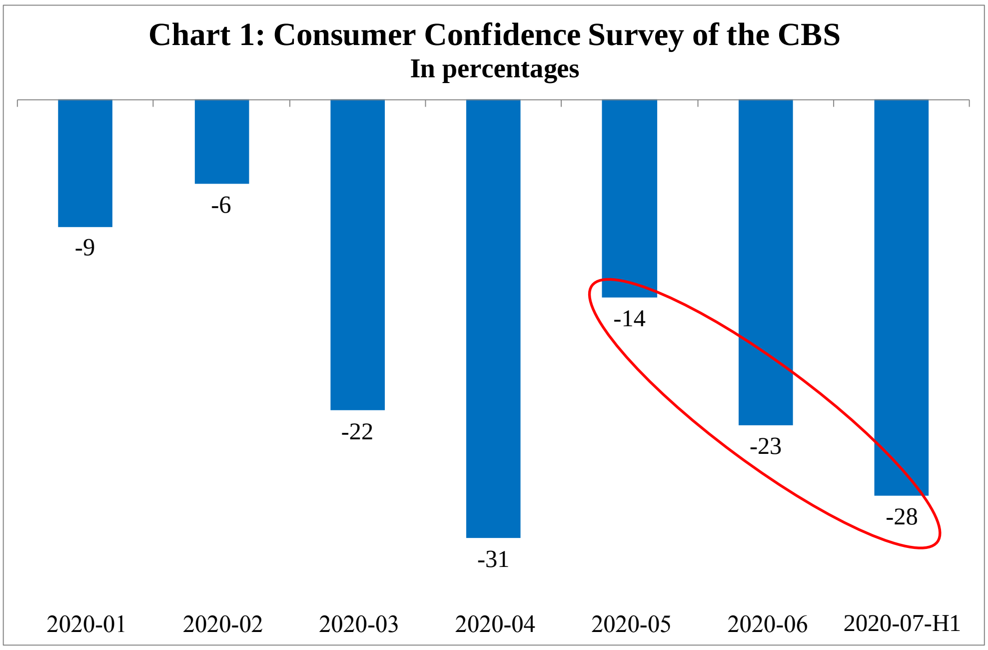
Leumi Economic Weekly

July 22, 2020

Bank Leumi's 2020 growth forecast for the Israeli economy has been revised downward, to minus 7.9%

The available economic indicators show a rise in pessimism regarding local economic activity, against the backdrop of the current wave of morbidity. Thus, the consumer confidence index of the Central Bureau of Statistics (CBS) indicates a rise in pessimism among consumers in the first half of July compared to June (see Chart 1), and close to the low registered back in April at the time of the government initiated economic shutdown. This comes against the backdrop of deterioration in almost all the components in the consumer confidence index, with the indices measuring the economic condition of the country and consumers' intention to carry out large purchases in the coming year being especially low.



At the same time, from the latest release of the Bank of Israel (BoI) regarding credit card expenditures (analysis of daily data, without excluding seasonality), it can be seen that since the initiation of restrictions against large gatherings in the beginning of July, most of the categories of credit card purchases have remained at a low level compared to the beginning of the year, or declined. This development reflects the moderation in household consumption with the rise in uncertainty (see Chart 2). This is with the exception of the food category and pharmacies, in which a rise in credit card expenditures was registered, similar to the trend registered back at the time of the implementation of restrictions at the beginning of the coronavirus crisis. It is likely this development shows the public is anticipating the implementation of stricter restrictions in the near term.

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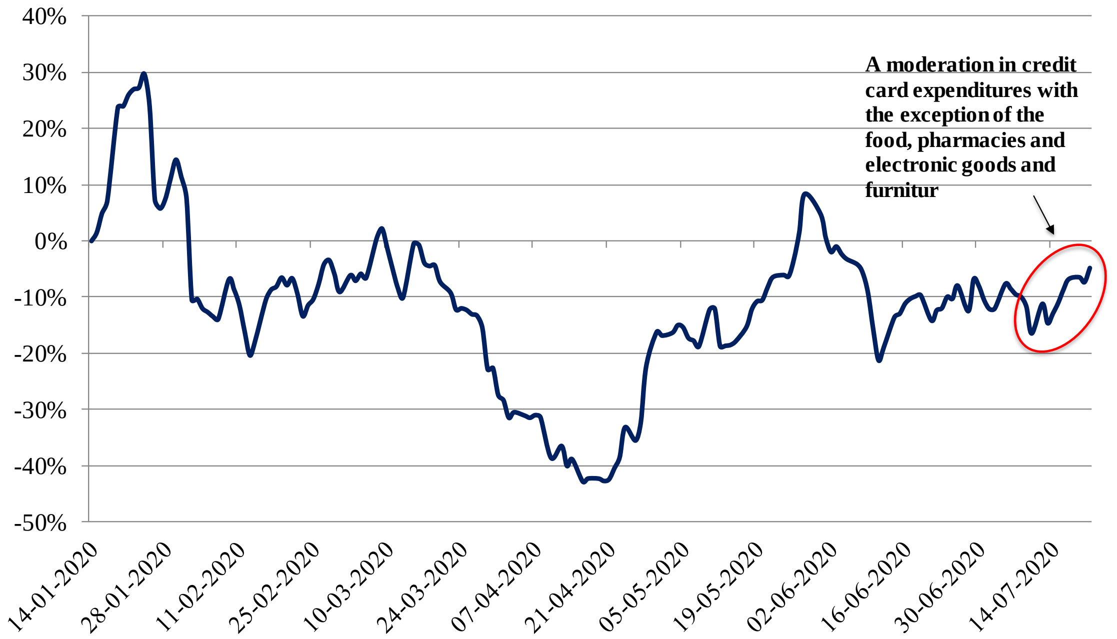
Chart 2: Bank of Israel (BoI) analysis of credit card expenditures data compared to the beginning of the year, bi-weekly average



At the same time, an increase was also registered in expenditures on electronic goods and furniture. It is likely this increase indicates the public prefers to advance purchases of these items due to concerns over upcoming restrictions on activity at local stores, shopping malls, and retail centers and/or restrictions on the shipment of items ordered on line. In addition, it is likely this increase comes, at least partially, at the expense of expenditure on tourism and leisure, which is usually at a high level during these months; however, against the backdrop of travel restrictions due to the coronavirus crisis, the current level is substantially below the level from the beginning of the year. However, it is important to take into consideration that these are unadjusted data, such that it is likely some of the changes are due to reasons related to seasonality.

Against the backdrop of the presented data, and in light of the renewed assessment of the situation due to the continuation and the severity of the current wave of virus infections in Israel as well as in other countries around the world, for example the US, Latin American countries, and India, we revised our *Bank Leumi* macro-economic forecast. Within the framework of this revision, <u>we deepened the expected decline in 2020 GDP from minus 4.6% to minus 7.9%, with a double-digit decline expected in the business sector, a development that indicates an increase in the degree of pessimism regarding Israeli economic activity in 2020</u>, in our view.

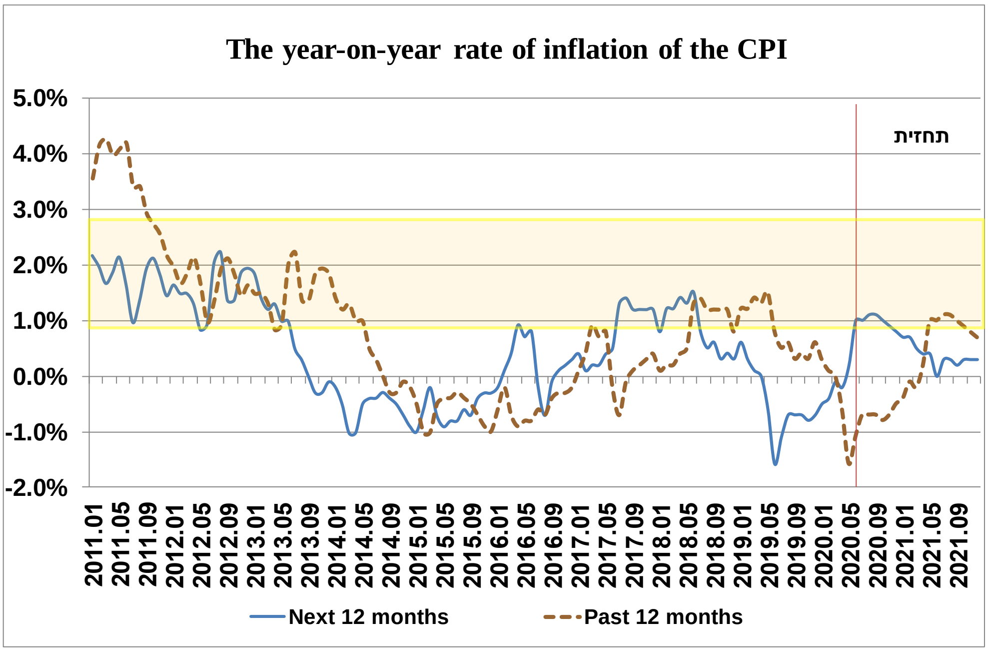
The growth components that were revised downward include exports and private consumption. Our revised estimate calls for private consumption to contract by a sharp, severe rate of 8.2%, as a result of both a drop in consumption of durable goods (automobiles, furniture, and electronic goods), and also due to a drop in non-durable consumption, primarily in services. Regarding 2021, in the scenario assuming a return to activity at a later stage this year, we forecast 5.5% growth; however, in the event the restrictions on activity will continue into the coming year, then we forecast only 3.2% economic growth.

In addition, we revised <u>downward</u> our forecast on the unemployment rate according to the definition of the Central Bureau of Statistics (CBS), which does not take into consideration employees placed on unpaid vacation and most of the dismissed employees during the coronavirus period, from 8.3% to 7.1% (annual average for 2020). It is important to note that this rate is biased substantially downward, since it represents only a partial picture of the current labor market, and thus does not express a significant improvement. This is because as long as the coronavirus continues, and with it the high number of workers remaining on unpaid vacation, then there are more months in 2020 with a low unemployment rate, which tilts downward the annual average of the forecast unemployment rate. In light of this, we lowered our annual unemployment forecast (which is also an annual average).

In summary, the revised forecasts indeed express a pessimistic view regarding the foreseeable future. However, it is worthwhile to remember the high level of uncertainty that is attached to these forecasts at this time. On this regard we recall the recent words of the governor of the BoI, regarding the release of the central bank's macro-economic forecasts, stating *"The forecast is conducted under conditions of high uncertainty and it is difficult to estimate the impact of the crisis on economic activity."*

The consumer price index (CPI) continued to decline also in June; actual annual inflation remains deep in the negative territory

CBS data show June's CPI declined 0.1%, in-line with the *Bank Leumi* forecast and the consensus average.



Notable price declines were registered in the following components: fruits and vegetable, primarily due to reasons related to seasonality; and culture and entertainment, primarily against the backdrop of the return of the measurement of the sub-component involving recreation and leisure in Israel, which was not directly measured since the beginning of the coronavirus crisis, and in actuality in April-May was imputed using the change in the general index. In June this sub-component was once again calculated using regular methods, and a sharp drop was registered, which reflects the attempts of Israeli hotels to increase demand, by lowering prices, this in contrast with what generally occurs in June, which is usually characterized by a rise in prices. This development is reflected in an unprecedented annual drop of 17%, which will likely moderate in the coming months, depending on the development of the current wave of morbidity and its impact on hotel occupancy.

On the other hand, notable price increases were registered in the transportation component, primarily against the backdrop of a rise in gasoline prices, which reflects the change in the trend in the global oil market in May. The clothing and shoes component continued to surprise with a relatively moderate decline, this in contrast to the relatively large decline in the index of May, which actually reflected an advance of end-of-season sales.

The housing component declined 0.1%, resulting from a decline of a similar degree in the owned dwellings services sub-component (which reflects housing rental prices in new and renewed contracts that started in May-June 2020). This decline reflects a continuing moderation in rental prices against the backdrop of the coronavirus crisis. In light of this, the annual rate of increase of rental prices slowed from 2.0% to 1.7%. In our opinion, the rate of increase in rental prices is likely to continue to moderate in the coming months, against the backdrop of the coronavirus crisis; however, this trend is not expected to continue over time. Among the factors that are likely to bring about a change in the trend over time can be noted the decline in the number of home purchases and in the number of new home deliveries in recent months, a development that supports rental demand.

At the same time, home prices (according to the monthly housing survey of the CBS, which is not calculated in the CPI) registered a 0.7% decline, in the shadow of the coronavirus crisis, which led, as mentioned, to a decline in the pace of sales, against the backdrop of, among other things, a decline in consumer confidence (which also continued in the first half of July – see details below) and a sharp rise in non-employment levels. The annual rate of increase of home prices slowed substantially to 2.0% compared with 4.2% in January. The moderating trend is expected to continue also in the coming months.

Inflation over the last 12 months (June 2020 compared to June 2019) increased slightly to minus 1.1%, while the CPI excluding housing stood at minus 1.9%. Looking ahead, we estimate annual inflation (meaning, each month vis-à-vis the parallel month in the preceding year) is expected to climb gradually during the coming year, this under the assumption the current wave of morbidity will not require a substantial burden involving shutdown measures. In this scenario, in our opinion 2020 is expected to conclude with negative inflation, at approximately minus 0.5%; however, in the coming 12 months (July 2020 – June 2021) inflation is likely to return to near the lower border of the price stability target range, or 1% (see accompanying chart).

The factors that are expected to support the rise in inflation over the coming year include: the exit of low index figures from the annual window of calculation (July 2019, and later on April-May 2020); the impact of the recent recovery in global energy and commodities prices; an increase in the housing component going forward; and expectations for a rise in prices in some of the services sectors (international flights, restaurants, etc.), with the purpose of compensating for the damage to profitability in the months in which activity was hurt due to the government initiated restrictions.

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