Leumi Economic Weekly

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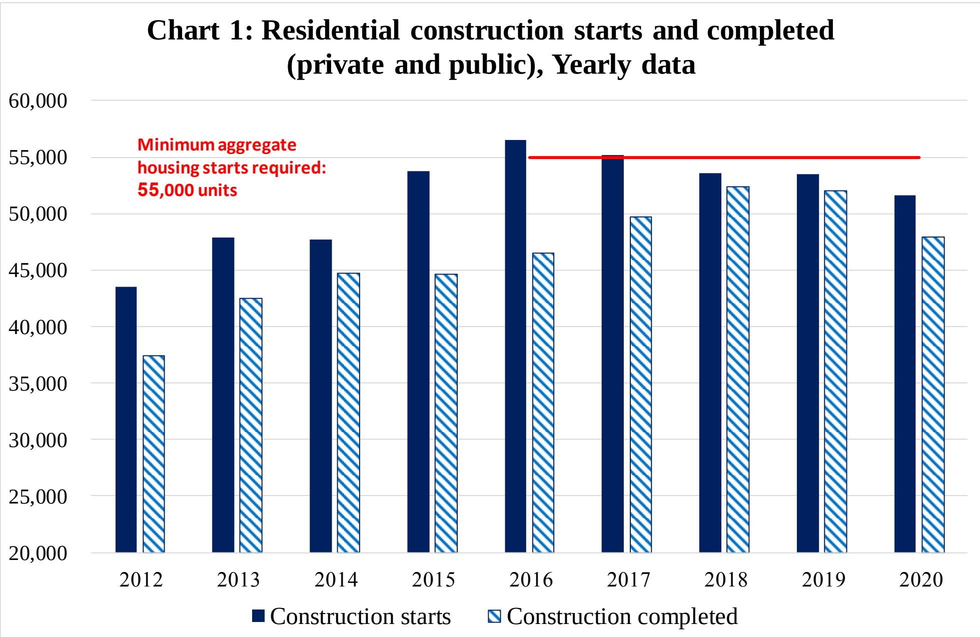
The pace of active construction and construction completions declined substantially in 2020 due to the coronavirus crisis

Data from the Central Bureau of Statistics (CBS) show that the number of construction starts in 2020 amounted to 51,600 units. This figure indeed represents a 3.5% decline compared to the number of construction starts in 2019; however, as the number of construction starts is likely to turn out later to be higher, in light of the tendency for these data to be revised upwards, it appears that in total, the coronavirus crisis did not substantially hamper activity with respect to residential construction starts. This is because the activity involving construction approvals continued more or less unobstructed throughout the year, a development that allowed developers to initiate the construction of new projects.



In contrast, the number of construction completions was negatively affected by the coronavirus crisis. In 2020, construction completions registered a sharp 8% decline to a level of only 47,900 units – the lowest figure since 2016 (see Chart 1). This is the result of, among other things, the difficulties encountered in construction sector activity during the coronavirus crisis, even though this sector was designated by the government as essential to the economy. These difficulties included: the need for the physical presence of workers on construction sites; a shortage of professional workers due to entrance restrictions on foreign workers into the country; movement restrictions; quarantine requirements; and more. This situation led to a slowdown in the pace of construction, as

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expressed as well in the data on investment in residential construction, which reflect a low level compared to the pre-crisis period. The delay in the construction processes is reflected as well in the number of units currently under construction, which reached a peak of 126,800 units.

In summary, the data show that the coronavirus crisis primarily hurt the pace of construction and construction completions, while construction starts and the issuance of construction approvals were not so much affected. From an analysis of the impact on prices, we note that recently there has been a renewed acceleration in the rate of price increases on housing. This comes against the backdrop of the release of substantial pent-up demand in the economy, particularly in the new housing segment, and also against the backdrop of the return of investors to the housing market. In the coming months the rise in housing prices is expected to continue, supported by, among other things, demographic increases, the economy's gradual exit from the coronavirus crisis, and the low interest rate environment (which is supported also by an easing in the restrictions by the Bank of Israel on the granting of mortgages linked to the prime rate).

The slowdown in the pace of residential construction, to a level below that deemed as necessary for the economy, also supports a continued increase in housing prices. The number of construction starts is indeed expected to recover in the short-term, yet in another 2-3 years a renewed decline is expected, in light of the slowdown in the "planning pipeline" in the recent period. This will be in such a manner that is likely to increase the shortage in new housing units in the economy in the medium-term, which is expected to create upward pricing pressures.

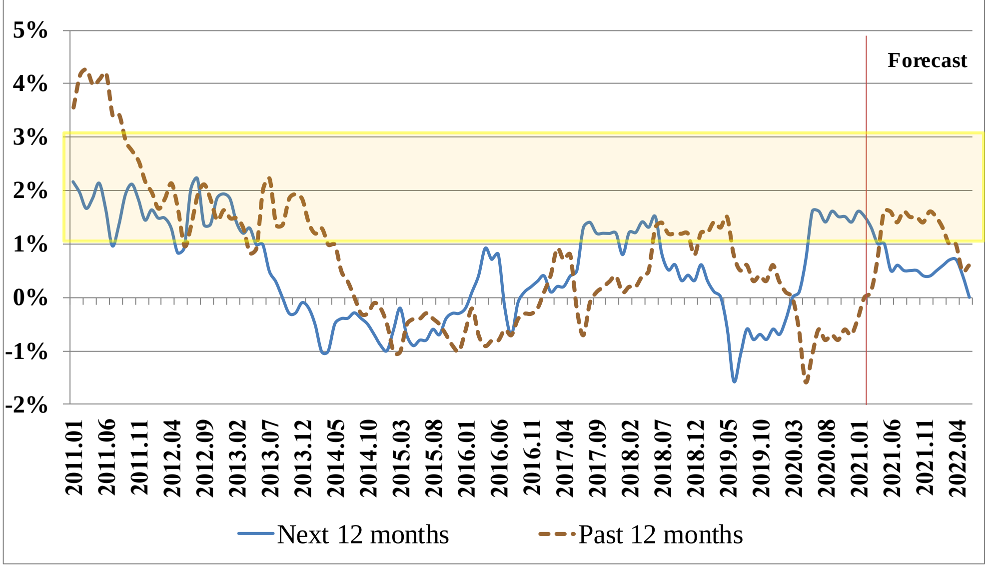
The consumer price index (CPI) surprised on the upside also in February; inflation is expected to rise throughout 2021

The CPI surprised on the upside, as it increased 0.3% in February compared to the consensus forecast that called for only a 0.1% increase. This is the second consecutive month in which the change in the CPI was greater that the initial estimates. Notable price increases were registered in the fresh fruits, clothing, and transportation components. We note that the clothing and shoes component, which has been characterized over the years by declines each February, registered an extraordinary increase this year, which likely comes as a correction to the sharp drop in this component in January.

The housing component increased by a rate of 0.2%, resulting from an increase by a similar rate in the owned dwellings services sub-component (which reflects housing rental prices in new and renewed contracts), as the annual rate of increase of this sub-component rose to 1.5%. At the same time, housing prices (according to the monthly housing survey of the CBS, which is not included in the CPI calculation) registered for the second month in a row a relatively sharp increase of 0.9%. Consequently, the annual rate of increase of housing prices rose to 4.3% – the highest rate since August 2017. As we noted in the preceding section, the annual rate of increase of housing prices is expected to continue to climb also in the coming months, against the backdrop of the trends in the residential real estate market, coupled with the expected recovery in demand later in the year, as long as the process of exiting from the crisis progresses as planned.

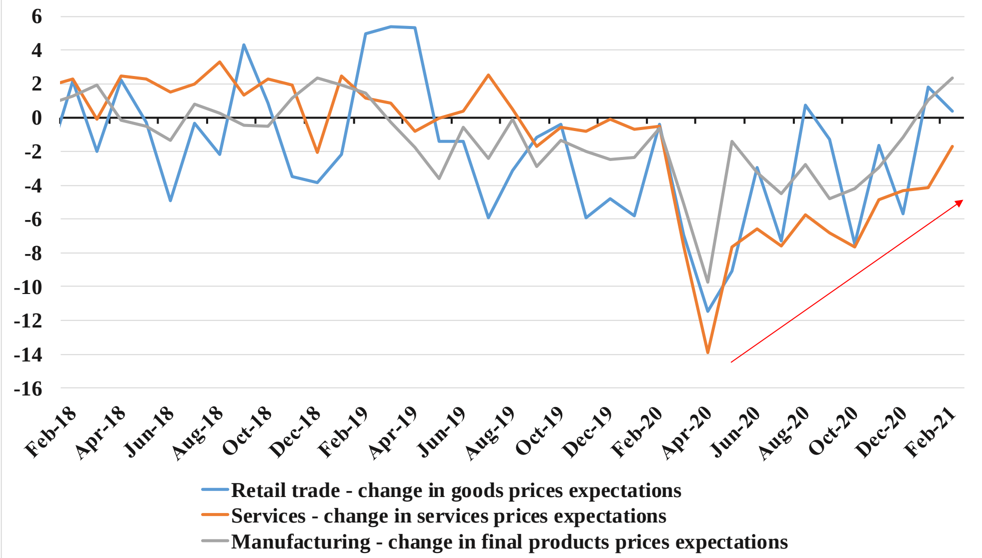
In summary, over the last 12 months (February 2021 compared to February 2020) the general CPI remained unchanged (see Chart 2), the CPI excluding fruits and vegetable increased 0.1%, and the CPI excluding energy increased 0.3%. In contrast, the CPI excluding housing <u>declined</u> 0.2%.

Chart 2: The year-on-year rate of inflation of the CPI



As expected, the rise in inflation accelerated recently, and within a relatively short period of time the annual rate of change in the CPI went from minus 0.7% to no change at all (0.0%). The uptrend in the CPI is expected to continue in the coming months, as it reaches an annual rate of increase of 1.5% - 1.7% already in the coming months, due to, among other things, the exit of especially low CPI figures from the window of calculation (April-May 2020), which were affected by the decline in energy prices. Inflation in all of 2021 is expected to amount to 1.4% - 1.9%.

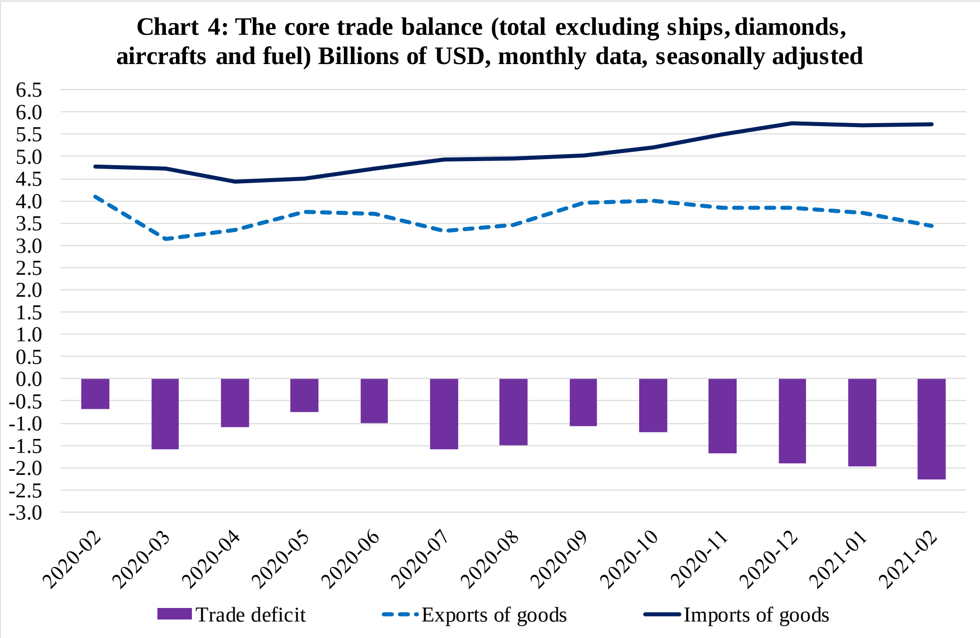
Chart 3: The change in goods and services prices expectations, business tendency survey index, total balance, in percentages



Continued progress in the process of opening up the economy is expected to support an increase in local demand for the consumption of goods and services, with an emphasis on sectors that were subject to substantial restrictions over the past year. It is important to note that there are certain sectors in which the supply side suffered sustained damage in light of the difficulties over the past year. Heightened demand on one side, coupled with limited supply, may lead to a continuing increase in prices. Also the rise in global commodities prices and the increase in international cargo shipping prices are expected to support an increase in local prices. As can be seen in Chart 3, over recent months there has been a relatively substantial rise in expectations within the business sector for price increases in various areas of activity, a development that reflects the current trends.

The core trade account deficit continued to expand also in February 2021

In February, the export of goods from Israel (excluding ships, aircraft, and diamonds) amounted to US$3.44bn (seasonally adjusted data). This represents a 7.5% decline (in nominal US dollar terms) compared to exports in the preceding month, and a 15.9% decline compared to February 2020, just prior to the outbreak of the coronavirus crisis.



Industrial exports declined mainly due to an especially sharp drop in chemicals exports, in light of their high weighting in the basket of goods exports. Excluding this sector, exports amounted to a moderate increase. Notable declines, yet more moderate than those of chemical exports, were registered in the following export sectors: pharmaceuticals; metal, rubber, and plastic goods; and others. On the other hand, an increase was registered in the export of transportation vehicles.

Goods imports (excluding ships, aircraft, diamonds, and energy materials) amounted to US$5.7bn in February. This figure is similar to the level of imports in January, and reflects a sharp 19.8% increase compared to February 2020. Each of the categories of goods (consumption, investment, and raw materials) increased compared to February 2020, while the most notable increase occurred in the import of investment goods. The increase in imports, parallel to the decline in exports, led to an expansion in Israel's core trade account deficit (excluding ships, aircraft, diamonds, and energy materials) in

February to a level of US$2.3bn, this in continuation of the trend from recent months (see Chart 4). Looking ahead, the trend is expected to continue also in the coming months, against the backdrop of progress in the economy's process of exiting from the crisis.

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