Leumi Economic Weekly

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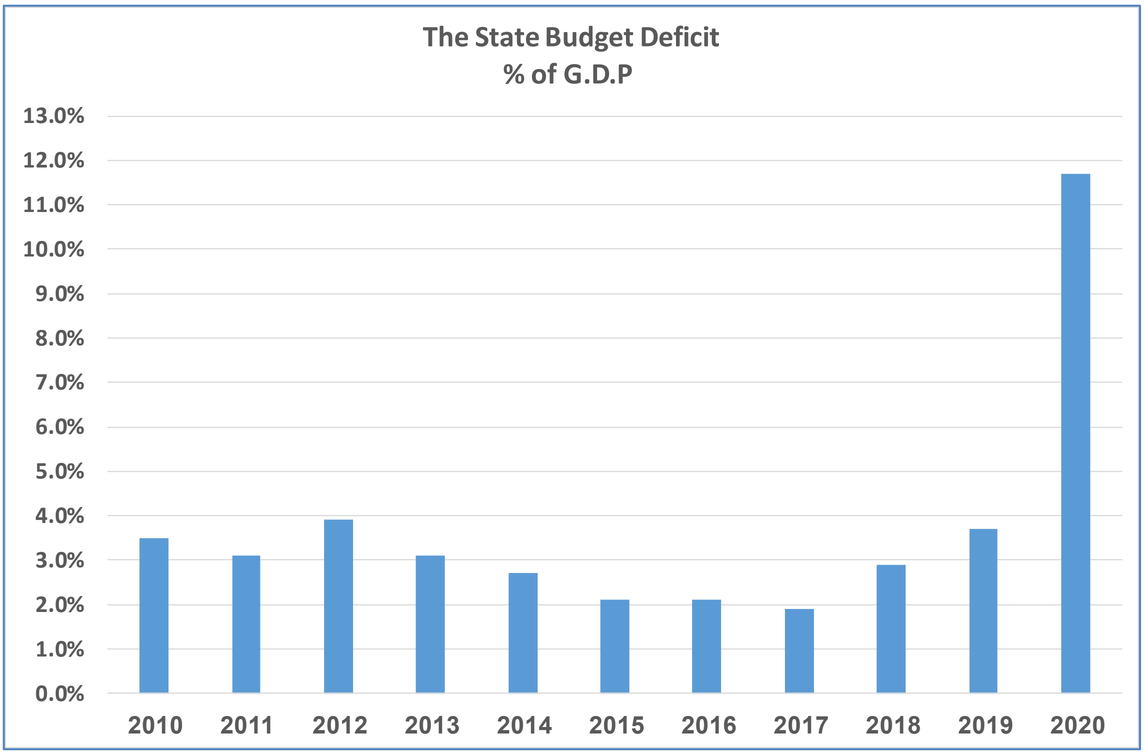
The state budget deficit amounted to 11.7% of GDP in 2020, compared to an annual average of 2.9% of GDP over the preceding decade

In 2020, the state budget deficit amounted to NIS 160.3bn (11.7% of GDP) compared to a deficit of NIS 52.2bn (3.7% of GDP) in 2019. This sharp increase in the deficit derives from the health crisis that engulfed the entire world, including Israel, starting from the beginning of last year. When analyzing the increase of 8% of GDP in the deficit, we see that most of this was the result of a substantial expansion in government expenditures due to the coronavirus crisis (accounting for 6.5 out of the 8.0 percentage points), whereas the decline in state revenues amounted to a contribution of 1.5 percentage points. This comes against the backdrop of a fall in tax revenues that was relatively moderate. This is because, among other reasons, the collection of direct taxes actually increased last year, since the impact of the sharp rise in the number of unemployed persons was not greatly felt (to a substantial degree) in the overall tax collections of their income.



As mentioned, the bulk of the increase in the deficit originated from the expenditure side. The most notable component on this regard involved the economic program set up in response to the pandemic – expenditures amounting to NIS 68.7bn for dealing with the coronavirus crisis, while the budget ceiling for this plan in 2020 equaled NIS 84.8bn.

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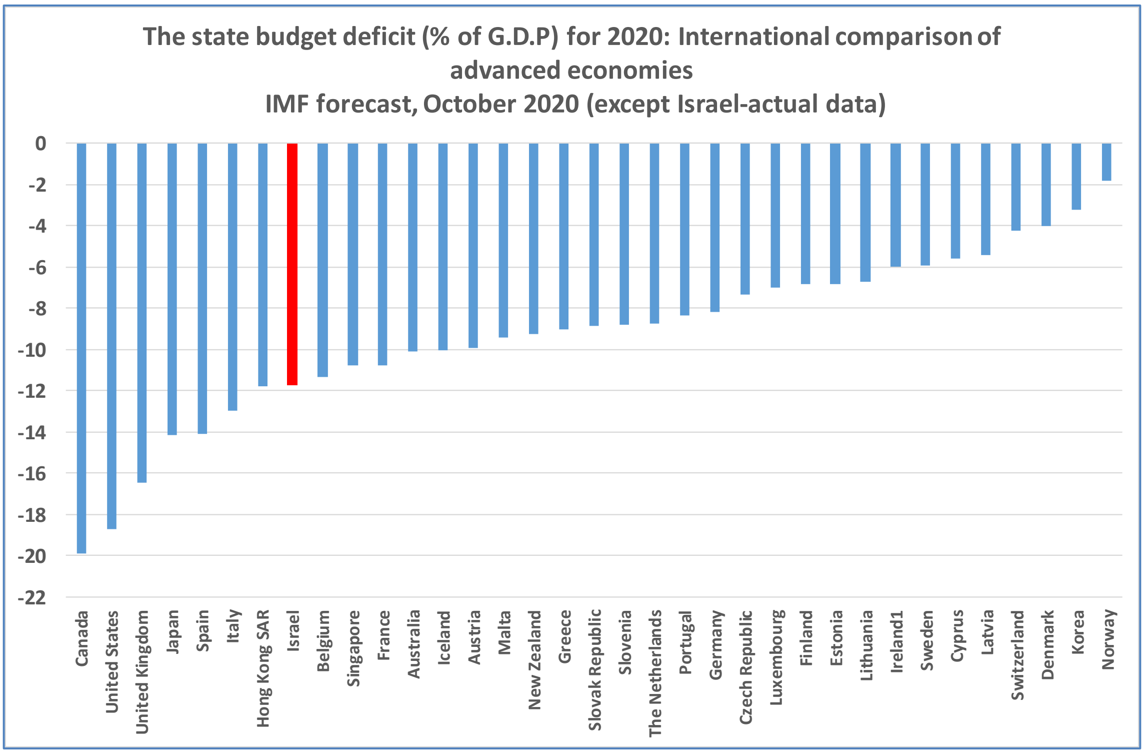
That is to say, only 81% of the budgeted sum was actually utilized. In addition to the direct fiscal assistance as mentioned, the government assistance program also included assistance by means of credit and cash injections amounting to NIS 40.5bn (primarily state guaranteed loans provided by the banks) and also assistance provided through the National Insurance Institute (to furloughed employees). Overall, the total sum budgeted for government assistance with respect to the crisis amounted to NIS 137.3bn, yet in 2020 only 80% of this sum was actually utilized.

Looking ahead, the coronavirus crisis makes it very difficult to forecast the fiscal deficit. The Bank of Israel (BoI) recently estimated that in the coming year the fiscal deficit is expected to fall within a range of 8%-11% of GDP, on the basis of two different scenarios on the development of the economic situation. Our forecast at *Bank Leumi*, based on the baseline scenario, falls as well within the central bank's forecast range. Against this backdrop, it appears that a return to the deficit levels prevalent over the decade preceding the crisis (see accompanying graph) is likely to take a number of years.

The state budget deficit of Israel in 2020 was high compared to most of the advanced economies

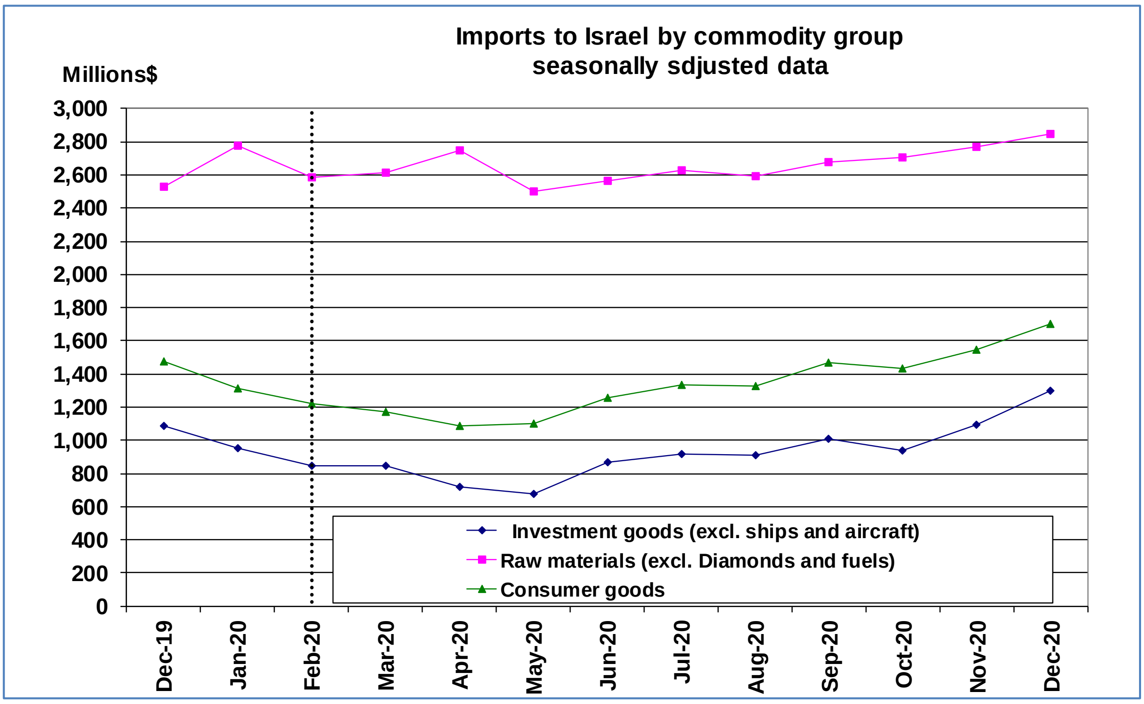
Most countries around the world were severely hurt by the coronavirus crisis. Naturally, the fiscal policy instrument is the leading and most substantial tool in efforts to support the economy. This was supplemented by supportive monetary policy instruments that were widely implemented around the entire world, as well as in Israel, through a list of expansionary measures. Even though the Israeli government operated over the past year without an approved budget (as well as in the preceding year) the government made use of various fiscal instruments in order to support the economy, and the deficit, as mentioned in the preceding section, increased substantially.



The accompanying graph analyzes the degree to which the fiscal expansion in Israel, which influenced the deficit, was similar to or different from what occurred in advanced countries around the world. These countries have been defined by the International Monetary Fund (IMF), while the data are the forecasts of the IMF for the 2020 budget deficit, as published in October 2020. The figure for Israel is based on the actual figure published recently by the Israel Ministry of Finance (MoF). In the accompanying international comparison, it can be seen that Israel's deficit is among the highest of the advanced economies of the world, a situation that reflects substantial fiscal support, but also a high "starting point" – that is to say, a high basic fiscal deficit relative to many countries, even before the outbreak of the coronavirus crisis.

The foreign trade of Israel in 2020 – a reduction in both exports as well as imports of goods

Israel's trade deficit, that is to say, the difference between the import and export of goods, amounted to US$20.2bn in 2020, representing a 15% decline compared to the 2019 deficit. However, the core trade account deficit (the deficit excluding ships, aircraft, diamonds, and energy products) actually expanded last year by 22%, amounting to US$15.9bn. Consequently, it appears the impact of the decline in energy prices resulting from the crisis is the main factor behind the reduction in the value of imports and the decline in the overall deficit.



The crisis, which began with the imposition of an economic shutdown during March 2020, initially caused a sharp decline in both imports and exports of goods. However, starting from May 2020 and despite the shutdowns later in the year, a recovery in foreign trade activity was registered. This development was evident in goods imports, as can be seen in the accompanying graph. There was a notable expansion in both the import of consumption goods and also in the import of investment goods, to levels substantially higher than the levels prior to the crisis. The import of raw materials expanded as well and this was expressed also in a recovery in industrial exports.

These data are encouraging as they reflect trends of expansion in activity, and not a trend of moderation. In our estimation, these developments are expected to be expressed in the coming year in a substantial expansion in both exports as well as imports of goods and services, following the decline in their volumes last year. This comes against the backdrop of an expected recovery in global trade and in economic activity within Israel's main trading partners. All of this, of course, depends on there not being any further deterioration or increased severity in the coronavirus crisis.

As long as the inoculation process in Israel will be relatively quick compared to the rest of the world, and consequently the recovery in demand within Israel will also be relatively quick compared to the rest of the world, then this situation is expected to affect Israel's trade deficit and also the level of the surplus in the current account of the balance of payments. The recovery of demand for goods and services in Israel, if possible against the backdrop of achieving a critical mass of inoculations and an accelerated increase in demand, is expected to be reflected in a substantial increase in the volume of imports into Israel. In the event a possible spike in imports such as this will occur without there being an equally substantial increase in exports from Israel, this due to the relatively slow recovery in demand on the side of Israel's export destinations, this situation is likely to be reflected in an additional increase in the trade deficit and a slight reduction in the relatively large surplus in the current account of the balance of payments.

Such a development, coupled with a continuing policy of foreign currency purchases, may eventually moderate the strength of the shekel's appreciation vis-à-vis the currency basket, which has strengthened very unusually since mid-November 2020. It is quite possible that this recent extraordinary appreciation, which may very likely turn out in the end to be only temporary, is also related to the activity of institutional investors in Israel, who responded with hedging activity on an unusual scale in order to compensate for the sharp and unusual rise recorded in the US stock market since November.

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