchases in the tourism, restaurant, and leisure sectors remains significantly low (within a range between 40%-80%) compared to the pre-coronavirus crisis levels, since activity within these sectors remains very limited.

Chart 2: Bank of Israel (BoI) analysis of credit card expenditures data compared to the beginning of the year, bi-weekly average, original data

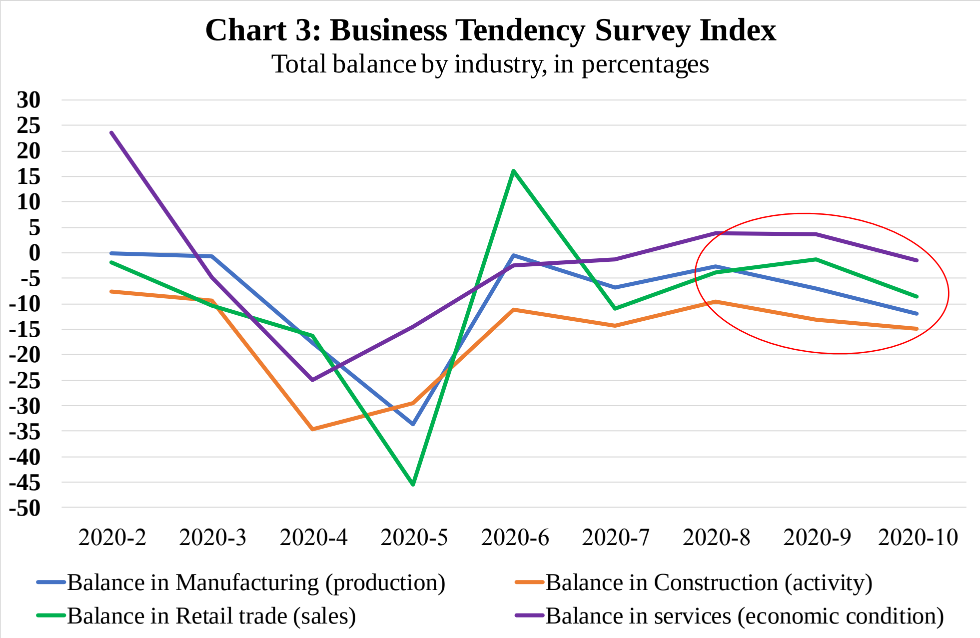


On the other hand, as restrictions on activity continue to be eased, with an emphasis on renewed activity in neighborhood stores and retail centers, a sharp increase has occurred in clothing purchases, to above the levels from the beginning of the year. In all other areas the volume of purchases was stable. As long as activity in the local economy will continue to expand, it is expected to be expressed in a rise in the volume of purchases using credit cards, yet with substantial differences among the sectors, with an emphasis on continued moderate activity in the services sectors.

The second shutdown led to an increase in the degree of pessimism within the business sector; the forward expectations in most sectors are for only a moderate improvement

The Business Tendency Survey of the CBS indicates a relatively moderate decline in the net balances (the weighted difference between the percentage of company managers reporting an improvement in their situation and the percentage of those reporting a deterioration in their situation) of the leading indices of most sectors in October (see Chart 3).

This finding likely shows that the second economic shutdown hurt business sector activity very moderately compared to the case in the first shutdown earlier in the year. This is because, among other reasons, the second shutdown involved less severe restrictions compared to those implemented in the first shutdown, and apparently the business sector was better prepared to act under the restrictions at the time of the second shutdown.

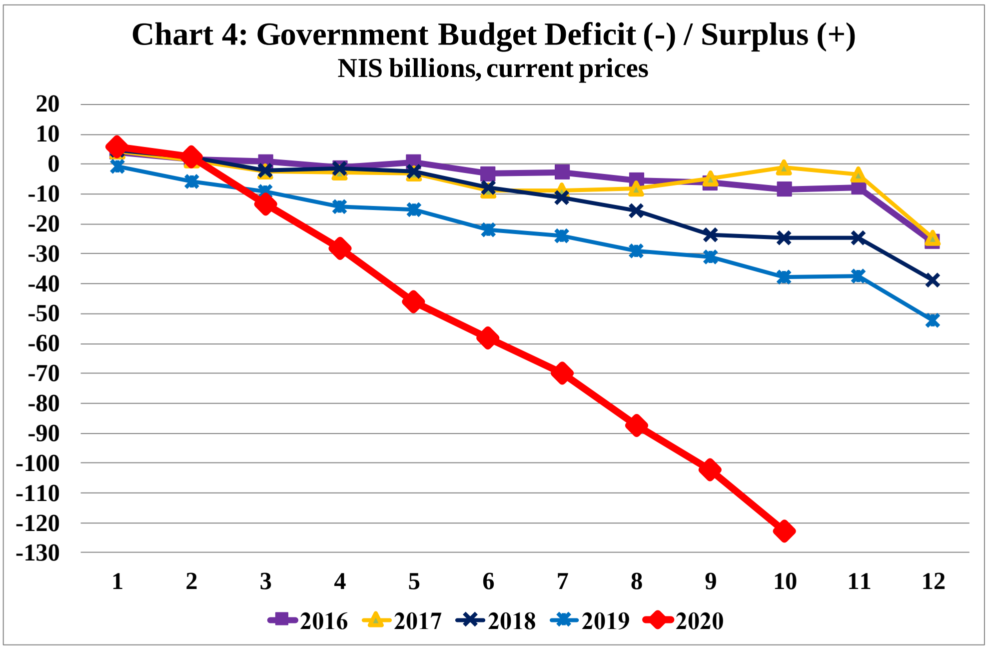


A sector analysis of the data indicates similar declines in most of the sectors in October. However, sectoral differences exist in an analysis of the current levels of the net balances compared to February 2020 (prior to the coronavirus crisis). From the analysis it can be seen that the net balance of the services sector fell by a very sharp rate from positive 24% to minus 1.4%, and reflects the substantial negative consequences of the social distancing policies on the activity of this sector. In the industrial sectors the net balance declined from close to 0% down to minus 12%, and in all the other sectors the current level is below the level from February this year, yet by more moderate rates. Looking ahead, in the services and construction sectors a slight improvement is expected in activity (yet the balances remain negative). The volume of export orders also bodes well for the industrial sectors. On the other hand, in the trade and hotel sectors, the expectations are for a continued deterioration in activity in all the indices.

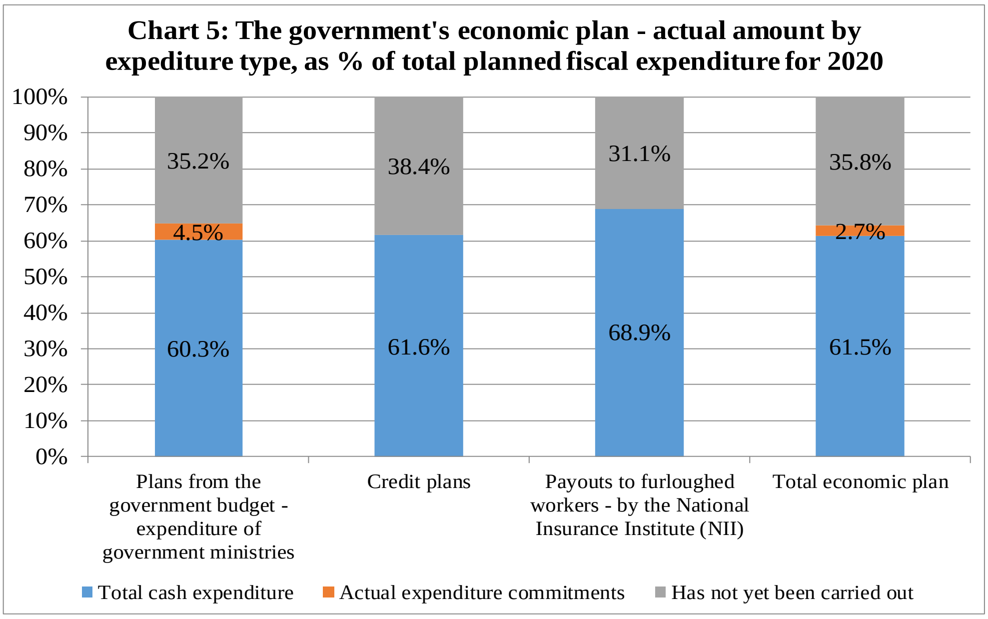
In October the sharp increase continued in the government deficit, which stands at 10.1% of GDP

In October this year, government activity amounted to a deficit of NIS 20.3bn, compared to a deficit of NIS 6.7bn in October 2019. The cumulative deficit in the first ten months of 2020 (January – October) amounted to a peak sum of NIS 122.7bn, substantially higher than the deficit in the parallel period last year (NIS 37.8bn) and also in preceding years (see Chart 4). The fiscal deficit over the trailing 12-month period (November 2019 – October 2020) increased to 10.1% of GDP, compared to 9.1% of GDP in the preceding month, and it is expected to continue to climb in the final two months of 2020.

The extraordinary deficit is the result of a sharp jump in government expenditures, affected by the coronavirus crisis, coupled with a drop in revenues. On this regard, we note that government revenues declined since the beginning of the year by a relatively moderate rate of 3% (at uniform tax rates, compared to the parallel period last year), primarily as a result of a decline in revenues from indirect taxes and fees. Direct taxes fell by only 1%, since the substantial portion of dismissed or furloughed employees due to the crisis were low-income earners, such that the direct tax liability on them is very low.



The rate of performance of the government's economic program to assist in dealing with the coronavirus crisis remains low. Out of a cumulative spending ceiling (according to law) of NIS 64bn, the cumulative (fiscal) expenditure through the end of October stands at NIS 51bn, or less than 4% of GDP, representing a very low rate compared to most of the developed countries of the world. This represents a cash outlay amounting to 60% of the total planned sum of NIS 85bn out of the state budget. In addition, analysis of the actual rate of performance of the total government program as a percentage of the total plan for 2020, shows that approximately 36% of the total economic plan for 2020 has not yet been carried out, with only two more months remaining until the end of the year (see Chart 5).



In summary, we expect the government deficit will continue to increase in the coming two months, such that 2020 will conclude with a deficit equal to 12% of GDP. Regarding 2021, we forecast a high single-digit deficit, depending on the economy's pace of return to activity, as a rapid pace will support an increase in revenues from taxes and a reduction in the need for government support of the economy. The increase in the deficit, parallel to the contraction in GDP in 2020, is expected to lead to an increase in the debt/GDP ratio to a level of 72% in 2020 and close to 80% in 2021, compared to less than 60% of GDP in 2019, prior to the coronavirus crisis. The implication of this is an extraordinary increase of NIS 250-300bn in government debt within a short period of time, a development that is likely to create difficulties in repayment of the debt over the longer-term (particularly if the debt will need to be re-financed at higher interest rates than the prevailing rates of today).

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