Leumi Economic Weekly

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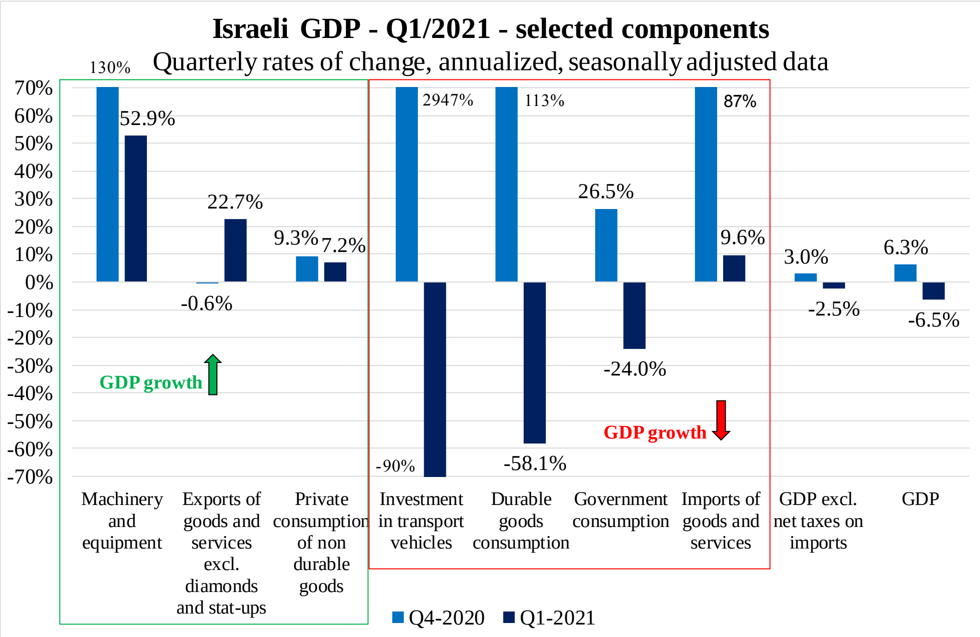
Israeli GDP contracted 6.5% in the first quarter of 2021 (in annualized terms), mainly due to a sharp drop in automobile purchases

The Central Bureau of Statistics (CBS) released the initial estimates of the national accounts data for the first quarter of 2021. The growth data surprised on the downside, as Israel's GDP declined 6.5% (in real, annualized terms; seasonally adjusted data) after it had increased by a similar rate in the fourth quarter of last year.



A deeper analysis of the data shows the decline stemmed primarily in part from technical reasons. This is due to a sharp decline in automobile purchases in the beginning of the year, after these had increased sharply in the second half of 2020, against the backdrop of advanced purchases due to a revision in the 'green' taxation formula starting at the beginning of 2021. The revised tax formula led to a rise in automobile prices in the beginning of this year, and consequently private car purchases declined – which in turn led to a sharp drop in durable goods purchases, and also to a drop in investment in transport vehicles (vehicles for the business sector). In light of the fact that the contribution of these components to GDP comes from state revenues derived from taxes on imports, it can be seen in the accompanying chart that the growth rate of GDP excluding net taxes on imports fell by 2.5% after rising by 3.0% in the fourth quarter last year.

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Another component of activity that contributed to the fall in GDP includes government consumption. This was due to, not only the absence of a government budget, but comes also against the backdrop of the fact that government expenditures generally increase at the end of each year and fall afterwards at the start of the following year. It is important to note that currently the volatility in the data has been very substantial compared to the past, this is likely due to the accelerated purchases related to the coronavirus from last year; and the import of goods and services, which continued to climb (when imports rise the GDP falls, when all other things remain the same) after increasing sharply in the fourth quarter of 2020, this apparently as part of the process of re-stocking inventory (which corresponds to an increase in inventory registered in this quarter). If it were not for the fall in automobile imports, apparently imports would have increased more.

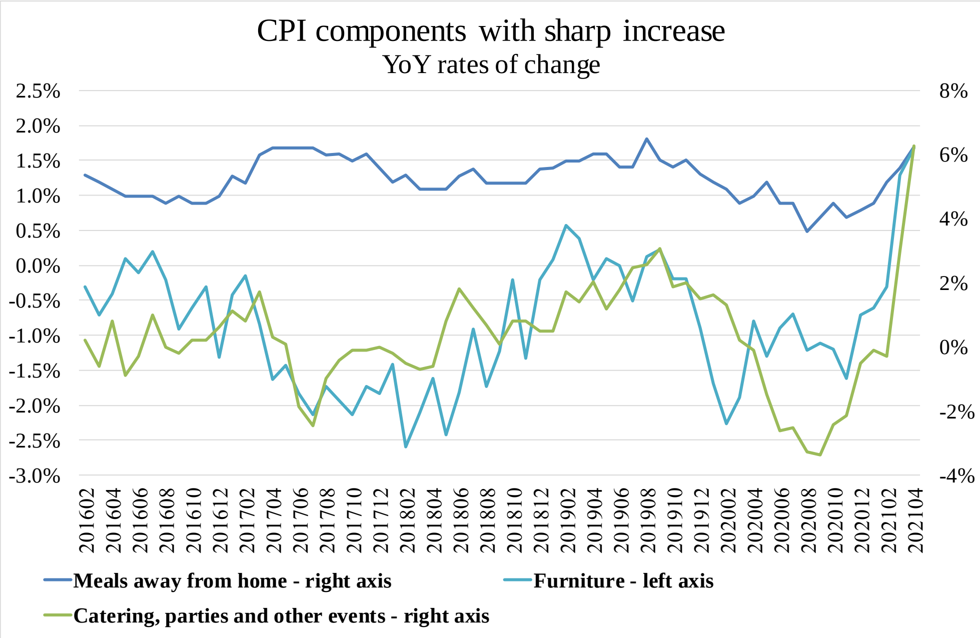
As can be seen in the accompanying chart, **the components unrelated to vehicles registered increases, including: non-durable private consumption (including current consumption of services), electronic equipment and furniture (other durables), investment in machinery and equipment, and exports of goods and services.** Thus, it can be said that the bulk of the growth data were positive overall, and also that the main growth engines of the economy (private consumption and services exports) continue to lead economic activity. This development indicates a continued recovery of the economy from the effects of the coronavirus crisis, this even though during a substantial portion of the first quarter of the year the economy was subject to a general shutdown (the "tightened" portion of the third shutdown) that was eased gradually afterward.

In light of the above, it can be estimated that GDP is expected to increase in the second quarter of this year, during which time the economy has been functioning at a much greater capacity. This is on the assumption that the current security events ("Operation Guardian of the Walls") will not drag on, in a manner that will disrupt economic activity and will hurt GDP growth. On this basis and looking ahead, we estimate that in the baseline scenario, 2021 will conclude with 5.2% GDP growth, a more moderate rate compared to the Bank of Israel (BoI) estimate of 6.3% (the BoI's forecast from April 2021).

The April consumer price index surprised slightly on the downside against the backdrop of a decline in the housing component; expectations for price increases throughout 2021

The April consumer price index (CPI) increased 0.3%, a moderate rate of increase relative to the initial estimates – the consensus forecast called for an increase of 0.4%. Price increases were registered in the fruits and vegetables component, the clothing and shoes component, and the food component, this against the backdrop of, among other things, increases in commodities prices around the world and an increase in global shipping costs recently. It is important to note that these factors are likely to continue to drive price increases on these goods and others also in the near term. Price increases were registered also in the furniture component, this for the first time in a decade, against the backdrop of, among other things, the factors noted above, and also supported by the recent rise in housing market activity.

Despite the relatively moderate increase in April's CPI, price increases can be identified in some of the components of the CPI that were not fully measured during the time of the coronavirus crisis. Thus, continuing what occurred in March, price increases were also registered in a number of services sectors, including: recreation and leisure in Israel, catering, parties and other events, and meals away from home (see accompanying chart). This trend reflects an increase in the demand for consumption of local services, with the return of the economy to broad activity, and particularly services that were greatly affected by the pandemic-related restrictions. Meanwhile, in parallel, the supply in some of the services sectors declined over the past year, resulting from the negative effects of the crisis on activity. This development is expected to continue also in the coming months.



The housing component declined in April, resulting from a 0.2% decline in the owned dwellings services sub-component (which reflects housing rental prices in new and renewed contracts), and therefore the annual rate of increase of this sub-component fell to only 0.9%. This decline, which is within a range of seasonality for the month of April each year, reflects a slow recovery in demand for housing rentals at this time, while the number of furloughed employees in the economy is still relatively high, especially among the portion of the population that is active in the rental market. In our estimation, the economy's return to activity, together with the recovery in the economic indicators, in combination with a continuing rise in housing prices (which is gradually trickling into rental prices, with a slight delay), are expected to lead later on to a renewed acceleration in the owned dwellings services sub-component.

Housing prices (according to the monthly housing survey of the CBS; not included in the CPI) increased in February – March 2021 by 0.8% compared to January-February 2021, and therefore the annual rate of increase of housing prices increased to 4.5%. In our estimation, this trend is expected to continue also in the coming months, against the backdrop of increasing demand for home purchases, which is coming up against a relatively low supply of housing, compared to the needs of the economy.

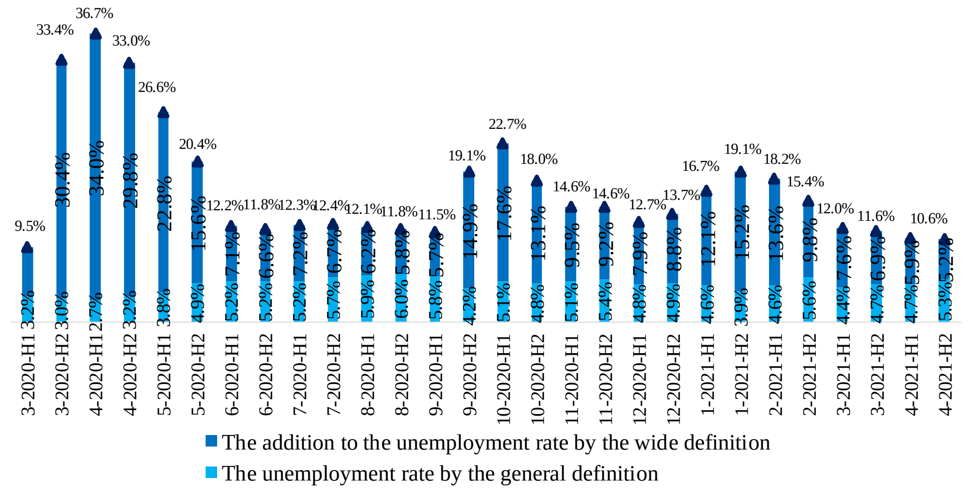
In summary, over the trailing 12-month period (April 2021 compared to April 2020) the CPI increased 0.8%, compared to an increase of 0.2% in the preceding month. This acceleration in the annual rate of increase in prices is the result of, among other things, the exit of the April 2020 CPI, which was especially low, from the window of calculation, a development that is expected to continue also in the coming months and to support the rise in inflation.

In summary for the year, 2021 is expected to conclude with inflation between 1.5% - 2.0%. This will be the result of one-time price increases, following the declines registered last year. That is to say, currently it does not appear that a sustained acceleration is expected in the rate of price increases. As for 2022, in our estimation, inflation is expected to slow during the year, in light of weakness in the strength of the factors acting to raise inflation at this time, including: a stabilization in energy and commodities prices, a stabilization in global shipping prices, recovery in the supply in the services sectors, a renewed strengthening of the shekel, and more.

In the second half of April the "broad" unemployment rate remained unchanged at 10.6%

The findings of the workforce survey for the second half of April were released by the CBS. The data show that in the second half of April the "broad" unemployment rate, which includes, among other things, the unemployed and furloughed workers, remained unchanged at 10.6% (see accompanying chart).

The unemployment rate by the wide definition, as of the Israeli CBS*, as % of workforce, original data



* 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 since March 2020.

The data reflect a number of 446,000 unemployed persons (under the broad definition), of these 104,000 are furloughed employees (temporarily absent the entire week due to reasons related to the coronavirus). The number of furloughed employees is continuing the downward trend of recent months, and is now at its lowest level since the crisis outbreak.

The unemployment rate referred to for setting the amount of unemployment benefits paid to furloughed workers fell moderately to 7.9%. This figure remains above 7.5%, which is the threshold at which unemployment benefits to furloughed workers will be cancelled. That is to say, the payment of unemployment benefits to these workers will continue until the time established in the law (June-July 2021). Thus, the incentive of some of these workers to return to the labor market remains low; therefore, the process of recovery of the labor market will continue to advance slowly, with an emphasis on the accommodation and food, the hotel, as well as the entertainment and leisure sectors. This development is reflected in the data on job vacancies in the economy in April, the number of which increased to a peak of 130,000, while the rate of job vacancies in the food and accommodation sectors (hotels and restaurants) increased to an extraordinarily high level. Looking ahead, the "broad" unemployment rate is expected to continue to decline as economic activity accelerates, and even more so after the cancellation of the payment of unemployment benefits to furloughed workers. In our estimation, 2021 will conclude with a low double-digit "broad" unemployment rate, as an annual average, while at year-end the rate is expected to reach a single-digit rate, although still substantially higher than the pre-crisis level (less than 4%).

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