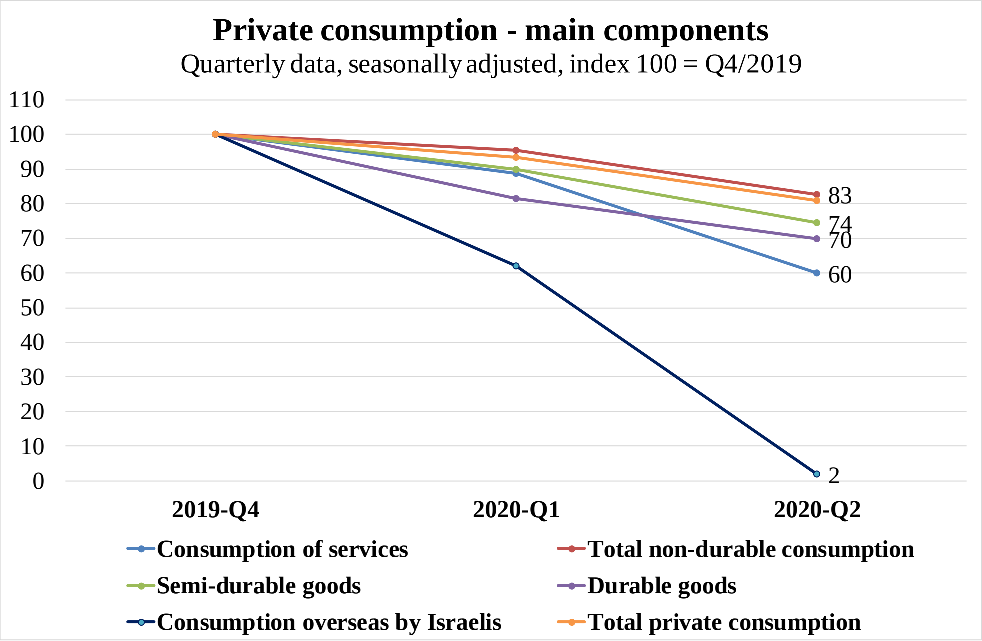
Leumi Economic Weekly

August 19, 2020

Israel's GDP continued to contract also in the second quarter of 2020, by a sharp rate of 28.7% (in annualized terms), due to the coronavirus crisis

Against the backdrop of the coronavirus crisis, the Central Bureau of Statistics (CBS) released its initial estimates on the second quarter of 2020 national accounts. The figures indicate a 28.7% contraction in Israel's GDP (quarterly change in annualized terms, seasonally adjusted data), in continuation of the 6.8% decline in the first quarter of the year. This represents the sharpest decline ever registered in the current data series (since 1995), which has returned the GDP (in real terms, seasonally adjusted) to the level similar to that of the fourth quarter of 2016. Naturally, the decline in activity of the business sector was more substantial, with a drop of 33.4% (in annualized terms), in continuation of the 7.8% decline in the preceding quarter.



An international comparison of the rates of decline in GDPs in the second quarter of 2020 compared to the final quarter of 2019 shows that Israel's GDP fell by a rate similar to that of Germany and the US, while the rates of decline in the GDPs of Spain and England were double that of the decline in Israel.

Regarding the GDP components, the bulk of the contribution to the decline in the GDP came from private consumption, which has been severely hurt by the coronavirus crisis. In the second quarter of 2020 private consumption contracted 17% compared to the final quarter of 2019 (see accompanying chart). The hardest hit consumption components include: consumption overseas by Israelis, against the backdrop of the "closure of the skies"; durable goods consumption (automobiles, electronic goods, and furniture), with an emphasis on large purchases, of which households are currently tending to avoid according to the various surveys; and expenditures on the consumption of various services that have been directly affected by the social-distancing restrictions, which dropped 40%, with an emphasis on sharp declines in transportation services (both in Israel and also in overseas flights), in hospitality services, and in culture and leisure services, as well as health. Also the components involving other consumption registered declines. Only expenditures on equipment purchases for households registered increases in the second quarter. These include such items as refrigerators, laundry machines, and air-conditioners.

Declines were also registered in investment in fixed assets (investment in residential construction and investments of the industrial sectors in construction, equipment, and transport vehicles), and in exports. Although exports of goods and services (excluding diamonds and start-up companies) fell in the second quarter of 2020 by 28.1% (in annualized terms), exports of other services (exports of high-tech services, such as software exports; transportation; and communication services, etc.) increased 5.5%. Since the decline in imports was more severe than the decline in exports, overall net foreign trade (exports minus imports) represented a positive contribution to growth. On this regard, we note that the foreign trade data for July indicate a continuing decline in exports also in the beginning of the third quarter.

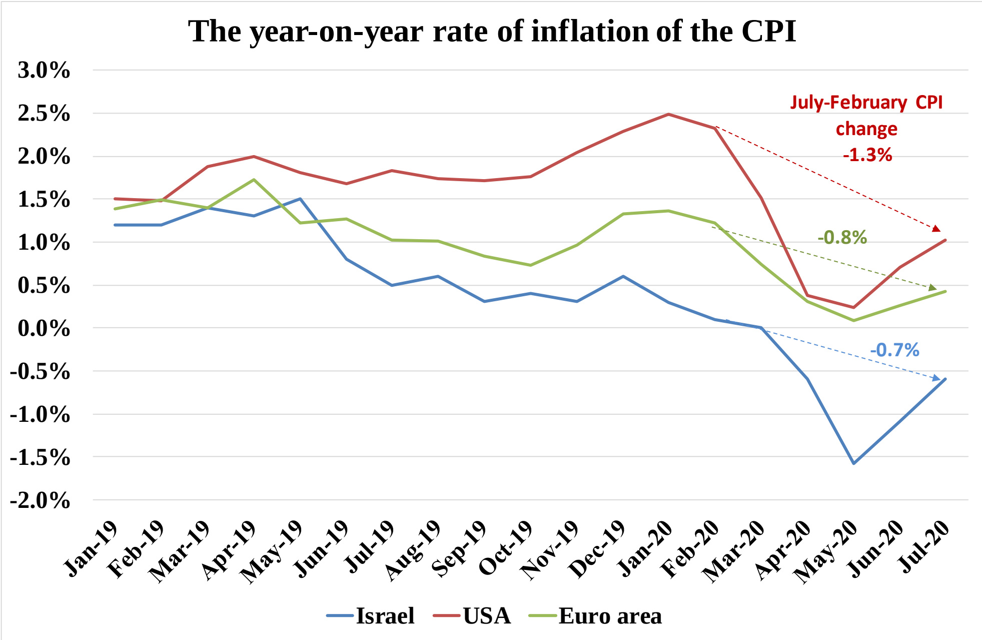
Following the publication of the second quarter growth data, along with the follow-up of other current indicators, we slightly revised upward *Leumi*'s growth forecast for Israel's 2020 GDP, which currently stands at minus 5.5%. This is mainly against the backdrop of expectations for a more moderate decline in exports and a sharper decline in imports - two developments that work in tandem to increase GDP (while all other factors are fixed), and also due to moderation in the expected contraction in investment in fixed assets, both residential construction and investment in industrial sectors of the economy. The components of uses in which there have been no significant changes in the forecast include private consumption, which is expected to fall sharply, and public consumption.

The consumer price index increased in July; actual annual inflation increased, yet remains in negative territory

The consumer price index (CPI) increased 0.2% in July. An increase in gasoline prices had a substantial contribution to the rise in the CPI, as did the housing component and the education, culture, and entertainment component. In contrast, price declines were registered in the clothing and shoes components.

At the same time, home prices (according to the monthly housing survey of the CBS, which is not calculated in the CPI) registered a 0.4% decline (May-June compared to April-May). The annual rate of increase in home prices declined to 1.9%, that is to say that also during the coronavirus period home prices continued to climb, at a rate slightly more moderate than that registered in preceding months.

Annual inflation in Israel (the rate of change over the trailing 12-month period), which just two months ago stood at minus 1.6%, became less negative in July, reaching a level of minus 0.6%. This change occurred primarily due to the recovery in energy prices and also due to the exit of the June-July 2019 CPI figures from the window of calculation, as these were relatively low compared to the seasonality in preceding years.



In Israel, as in other developed countries (see accompanying chart), there was a sharp decline in inflation with the outbreak of the coronavirus and the implementation of government restrictions on economic activity. Afterwards, in parallel with the gradual removal of the restrictions on economic activity (and a recovery in oil prices), inflation started to climb, as mentioned, yet remains below the pre-crisis level.

As can be seen in the accompanying chart, the declines in inflation in Israel and in the euro bloc were moderate compared to the decline in the US. Between Israel, the euro bloc, and the US there are unique aspects that likely explain the differences in inflation, among them being: the different weightings of the main CPI components, together with the scope and the composition of monetary policy and the government assistance for dealing with the crisis (support for households, in the labor market, the restrictions on activity, and more).

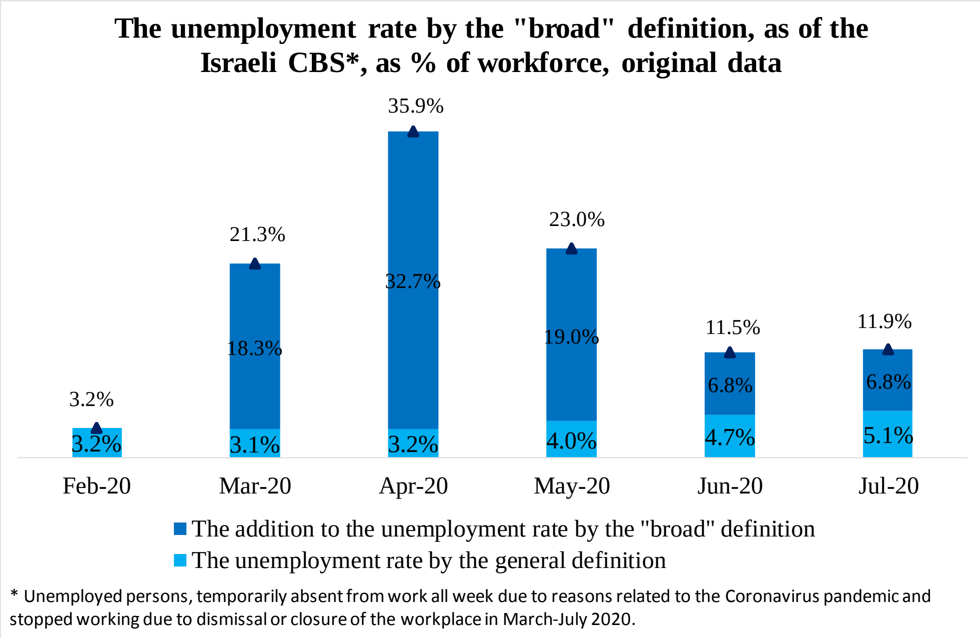
However, there is another possible explanation, which derives from the fact that in the US they continued to use the regular methods for measuring the CPI components of chosen services that were heavily hurt during the crisis, this in contrast to the situation in Israel and in the euro bloc. Among these services can be noted the airplane travel component (domestic and international) and overnight hotel stays, both of which have been measured in the US using the regular practices throughout the coronavirus period. In contrast, in Israel and in the euro bloc these components were imputed to the general index at the height of the pandemic, and in Israel the imputation of the overseas travel component continues even today. This is due to the scarcity of transactions in a manner that would permit direct measurement. In light of the above, inflation in Israel declined by a lesser degree than inflation in the US, where the airplane travel and hotel components fell by double-digit rates.

Looking ahead, in our opinion, annual inflation is expected to climb gradually over the coming year, this under the assumption there will be no substantial shutdown measures implemented going forward. Within the framework of this scenario, we estimate that 2020 is expected to conclude with negative inflation, within a range of minus 0.4% -

minus 0.8%, while over the coming 12 months (August 2020 – July 2021) the CPI is expected to increase 0.7% - 1.0%.

The "broad' definition of the scope of non-employment currently reflects a double-digit unemployment rate, which increased slightly in July

The CBS recently released July's employment data (based on workforce surveys), including detailed tables that enable us to get an indication of the scope of unemployment under the "broad" definition of the word. The analysis in this section relies on the original data and not on seasonally adjusted data, as we have noted in our previous weekly surveys, this due to the disruption in the data series resulting from the coronavirus crisis.



From the tables it can be seen that the unemployment rate under the "broad" definition includes the following components: the number of unemployed (which only these are included in the standard calculation of the unemployment rate), employees who are temporarily absent from their places of work due to the coronavirus crisis (mainly workers released to unpaid vacation), and workers dismissed from their jobs in March-July and are not currently participating in the workforce.

As can be seen in the diagram, the "broad" unemployment rate (which is calculated as the percentage out of total workforce participants) increased slightly in July to 11.9%, this following two consecutive months of declines (May and June). Indeed, the current unemployment rate is substantially below the peak level registered in April; however, it remains very high compared to the pre-coronavirus level (3.2% in February). The current level of non-employment stands at approximately 500,000 workers, this compared to 150,000 workers prior to the crisis. Furthermore, it is important to note that the renewed rise in the unemployment rate in July reflects the renewed outbreak of the coronavirus in Israel and the slight intensification of restrictions on activity, a development that is delaying the economy's exit from recession.

Looking ahead, the continuation of the current wave of morbidity, which is expected to delay the removal of restrictions on economic activity, coupled with the extension of the period of government support for the unemployed public (which may continue until June 2021), represent factors that support the "broad" unemployment rate remaining at a high level.

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