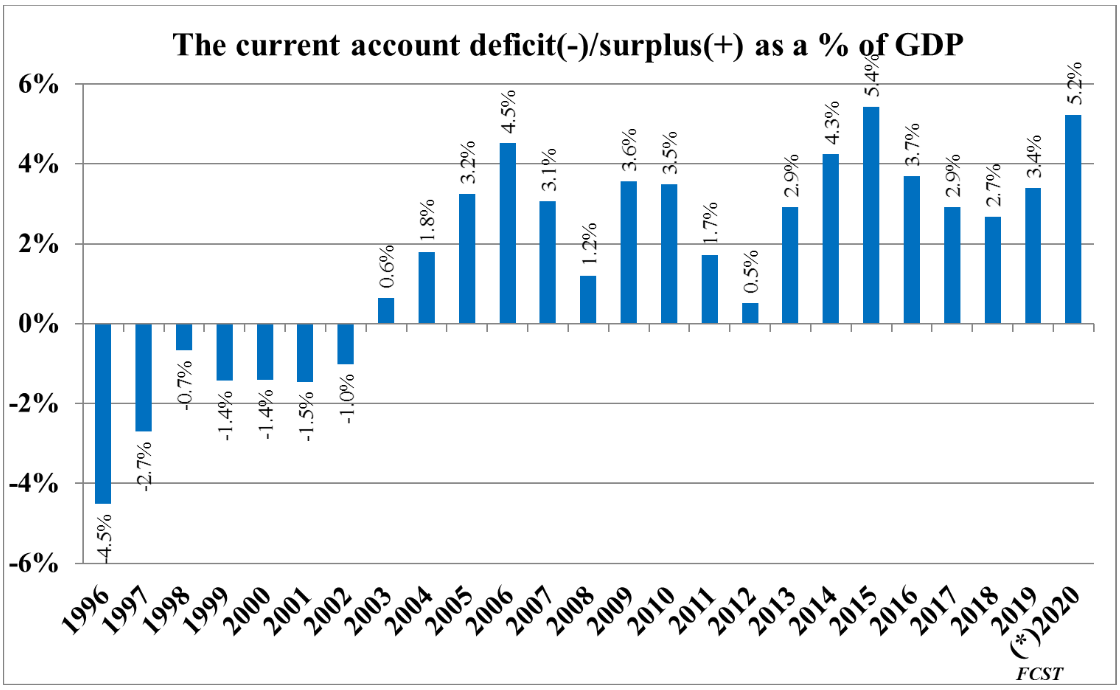
Leumi Economic Weekly

December 16, 2020

The surplus in the current account of the balance of payments reaches a peak

The surplus in the current account of Israel's balance of payments amounted to US$6.4bn in the third quarter of this year, based on seasonally adjusted data. This is a rise from a surplus of US$5.1bn in the second quarter of the year. The latest figure represents a peak for a single quarter. Since the beginning of the year, during the first three quarters of 2020, the surplus in the current account of the balance of payments has exceeded US$15bn and is expected to climb to above US$20bn for all of 2020.



The increase in the aforementioned surplus is mainly the result of a reduction in the deficit in the goods account (among other things, against the backdrop of the decline in energy prices) together with the continuing upward trend in the services account surplus, which was affected by a substantial volume of exports of high-tech services.

In addition to the substantial and impressive sum of the current account surplus, which reflects the foreign currency flows in Israel's economic activity vis-à-vis the rest of the world with respect to the exports and imports of goods and services, there are additional sources of foreign currency inflows into Israel: within the framework of the current account there are also foreign currency transfers to the government, to institutions, as well as to private individuals; and within the framework of the financial account there are

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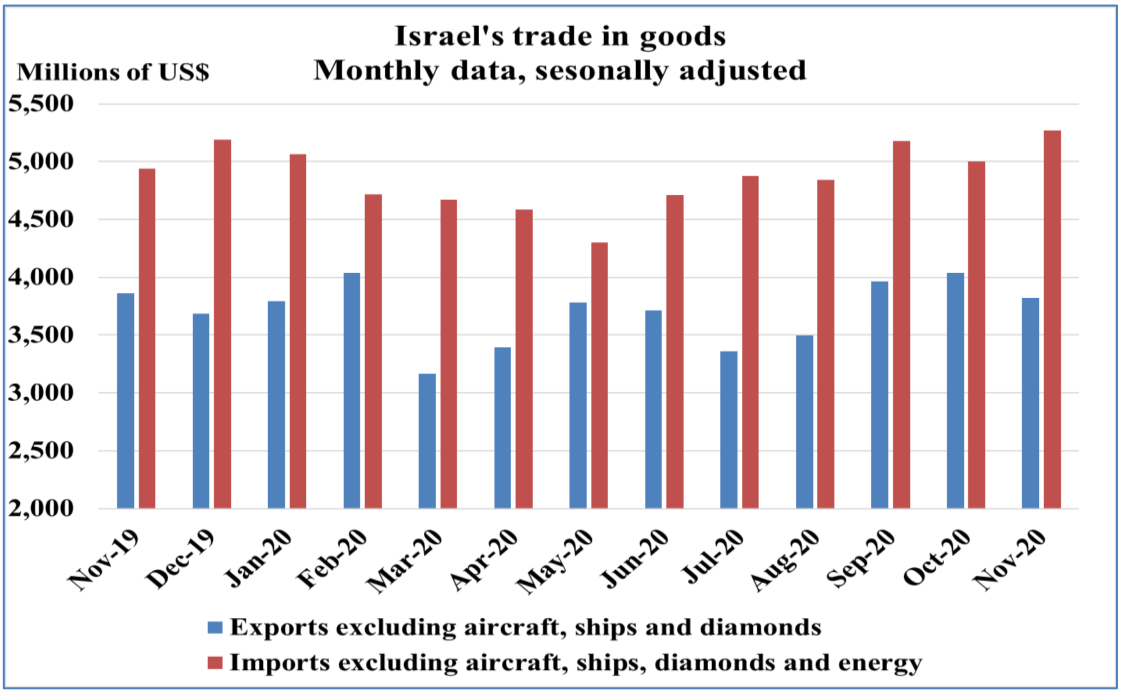
foreign currency inflows to Israel via financial and direct investments, in net sums exceeding US$10bn in the first three quarters of 2020.

The strong standing of Israel's foreign accounts includes not only the foreign currency flows into Israel, but also the existing large surplus of the economy's foreign currency assets in relation to its foreign currency liabilities in debt instruments. According to data from the Central Bureau of Statistics (CBS), at the end of September 2020, this surplus (meaning an overseas net negative debt held by the economy) amounted to US$192.3bn, compared to US$164.0bn in the parallel quarter last year. This means the long-term trends, as can be seen in the accompanying graph on Israel's current account, continued also throughout the period of the coronavirus crisis.

These underlying conditions, which reflect the economy's positive fundamentals, supported the strength of the shekel, which, with the exception of a short-term weakness with the outbreak of the pandemic (the Bank of Israel acted to moderate this trend), continued and strengthened, a trend that is likely to continue also in the coming year.



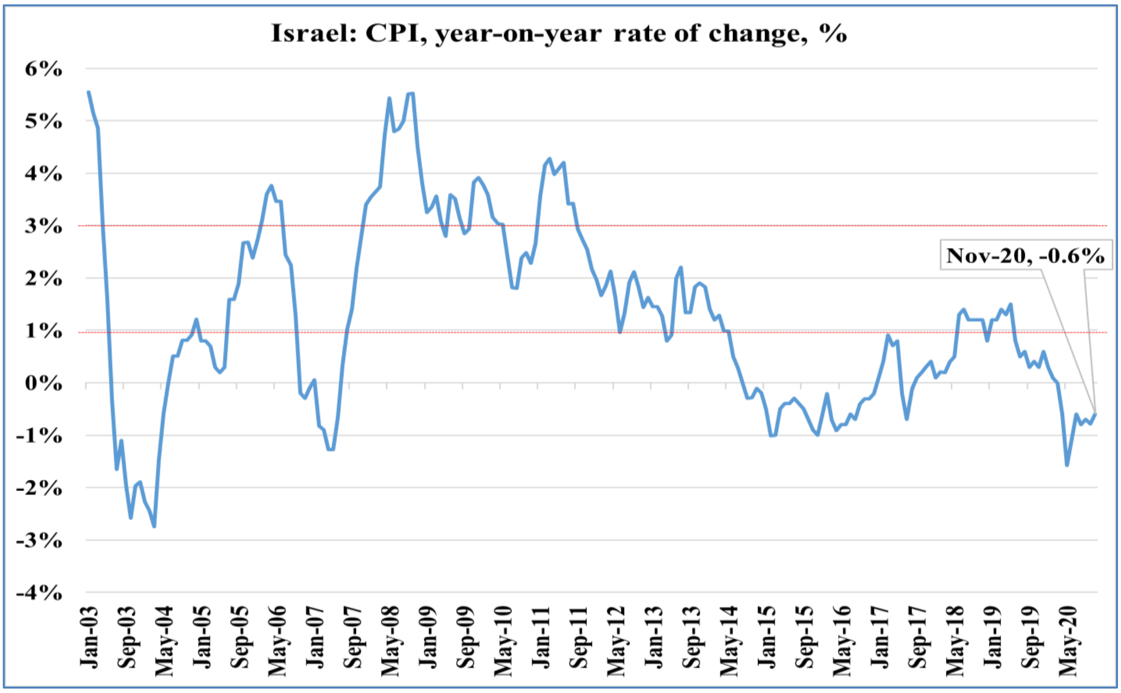
What happened to Israel's foreign trade since the outbreak of the pandemic?

Israel's trade deficit amounted to US$17.2bn in the first 11 months of the year, compared to US$20.7bn in the parallel period last year. However, excluding activity in the trade of diamonds and energy products (which were affected also by a decline in prices), the "core" deficit (that is to say, the general trade deficit excluding ships, aircraft, diamonds, and energy products) increased by approximately US$2.0bn. When analyzing the development of the import and export of goods in the last year, as shown in the accompanying chart, it can be seen that the import of goods, which declined with the outbreak of the pandemic, has recovered and in recent months has been at a level similar to that back at the time prior to the outbreak of the crisis. This development is notable in the three main components of good imports: consumption goods, raw materials, and also investment goods. Also regarding the export of goods, there has been a recovery in most of the industrial sectors.

Against this backdrop, it appears the losses to Israel's foreign trade resulting from the crisis, which led to a sharp drop in global trade and in the economic growth of most of the countries of the world that trade with Israel, was not of such a sharp, on-going nature. This development is also among the factors behind the fact that, while Israel's economy suffered just like what happened in all the other countries of the world, the cost was more moderate compared to many Western countries. Consequently, we estimate economic growth in the coming year (2021) is likely to reach 4.9%, while foreign trade, with an emphasis on the technology sectors (both in the goods, as well as in the services sectors) is expected to contribute substantially.

A positive inflation environment is expected in 2021, in contrast to the decline in the CPI in the current year

The consumer price index (CPI) declined 0.2% in November, while year to date, as well as over the trailing 12-month period, the index declined 0.6%. The main contributor to the decline was the housing component, which declined 0.4%, while last year its increase moderated to only 0.4%. Also the fruits and vegetables, as well as the transportation and communication components had a relatively large contribution to November's decline, whereas the clothing and shoes component, which increased 4.2%, had a positive contribution of 0.1 percentage point to the CPI.



It is worthwhile to remember that in November (as in all the preceding months since the outbreak of the pandemic) the CBS faced many challenges related to the matter of measuring prices during the period in which many businesses remained closed. According to the CBS announcement, in the month as a whole, submission rates reached 80% of the total reports, a situation that allowed the formulation of most of the index as planned, with estimates used to calculate the required adjustments in the components in which it was not possible to measure prices as is done during normal periods. Against this backdrop, in addition to the monthly analysis of the CPI, it is also worthwhile to analyze the annual rate of the rise in prices over time, which makes it possible to analyze the trend in inflation.

Looking over the long-term, as shown in the accompanying chart, we see that the current rate of decline in prices is not unusual compared to recent years in which the inflation environment was below the lower limit of the price stability target range (1%-3%). However, as we approach the coming year and under the assumption that a scenario will evolve in which a substantial portion of the population will be vaccinated against the coronavirus during 2021, it can be expected that prices will adjust upwards in some of the CPI components that were affected by the closure of businesses/services since the outbreak of the pandemic. This will come against the backdrop of the creation of surplus demand over and beyond the supply in the short-term, during the process of recovery in the coming year.

Similar phenomena are likely to occur also around the world, such that there is likely to be an "import" of global inflation into Israel's CPI. In our opinion, this will involve a return to the rate of increase in prices close to 1% in the coming year, while a situation in which inflation stabilizes over time within the target range remains far off.

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