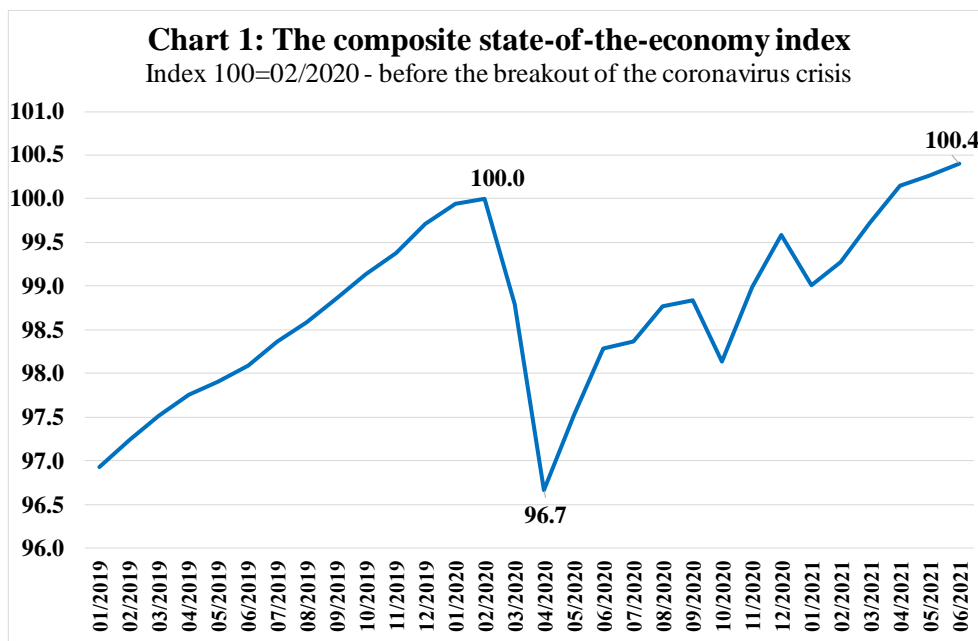


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The composite state-of-the-economy index for June: the recovery in economic activity is continuing, with a slowdown in the pace

According to Bank of Israel (BoI) data, the composite state-of-the-economy index increased 0.14% in June (compared to the preceding month). This follows an increase by a similar rate in May, and sharper increases in February-April. That is to say, from the composite index data it can be seen that local economic activity continues to expand, albeit with a slight slowdown in the pace, following the accelerated growth that occurred with the opening of the economy.



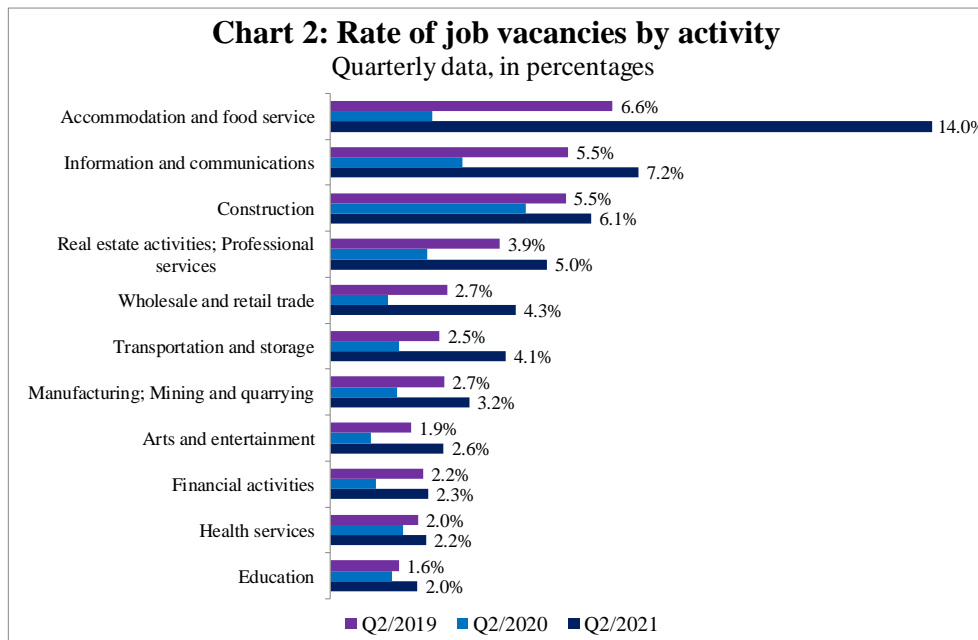
The index components that stand out positively include: imports of consumption goods, imports of manufacturing inputs, and salaried employment positions (April). On the other hand, goods exports, revenues in the trade and services sectors (May), services exports (April), and construction starts (March), all contributed to offset the rate of increase in the composite index.

As can be seen in accompanying Chart 1, June's composite index indicates a level of activity that is 0.4% greater than that before the crisis (February 2020). However, analysis of the actual current level of activity compared to the level that would have been expected in the absence of the crisis shows that the damage inflicted upon the economy until now resulting from the coronavirus crisis is substantial, with an estimated loss to GDP of 3.5%-4.0%.

Furthermore, we note there are variances among the components of the composite index. Whereas there are components that experienced relatively weak performance (construction starts, salaried employment positions, and more), there are components that increased substantially compared to their pre-crisis levels (the latest figure compared to February 2020). These components are headed by imports of consumption goods, resulting from the release of "pent-up" demand against the backdrop of the continuing improvement in consumer sentiment and in the employment data. Another component with positive developments includes the rate of available jobs in the economy.

The rise in the number of available jobs is not sufficient enough to absorb all the surplus unemployment created by the crisis

In its statement on the composite index, the BoI makes reference to the continuing rise in the demand for workers against the backdrop of the expansion in activity following the opening of the economy. Data from the Central Bureau of Statistics (CBS) show that the rate of available jobs stood at 3.4% (which is equivalent to 100,000 positions) prior to the breakout of the crisis, then fell to a low of 1.7% (or 40,000 positions) immediately with the outbreak of the crisis (March-April 2020), and then afterwards started to climb gradually, until just recently, following the re-opening of the economy, reaching a peak of 4.8% (equivalent to 130,000 positions).



The process of expanding economic activity over recent months led to an increase in the demand for workers; however, in some sectors employers encountered a severe shortage of workers. This comes against the backdrop of, among other things, the payment of unemployment benefits for an extended period of time (until recently) to furloughed workers. These benefits lowered the incentive for unemployed persons (with an emphasis on those with relatively low wages) to return to the workforce. As can be seen in accompanying Chart 2, this development is most notable in the accommodation and food services sector, in which the rate of available jobs increased in the second quarter of this year to an extraordinary rate of 14%. We also note that the most substantial increase in the number of available jobs occurred in the Tel Aviv and central districts, in which there

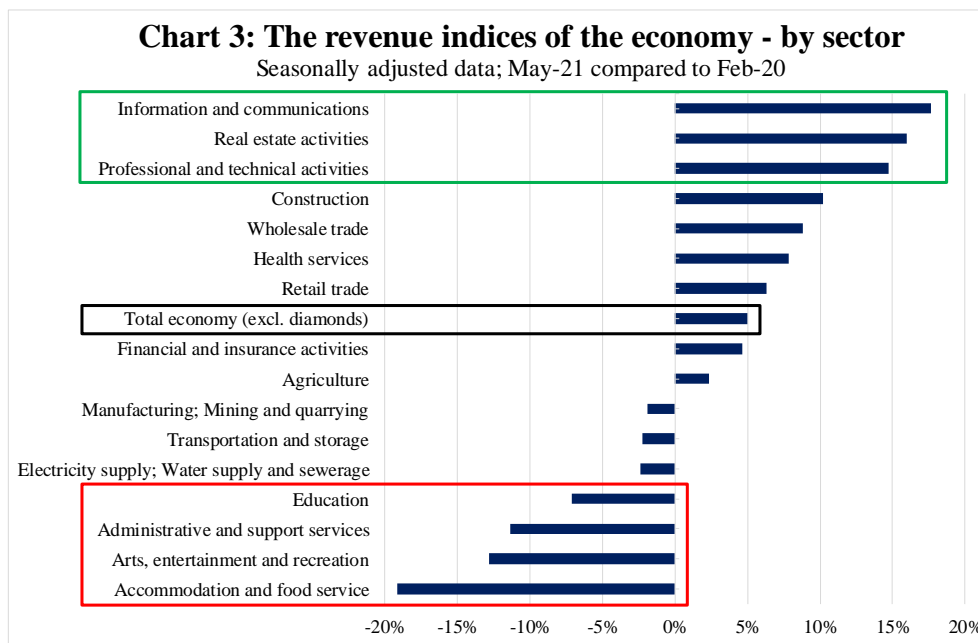
is a high concentration of jobs in the sectors in which there are shortages of workers, also including in information and communication (high-tech).

In summary, there are currently approximately 30,000 more available jobs in the economy compared to the situation before the crisis, at a time when the number of unemployed persons has increased much more substantially, with 388,000 unemployed persons (according to the broad definition) in June 2021 compared to 150,000 unemployed persons prior to the crisis. On this regard, we emphasize that the ratio involving the number of unemployed persons and the number of available jobs in the economy currently stands at 3, which is double the ratio from before the outbreak of the crisis (1.5). In other words, the economy is recovering from the coronavirus crisis, yet the current rate of job creation is not sufficient enough in order to absorb the entire increase in surplus unemployment, which was caused as a result of the crisis (more than 200,000 new unemployed persons).

This has resulted in an "underemployment" recovery, which represents a challenge to economic policymakers who are being asked to provide a solution for this problem, through massive, efficient government assistance in re-training unemployed persons and matching their skills to those demanded by the market, and also through encouraging local economic activity, in order to bring about a recovery in the labor market as early as possible.

The level of activity in the sectors of the economy: accommodation and food services; as well as art, entertainment, and leisure remain substantially below their pre-crisis levels

The slight slowdown in the rate of recovery in economic activity is evident also in the revenues data of the sectors of the economy.



Thus, following three consecutive months of improvement in activity, in February-April, during which time a cumulative 7.5% increase was registered, in May revenues declined 3.3% in all the sectors of the economy, excluding diamonds (monthly data, adjusted for

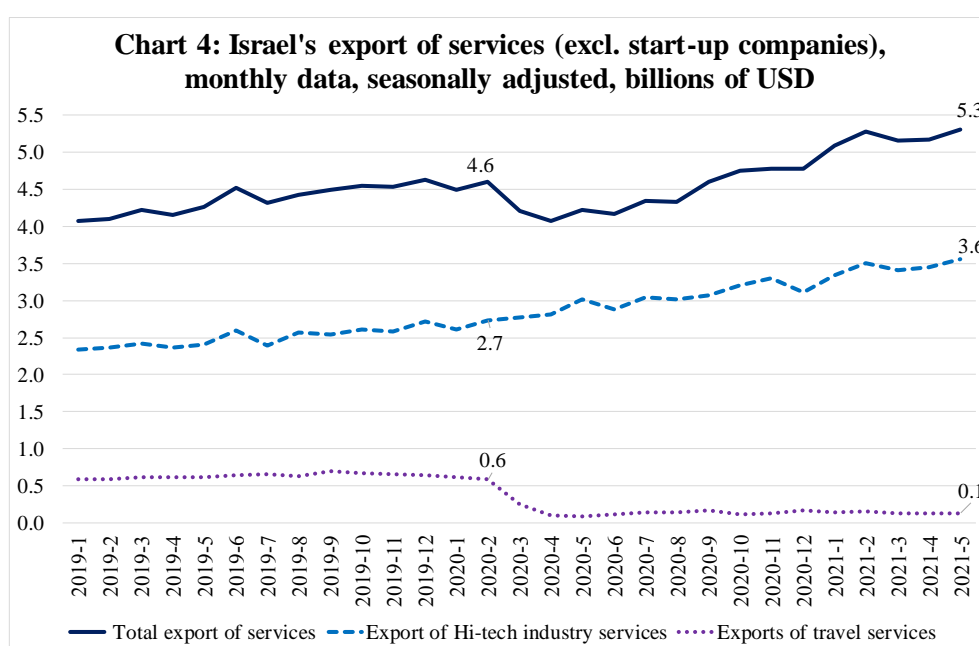
seasonality). However, the level of activity (revenues in all the sectors of the economy excluding diamonds) in May remained approximately 5% greater than the pre-crisis level (February 2020).

Accompanying Chart 3 presents an analysis of the revenue data for May 2021 compared to February 2020, broken down according to the various sectors of activity. The data indicate substantial differences among the sectors with respect to the development of activity. The sectors in which activity remains substantially below the pre-crisis level include: accommodation and food services; art, entertainment, and leisure; education; and administration and support services. On the other hand, activity in the following sectors stood out positively: information and communication (high-tech), real estate activity (agency services, building rentals, and more); as well as scientific and technical services. These sectors have been less exposed to adverse effects throughout the coronavirus crisis, and thus are now benefitting from a recovery in activity following the opening of the economy.

Looking ahead, in our view, in the baseline scenario, the current rate of increase in economic activity is likely to continue also in the coming months, this on the assumption that the current scope of morbidity will not spread broadly throughout the country in such a manner that will lead to an additional intensification of COVID restrictions, which would likely delay the economy's exit from the crisis. We forecast 5% average annual GDP growth in 2021-2022. This forecast matches the current estimates of the Israel Ministry of Finance (MoF) that were released over recent days.

The services exports of the high-tech sectors continue to grow, representing an important growth engine for the Israeli economy

Israel's services exports continue to show positive performance, yet with substantial differences among the various components. Total services exports (excluding start-up companies) equaled US\$5.3bn in May 2021, reflecting a 2.6% increase compared to the preceding month, this in continuation of a long-term trend.



A component that has supported the growth in services exports over time is that of high-tech services (communication services, software and computer consulting, information and storage services, research and development, and more). This component represents a substantial and important source of growth for the Israeli economy over recent years, and is supported by the relative advantage enjoyed by the Israeli economy in this space. This component has not been substantially impacted by the COVID restrictions, and thus continued to grow also throughout the entire crisis.

High-tech services export equaled US\$3.6bn in May this year (equivalent to 67% of total services exports), with an increase of 3.3% compared to the preceding month. In contrast, exports of tourism services, which were almost completely halted since the outbreak of the crisis due to the closure of the skies and the severe restrictions on flights and accommodation services in Israel and around the world, increased 1.1% in May. However, current tourism services exports remain 77.4% below the pre-crisis level (February 2020). On the other hand, as can be seen in accompanying Chart 4, the current level of high-tech services exports is 30.2% greater than the pre-crisis level, such that overall the total of services exports is 15.4% greater compared to the pre-crisis level.

In summary, in January-May 2021, services exports (excluding start-up companies) amounted to US\$26bn, reflecting an increase of US\$4.4bn compared to the parallel period in 2020. This development has acted to offset the trade deficit in the current account of Israel's balance of payments, which has increased substantially since the beginning of the year and stands at US\$7bn (including June). Looking ahead, within the baseline scenario, we estimate Israel's services exports are likely to grow 6% in real terms during 2021, and by a quicker pace in subsequent years.

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