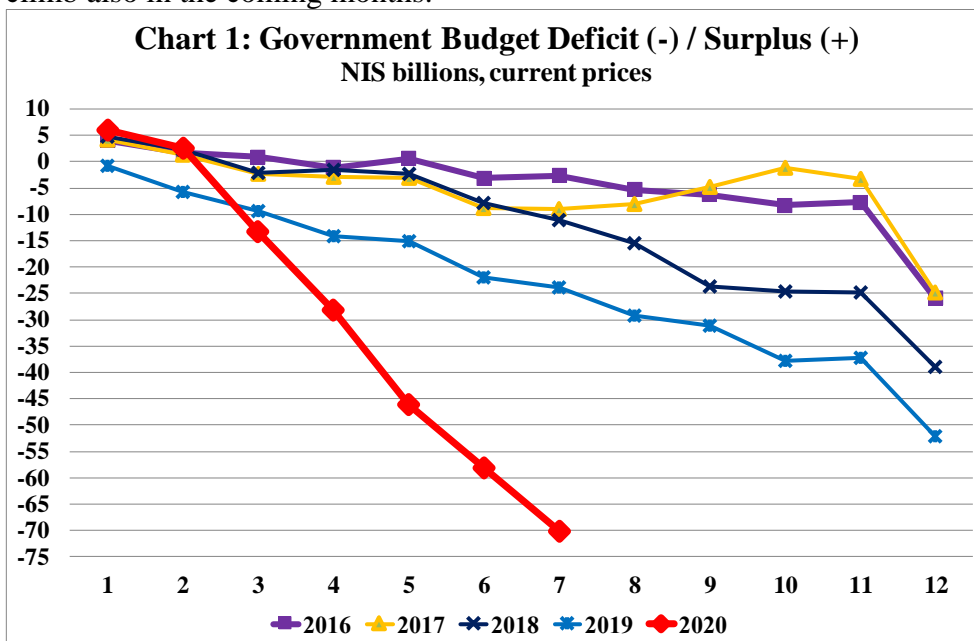


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The government budget deficit continued to increase in July, while the rate of performance of the government economic support plan remains relatively low

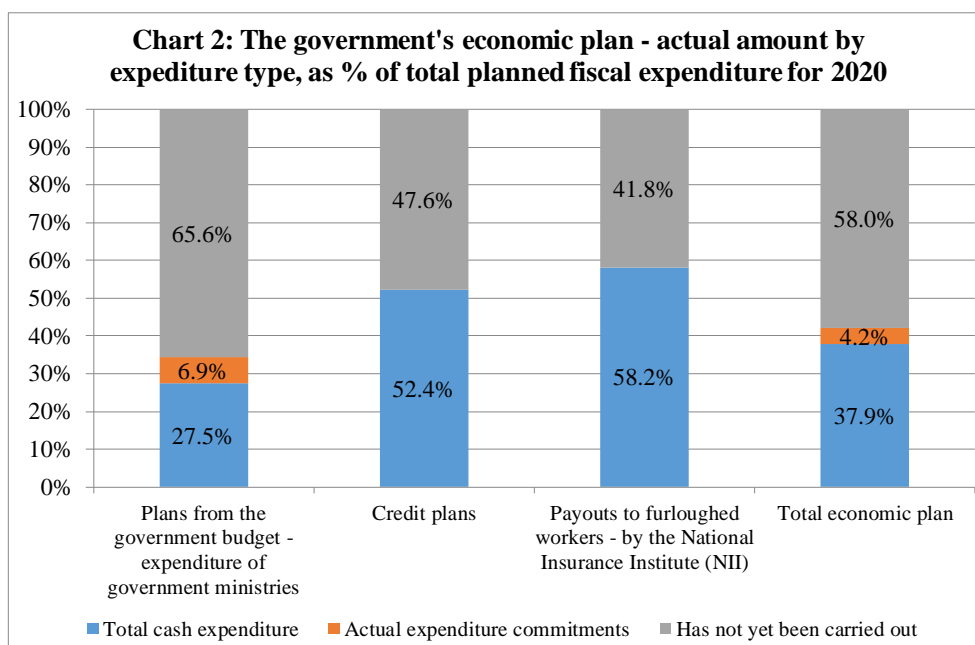
Government activity amounted to a NIS 12bn deficit in July, compared to a NIS 2bn deficit in July 2019. The cumulative deficit since the start of the year (January-July) stands at NIS 70.2bn, representing an extraordinary sum compared with the parallel periods over previous years (see Chart 1). Furthermore, it is important to note that the fiscal deficit over the last 12 months (August 2019 - July 2020) increased to 7.2% of GDP, compared to 6.4% of GDP last month, and this figure is expected to continue to climb also in the coming months.



The impact of the coronavirus crisis on the increase in the deficit over the January-July period is reflected in a 12% drop in state revenues (compared to the parallel period last year). The decline in revenues from direct taxes was lower than the decline in indirect taxes, against the backdrop of, among other things, the fact that the main portion of employees released to unpaid vacation or who were dismissed from their jobs due to the coronavirus crisis happen to have low tax liabilities; therefore, this does not negatively impact to such a large degree on this portion of government revenues.

At the same time, government expenditures increased 9.4%, with an emphasis on April-July, during which time government expenditures jumped 19.4%. However, it is important to note that excluding the expenditures allocated to dealing with the coronavirus crisis, government expenditures during this period were 0.4% below the expenditures in the parallel period of last year. This comes against the backdrop of the fact that the 2020 state budget has still not been passed; therefore, the government is

operating on a continuing budget, which involves a monthly budget equal to 1/12 of the full year budget from 2019, with an addition with respect to CPI linkage. This development represents a restraining factor on government expenditures.



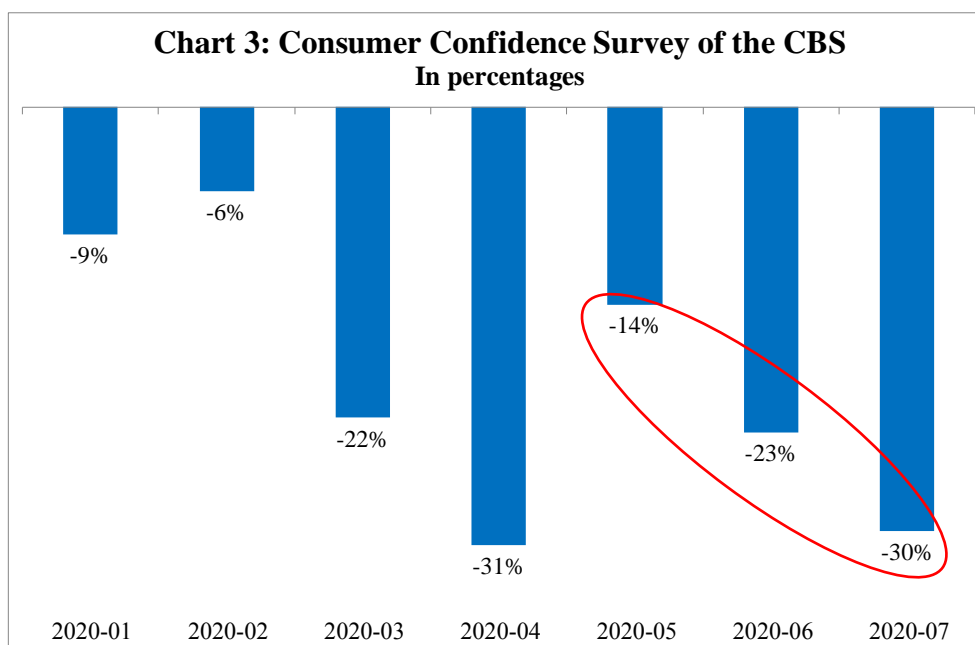
The total sum of the government's economic plan for dealing with the consequences of the coronavirus crisis amounts to NIS 135bn, as of July, of which NIS 82bn is from the state budget. Analysis of the actual performance vis-à-vis the ceiling set by law in the monthly allotment shows that until now the rate of performance of the fiscal portion of the government assistance plan is low. This sum, through July, stands at NIS 22.5bn, compared to a permitted ceiling of NIS 35.0bn.

Furthermore, as can be seen in Chart 2, almost two-thirds of the total planned fiscal expenditure for 2020 has not yet been carried out, while the cash performance stands at only 27.5%. In addition, total cumulative payouts to furloughed workers through the end of July, which are carried out by the National Insurance Institute (NII), equal NIS 7bn out of a total allocation of NIS 12bn, such that NIS 5bn remains for supporting employees released to unpaid vacation in the coming months. In total, through the end of July, a 42% portion of the total economic plan has been carried out – representing a relatively low rate of performance. Looking ahead, we estimate that within the framework of the current plans, the budget deficit of the Israeli government is expected to reach 12% of GDP in 2020. Also in the coming year a relatively high deficit is expected, coupled with an increase in the debt/GDP ratio to 80-85% in 2021.

The degree of pessimism among consumers and businesses increased in July

Consumer and business confidence surveys published over recent days by the Central Bureau of Statistics (CBS) indicate an increase in the degree of pessimism in July compared to June. This comes against the backdrop of the current wave of morbidity, which is showing a higher rate of coronavirus infections than that of the initial wave of morbidity (March-May), as well as a rise in the number of serious patients and the number of deaths from the virus. The rise in pessimism apparently reflects concerns regarding the implementation of more substantial intrusive measures, including a general lockdown,

that will severely hurt the economic activity of the sectors that have returned to operations, and will lead to a delay in the return to activity in sectors that still operate under a high rate of shutdown (such as hotels, leisure, and entertainment).

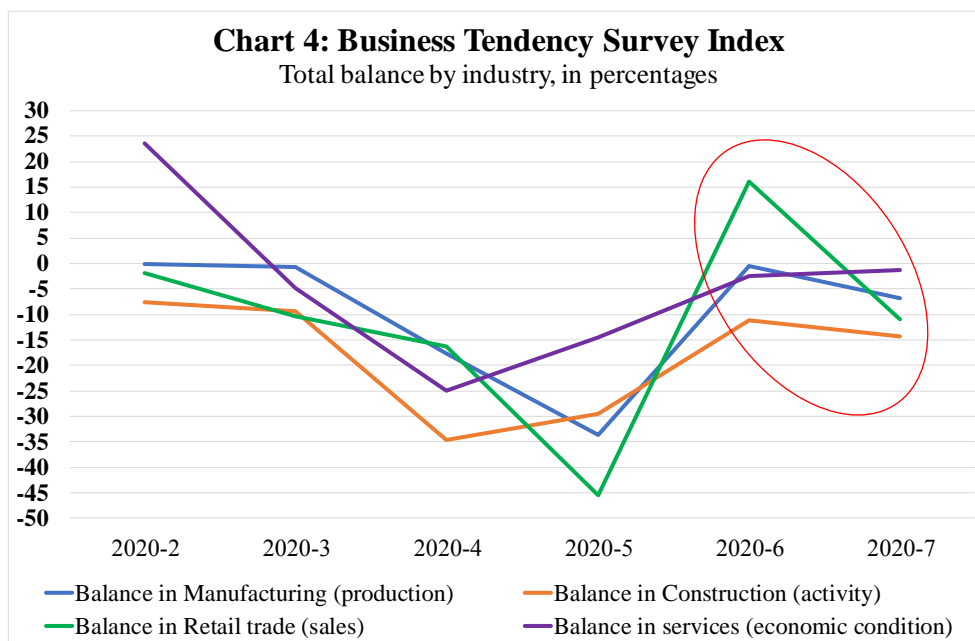


As can be seen in Chart 3, the consumer confidence index continued to decline also in July, and is currently very close to the level it was at in April – the peak of the first wave of morbidity. This decline occurred against the backdrop of a reduction in each of the components of the index, with an emphasis on consumers' readiness to make large purchases and the economic condition of the country. Thus, this serves as an expression of the increase in the level of uncertainty prevailing in the economy at this time, both with respect to the ability of households to earn a salary, and also with respect to the amount of government assistance plans and the ability to carry them out. In light of this, households are lowering demand for purchases that generally involve substantial outlays, a development that is likely to weigh on household demand for home purchases and also on private consumption, with an emphasis on durable goods (automobiles, furniture, and electronic goods) also in the beginning of the third quarter of 2020.

At the same time, the Business Tendency Survey of the CBS (see Chart 4) indicates declines in the net balances (the weighted difference between the percentage of company managers reporting an improvement in the situation and the percentage of company managers reporting a worsening in the situation) of the leading indices of most of the sectors in July. This is in contrast to the improvement registered in these indices in June, as the economy started a process of opening up.

In the industrial sectors, the indices on production and sales fell in July, and the expectations are for a deterioration in all of the indices, including orders for both the local and export markets, also in the coming month. Furthermore, the survey data show that the most substantial damage in the industrial sectors occurred among small businesses and the traditional industries. In the retail trade sector, a decline was registered in the sales index for July, and the estimations are for a deterioration in all the indices of activity in the coming month. On the other hand, a slight improvement was registered in the realm

of services, in continuation of the trend over the last two months, and the balance is close to zero (from below). However, it is important to note that differences exist between the various service sub-sectors, while among the sub-sectors that registered declines can be noted information and communication, transportation services, and financial services. On the other hand, increases were registered in the business services sector (primarily), as well as in food and beverages.



Looking at August, analysis of the quick indicators on activity published by the Bank of Israel (BoI), shows an increase in credit card purchases in the first third of the month, and currently this value is only slightly below the level from the beginning of 2020. The increase is broad across all the areas of activity, including in the sectors that until now had experienced a considerably low level of expenditure, such as hotels and restaurants, while expenditures on gas also increased. It is important to note that this expenditure is apparently seasonal for the most part, since a large portion of households go on vacation in August, a development that is expressed in an increase in car journeys and recreation. In addition, since the restrictions on airplane travel remain in place, households are spending more in the local market. It is important to wait for data from the entire month of August and the coming months in order to determine if there is an increase that does not derive solely from seasonal factors.

Looking ahead, in our opinion, Israel's GDP will contract 7.9% in all of 2020, alongside a substantial 8.2% contraction in private consumption that is expected to also include a decline in durable goods consumption and also a decline in services consumption as part of current consumption. Regarding 2021, in the scenario that assumes a return to activity at a later stage this year, our estimate is for 5.5% growth; however, in a scenario that assumes the restrictions on activity will continue beyond the current year, we forecast more moderate growth of 3.2%. However, it is worthwhile to note the high degree of uncertainty in formulating forecasts at this time, or as the BoI put it in its financial stability report that was released on August 11, 2020: *"The level of uncertainty regarding the macro-economic environment is very high, and this is primarily due to the rate of spread of the virus in the second wave, the depth of restrictions imposed on the economy, and the*

pace of return to 'normalcy'. The unemployment and growth forecasts are revised at a high frequency, as a function of decisions made with respect to exiting lockdowns, both in Israel and around the world".

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