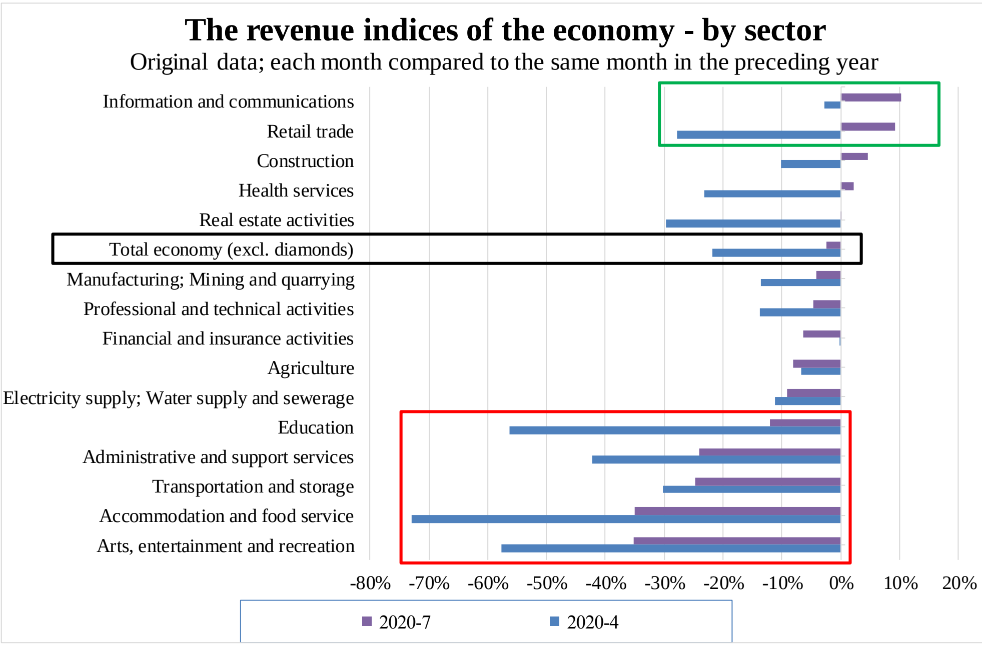
Leumi Economic Weekly

September 30, 2020

Revenues fell in all sectors of the economy in July, with substantial differences among the various areas of activity

The composite state-of-the-economy index, which is published by the Bank of Israel (BoI), declined in August by a moderate rate of 0.06%, in continuation of a decline also in July. We note that August's decline was relatively broad and included most of the components of the composite index.

The composite index started to decline back in February this year, against the backdrop of the coronavirus crisis, with very sharp drops registered in March-May. In June, after most of the sectors of the economy returned to activity with the cancellation of most of the government imposed restrictions, the composite index increased moderately. However, as mentioned, with the outbreak of a second wave of infections in the beginning of July and the reinstatement of some of the restrictions on congregating that impact the activity of some of the sectors of the economy, the composite index started to decline again. In light of the current shutdown the economy now finds itself in, it appears the composite index will continue to decline in September-October, and by a very sharp rate.



The annual rate of change of the composite index continues to indicate an on-going substantial contraction in the GDP as a result of the coronavirus crisis. In August, the annual rate of change of the composite index stood at minus 3.3%, compared to positive growth of 3.1% in January, prior to the outbreak of the coronavirus crisis. In addition, it

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is notable that the current figure is similar to the low level registered back at the time of the economic crisis at the beginning of the millennium. In light of the fact the coronavirus is continuing to spread around the world, and in the absence of an effective vaccine in widespread distribution and/or an effective cure, the way of dealing with the virus involves adherence to rules of social distancing, including economic shutdown, which disrupts normal economic activity.

Nonetheless, there still does not seem to be a conclusion to this crisis anytime soon. This means that in the absence of effective measures to control the level of morbidity, the economic aspects of the coronavirus crisis may continue for an extended period. This situation supports the annual rate of the composite index remaining at its current level, especially as the current economic shutdown continues in its current format, or in some other form, also after the current Jewish holiday period (mid-October).

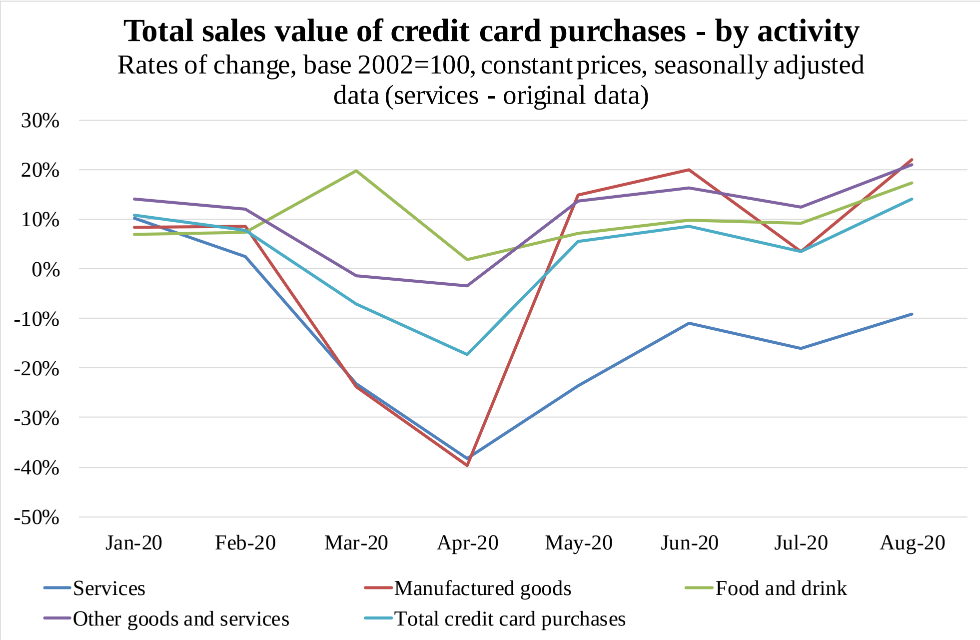
The accompanying chart presents an analysis of the revenue data in various sectors of the economy (original, unadjusted data; each month compared to the same month in the preceding year, since there are no seasonally adjusted data) in April-July. As can be seen in the chart, in April, the peak of the first wave of the crisis, revenues declined in all sectors compared to the parallel period of 2019. Afterwards, an improvement occurred in May-June, and in some sectors (including in the general economy) the level of revenues was even higher than that in June 2019. However, in July revenues in all the sectors of the economy fell once again, with notable differences among the various sectors. The sectors most negatively affected by the coronavirus crisis involve services, whereas the information and communication sectors (high-tech) and retail trade have been showing better performance.

This is to say, in light of the unique characteristics of the coronavirus crisis, its negative effects on activity are very inconsistent, with much greater damage felt in the sectors that are directly affected by the restrictions on activity, headed by the limitations on congregating and social distancing. As long as the crisis continues, the risk differentials among the various sectors of the economy are likely to widen. This is a situation in which the distribution of economic activity has changed considerably compared to the past, with an emphasis on increased risks for certain industries and also for specific socio-economic categories of households; therefore, at present, assessment of the overall situation must be based on specific analysis and cannot rely solely on aggregate data.

The volume of credit card purchases increased sharply in August; in September-October a decline in purchases is likely due to the economic shutdown

The volume of credit card purchases, based on data from the Central Bureau of Statistics (CBS), increased 7.2% in August compared to July (seasonally adjusted data; in fixed prices), when a decline was registered in purchase volumes. The annualized rate of the volume of credit card purchases increased sharply in August to 14.0%, compared to 3.4% in July. This is a higher rate of purchases than that in recent years, 7.5%-9.0%. It is likely the sharp rise in August to a level above the trend of recent years stems from, among other things, the fact that households spent their summer vacation in Israel and not overseas, due to the restrictions on international travel.

Analysis of the volume of credit card purchases according to area of activity indicates slight differences. As can be seen in the accompanying chart, after the volume of purchases had dropped sharply in March-April, a process of recovery occurred in most of the areas of activity, and at a relatively consistent pace. An exception is the realm of services. These services include, among other things, purchases in the areas of recreation and entertainment, as well as flight, tourism, and accommodation services, in which the volume of purchases remains low compared to the parallel period of last year, even though the levels have recovered slightly. This trend is not surprising, in light of the fact the services sectors are directly affected by the restrictions on congregating and on social distancing, as mentioned.



Analysis of credit card expenditures, according to BoI data (analysis of daily data without excluding for seasonality), from almost the entire month of September, shows that total purchases are indeed close to the level they were at prior to the coronavirus crisis; however, purchases in the tourism sector have fallen sharply since the beginning of September. This comes against the backdrop of, among other things, the conclusion of summer vacation and the renewal of restrictions on activity within this sector, while at the same time sharp declines were registered also among restaurants, transportation and gasoline, as well as education and leisure. It is important to note that a relatively sharp decline was registered also in expenditures on electronic goods, clothing, and furniture.
Looking ahead, the current government imposed shutdown is expected to continue to weigh on purchases in the realm of services, and likely also in other areas. In light of this, the trend in the volume of purchases is likely to change in September-October, turning negative, perhaps even very sharply. This development is expected to be expressed in a weakness, and even declines, in private consumption in the final quarter of 2020.

The OECD estimates Israel's GDP will contract 6% in 2020

The OECD released an up-to-date survey of the Israeli economy recently. As part of the in-depth review, the OECD's latest macro-economic forecast on activity in Israel was published.

In the opinion of the OECD, the recovery of the Israeli economy from the coronavirus crisis will be slow. The additional period of shutdown in which the economy now finds itself is expected to weigh even further on activity at least in the short-term, and to delay the recovery from the crisis. Furthermore, in the absence of a vaccine or cure for the coronavirus, uncertainty in the economy is expected to remain high. In addition, the social-distancing constraints and the "purple tag" business standards to which many businesses that serve the public must adhere are expected to weigh on local demand for consumption and investment. On the other hand, the OECD believes the government assistance programs represent a factor that supports demand. In parallel, the weakness in global demand is expected to weigh on the exports of goods and services from Israel.

OECD Forecasts on the Israeli Economy

Quantitative Annual Rates of Change	**2020**	**2021**
GDP	-6.0%	2.9%
Private consumption	-11.6%	6.0%
Fixed capital investments	-11.8%	-0.8%
Exports of goods and services	-4.3%	3.2%
Imports of goods and services	-9.0%	6.1%
Unemployment rate (annual average, ages 15 and above, based on the standard definition of the CBS)	6.1%	6.5%
Current account surplus (% of GDP)	4.1%	3.7%
Govt. debt (% of GDP)	-13.8%	-10.3%
Debt/GDP ratio (% of GDP)	77.0%	84.7%

In light of the above, the OECD forecasts Israel's GDP will contract 6.0% in 2020, taking into consideration an expected cautious and gradual exit from the current economic shutdown, and in 2021 the GDP is expected to increase 2.9%. Overall, this is a slightly more moderate forecast than that of the BoI (at least with respect to 2020), and similar to our forecast at *Bank Leumi*, while the growth forecast for 2021 matches the forecast of *Bank Leumi* in the situation that assumes the continuation of the restrictions on activity during 2021.

Regarding the unemployment rate, the OECD estimates the level of unemployment in 2020 will be substantially higher than that in 2019 (the unemployment rate in the accompanying table of forecasts is the "standard" definition, not including furloughed employees), and the rate will decline gradually during 2021, similar to our assessment at *Bank Leumi*. The forecasts for the unemployment rate in the accompanying table are in annual average terms; therefore, they do not reflect the downward process in the unemployment rate, which is expected to be below the average by the end of 2021. Furthermore, in 2020-2021 large government deficits are expected, and consequently the debt/GDP ratio is expected to climb substantially.

In the survey it is emphasized that the forecasts are calculated during a period that is characterized by a high degree by uncertainty; therefore, it is likely the forecasts may be revised down the road. Of course, a deterioration in the health situation, which will require an additional period of economic shutdown, is expected to delay the economy's exit from the crisis. Overall, it appears the coronavirus crisis will lead to a sharp drop in

GDP in 2020, with differences among the country's various areas of activity, with an emphasis on heavier damage in a portion of the services sectors.

Due to the upcoming seven-day holiday of the Feast of Tabernacles (Sukkot) in Israel, the next weekly survey will be published in mid-October.

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