

Leumi Economic Weekly

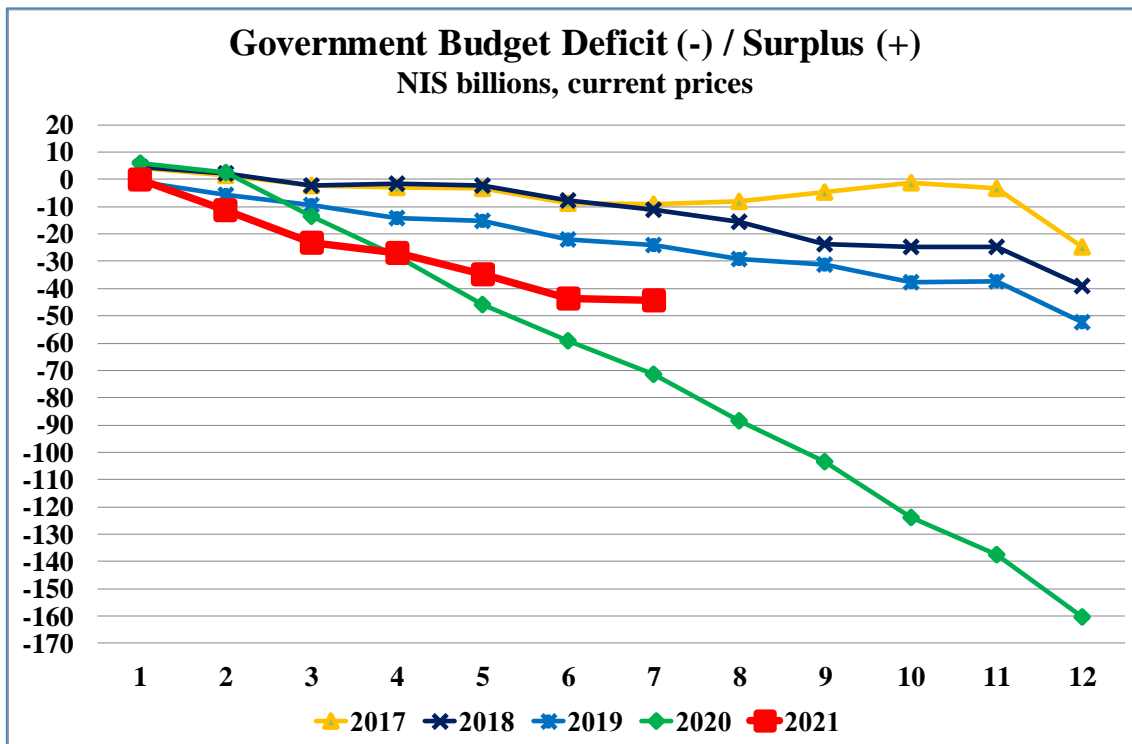
August 11, 2021

The fiscal deficit over the trailing 12-month period fell in July to a single-digit level of 9.3% of GDP

In July this year, government activity amounted to a deficit of NIS 0.8bn, compared to a substantially greater deficit of NIS 12.0bn in July last year. The deficit was financed primarily through domestic capital raising, as well by the proceeds from the sale of lands of the Israel Lands Authority (ILA).

The fiscal deficit over the trailing 12-month period (August 2020 – July 2021) continued its downtrend from the beginning of 2021, falling to a single-digit level of 9.3% of GDP (equivalent to NIS 133.2bn), compared to 10.1% of GDP (NIS 144.6bn) in June.

The accompanying chart presents a comparison of the cumulative government budget deficit in 2021 until now, to preceding years. From the chart it can be seen that the cumulative deficit (excluding net credit granted) from the beginning of this year (January-July) stood at NIS 44.4bn, which is very low compared to the parallel period last year, at which time a NIS 71.3bn deficit was registered.



The decline in the cumulative deficit from the beginning of 2021 is the result of a sharp, rapid jump in state revenues, coupled with a relatively moderate increase in expenditures. This is due to, among other things, the fact that government expenditures (excluding the assistance program in response to the coronavirus crisis) are still within the framework of the continuing budget, which restricts expenditures according to a formula based on the last approved budget of the government. The budget for 2021-2022 has indeed been confirmed by the coalition government, but has not yet received the approval of the Knesset (parliament); therefore, it has not yet come into effect.

Cumulative expenditures within the framework of the government's economic assistance program in response to the coronavirus crisis stand at NIS 42bn since the beginning of this year. On this regard, we note that the cumulative rate of performance of this assistance program since its initiation (2020-2021; expenditures in cash and obligations) stands at 79% (NIS 159bn out of a total of NIS 202.3bn), led by the social security components and the civilian and health responses.

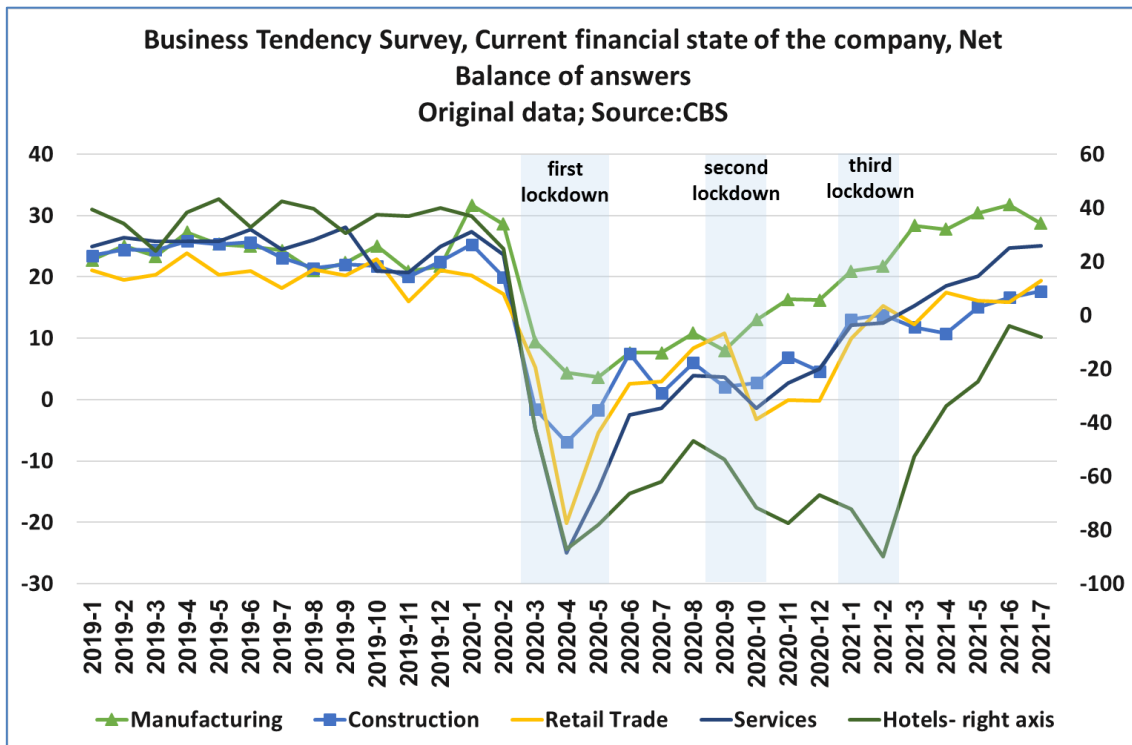
The cumulative sum of government revenues from the beginning of the year through July amounts to NIS 231.5bn, reflecting, among other things, a substantial increase of 23% (in real terms) in state revenues from taxes compared to the parallel period of last year (which was adversely affected by the coronavirus crisis) and an increase of 17% compared to the parallel period of 2019. The increase in revenues from direct taxes was greater than the increase in revenues from indirect taxes. This comes against the backdrop of the economy's return to full operations, an increase in revenues from capital gains (mainly from the high-tech sector), coupled with an increase in the number of real estate transactions in the economy and the rise in home prices.

In summary, the positive developments with respect to tax revenues are expected to continue, this in the absence of any substantial deterioration in the uptrend in morbidity from the coronavirus to a degree that would require an intensification of COVID restrictions. In light of this, 2021 is expected to conclude with a lower deficit compared to the initial forecasts, and this will mean lower financing needs on the part of the government. In our baseline scenario, we estimate the government deficit will stand at 7.0-7.5% of GDP for all of 2021.

Sentiment among companies active in the construction and hotel sectors remains low compared to the pre-coronavirus period

The July 2021 Business Tendency Survey of the Central Bureau of Statistics (CBS) indicates an increase in the overall balance of the business sector (original data) in June 2021, for the second month in a row. The net balance of the responses, which range between +100 and -100, is the weighted difference between the percentage of company managers who assessed the state of their company positively and the percentage of those who assessed the state of their company negatively. Thus, a higher balance represents a better outlook for the sector, while a low balance represents the opposite. According to the findings of the CBS, for the overall balance there is a positive correlation with the monthly rate of change of the revenue index of all the sectors of the economy (original data). Therefore, the latest increase in the overall balance likely attests to an increase in the revenues of all the sectors of the economy in June; however, we cannot rule out that any such increase may be attributed to seasonal factors, since the data are unadjusted for seasonality.

From an observation of the subjective assessments of the companies in the business sector with respect to their current financial situation, in a breakdown according to the main sectors, we learn that in the manufacturing and hotel sectors there has been a slight decline in the net balance of the responses of company managers during July 2021. On the other hand, in the other sectors including construction, services, and retail trade, there was a slight increase in this month (see accompanying chart).



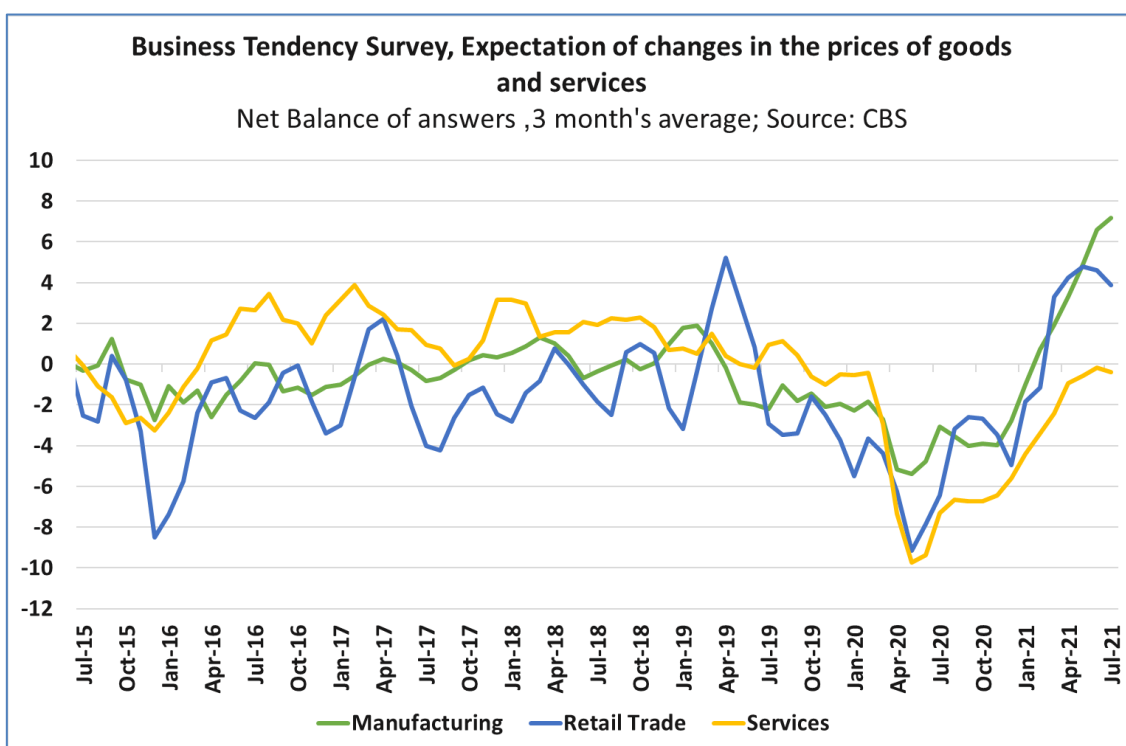
In a broader analysis, over time, it is evident that the sentiment in some of the main sectors, that is to say the services and retail trade sectors, returned to a level similar to the level that prevailed prior to the outbreak of the coronavirus pandemic, while the sentiment in the manufacturing sector is actually higher than its level in the pre-coronavirus period. On the other hand, it is notable that the assessments among the companies in the hotel sector are substantially below their pre-coronavirus period levels, this due to, among other things, the fact that the entrance of foreign tourists into the country remains heavily restricted, and because this sector becomes totally shut down whenever the government decides to impose restrictions on economic activity.

In addition, also the estimates of the companies in the construction sector are low compared to the estimates in the pre-coronavirus period, this despite the substantial increase in the level of new home sales in the recent period. According to the survey findings, it can be assumed that the relatively low sentiment in the construction sector stems from the relatively low level of new projects and an increase in the constraints on activity deriving from the shortages in equipment and in raw materials.

The Business Tendency Survey shows two additional findings that are worth noting. First, the constraint on activity deriving from a shortage of workers is found at relatively high levels in the services and manufacturing sectors, and to a lesser degree also in the retail trade sector. Apparently, the central factors behind this development revolve

around the government program supporting furloughed employees, which has been greatly reduced recently; the need to train new workers; and the transfer of workers from one occupation to another, or between different sectors of activity.

Second, in the realm of prices, the survey shows that the expectations for rising prices in some of the main sectors remained at a high level from the beginning of the year (see accompanying chart). Thus, indeed the expectations for a change in the prices of goods that the company sells in the manufacturing and retail trade sectors weakened in July 2021; however, nonetheless, the net balance shows that the percentage of companies estimating that prices will rise is greater than the percentage of those estimating that prices will decline, and at a relatively high rate compared to history. It can be estimated that these expectations exist due to the rise in raw materials prices, the difficulty in recruiting workers, and the reduction in supply (the closure of businesses due to the coronavirus). It should be emphasized that the net balance indicates the difference between the percentage of companies in the sector that estimates prices will rise and the percentage of those that say prices will fall, and does not purport to provide a quantitative forecast on the pace of inflation.



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