Leumi Economic Weekly

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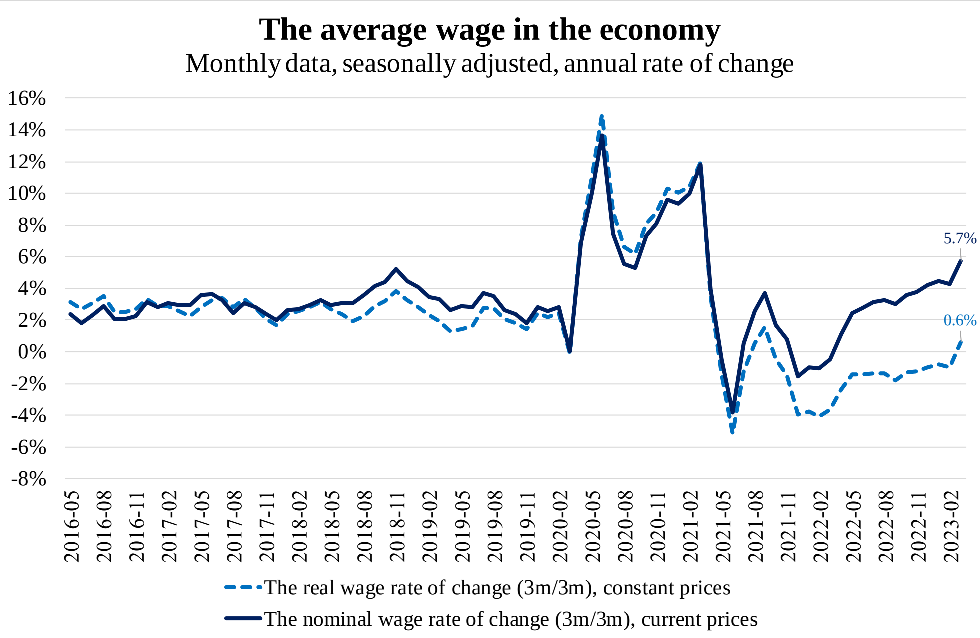
The rate of increase in the average salary in the economy made a one-time jump in March, against the backdrop of a public sector wage agreement coming into effect

In March 2023 the nominal average wage in the overall economy stood at NIS 12,384 (seasonally adjusted data; in current prices), this according to the Central Bureau of Statistics (CBS). This figure reflects a 2.8% increase compared to the preceding month, and a 7.1% jump compared to March 2022.



The real wage in the economy (in constant prices), which takes into consideration the rate of increase in the consumer price index (CPI), increased as well by a rate of 2.8% compared to the preceding month, and by a rate of 2.1% compared to the parallel month in 2022.

It should be emphasized that in March 2023 a one-time grant equaling NIS 6,000 was distributed to public sector employees, which temporarily "boosted" the growth rates of the salary data in this month. And according to flash estimates by the CBS, which are based on partial data for the month of April 2023, between March and April the annual rate of increase in the average nominal wage in the economy declined by three percentage points.

As can be seen in the accompanying chart, the annual rate of increase in nominal wages (measured in three-month increments vis-à-vis the parallel period in the preceding year)

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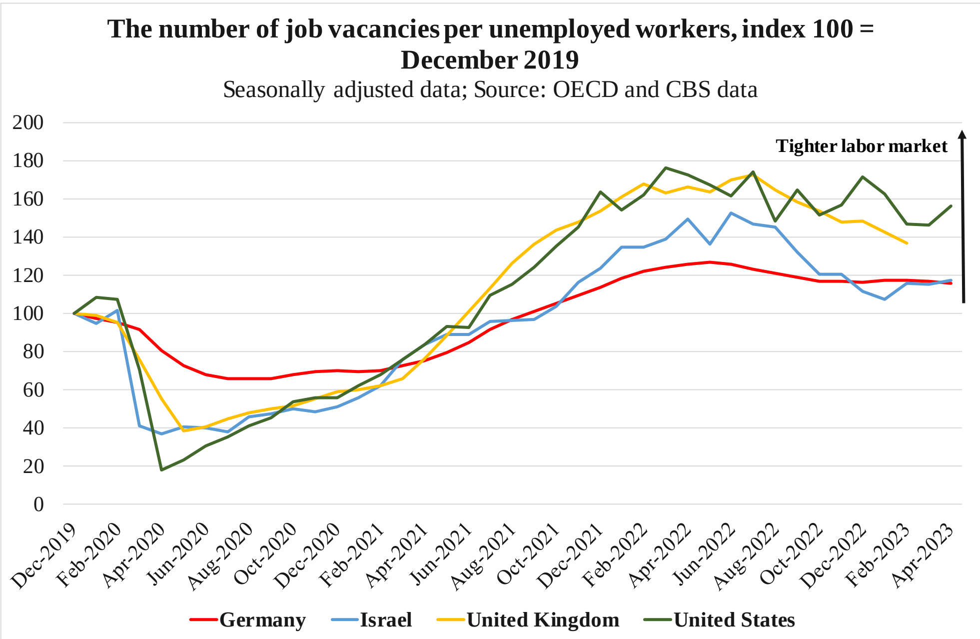
has been trending upward since the beginning of 2022, reaching 5.7% in March 2023. If we exclude the data from March this year, which as mentioned above was strongly affected by grants provided to public sector employees, from the end of 2022 the average nominal salary in the economy increased by a rate of more than 4%, this compared to a 3% average rate of increase in the years 2017-2019. The acceleration in the rate of increase stems from, among other things, the current characteristics of the labor market (see details in the next section), and from the current level of actual annual inflation (5% and above since the beginning of the year), and from the relatively high inflation expectations, which influence the demands of workers in salary negotiations.

Looking ahead, we expect that toward the end of 2023 the rate of increase in the average nominal wage in the economy will start to slow. This comes against the backdrop of moderation in demand pressures in the labor market, as can be learned from the weakness experienced over recent months in the number of job openings, and from the decline in expectations regarding the level of employment in the business sector (according to the April Business Tendency Survey of the CBS). In addition, also the expected decline in inflation through the end of this year, which will lead to a drop in inflation expectations, is expected to support a more moderate rate of increase in the average annual salary in the economy.

The upward pressures on salaries stemming from the Israeli labor market are not high compared to Israel's main trade partners

The current data from the Israeli labor market show the labor market has remained tight over recent months from an historical perspective. One of the accepted measures for analyzing the dynamics between demand and supply in the labor market is the ratio between the number of job openings and the number of unemployed persons. As this ratio increases, the labor market is considered to be tighter, since more employers compete for fewer potential employees. Of course, an increase in this ratio may also indicate, at least to some degree, that jobseekers may not be suitable with respect to the skills demanded by employers in the jobs waiting to be filled.



In Israel, at the end of 2019, prior to the outbreak of the coronavirus pandemic, the ratio between job openings and the number of unemployed stood at 0.67, that is to say, there were more job seekers than available jobs. As the pandemic started to spread, the ratio fell sharply (by 60%) – the number of unemployed spiked, whereas the number of job openings fell, against the backdrop of a substantial increase in the degree of uncertainty in the economy, and the COVID restrictions imposed on economic activity. Later on, with the removal of the restrictions during 2022, the aforementioned ratio started to climb (up to 50% above its level at the end of 2019), reaching a level of 1 at its peak, that is to say, there was a job opening for each job seeker. However, from that time the ratio has declined, and since the beginning of 2023 it has equaled 0.79, or 17% above its level at the end of 2019.

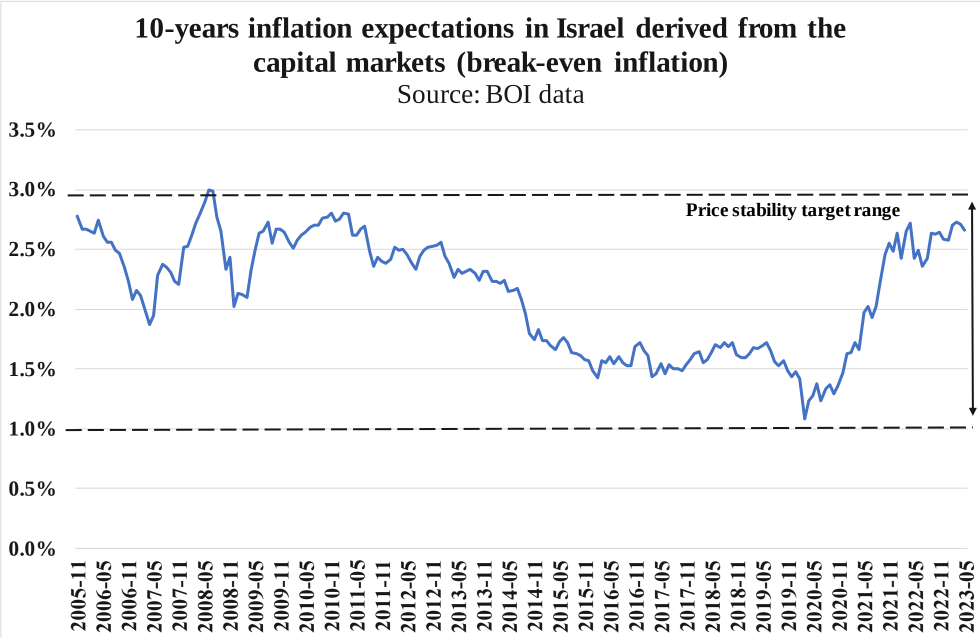
As can be seen in the accompanying chart, which presents the development of the aforementioned ratio since December 2019, in Israel and in other major countries (which were chosen from considerations of available data), the trend of the ratio over time has been similar among the countries that appear in the chart – peaking during 2022, and since then starting to moderate. However, there are differences in the intensity of the volatility of this ratio among the countries. To illustrate this point, in Britain and the US the ratio climbed substantially relative to the pre-coronavirus period, compared to the more moderate increases registered in Israel and Germany. These differences were maintained through the end of the first quarter of this year. That is to say, according to this measure, since 2022 the labor markets in Britain and the US were and have remained tighter compared to the Israeli labor market.

One possible explanation for the high increase of this index in the US and in Britain is the departure of workers in the older age groups from the labor market in these countries, attributed to health reasons (concerns regarding coronavirus infections) or against the backdrop of the advancement of early retirement. An additional explanation, affecting the US, involves the high amount of grants that were distributed by the government to individuals during the coronavirus period, which allowed some people to remain outside the labor force for a more sustained period. It is important to note that in contrast, there are countries, mainly in Eastern Europe, such as the Czech Republic, Poland, and Hungary (which are not presented in the accompanying chart), in which the aforementioned index is lower today compared to the pre-coronavirus period.

In summary, a tight labor market, that is to say, a labor market that is experiencing demand pressures, is generally characterized by salaries that are growing by a relatively high rate. Consequently, in Israel, and in the other countries presented in the accompanying chart, the current labor market supports an accelerated rate of increase in the average salary compared to the past (as presented in the preceding section). This situation is expected to affect the rate of increase in the costs of manufacturing in these countries, and consequently to support an increase in inflation, with an emphasis on services prices. However, it appears that in Israel the labor market's contribution to the rise in prices is low compared to the situation in Britain and in the US, such that according to this index (assuming all other variables remain the same) it is likely that in Israel a relatively lesser intensity of contractionary monetary policy will be required, and for a shorter period of time.

The placement of 10-year inflation expectations within the price stability target range indicates the credibility of the Bank of Israel in the eyes of the market

Analysis of 10-year inflation expectations in Israel from the capital markets (break-even inflation) from an historical perspective raises two interesting points. First, over the years the 10-year inflation expectations derived from the markets (yield differentials between non-linked shekel bonds and CPI-linked bonds) tended to be higher in retrospect than the inflation that actually materialized in this period, almost always. And second, the 10-year inflation expectations have been, starting since 2005 (see accompanying chart), after concerns in the economy regarding the security situation due to the second Intifada had faded, within the "price stability" target range established by the government (1%-3%).



It appears the main explanation for the two points noted above is rooted in the difficulty in issuing forecasts over the relatively long-term, and especially to be precise in these forecasts. Against the backdrop of this difficulty, the changes in the 10-year market derived inflation expectations have been regularly adapted, being derived to a large degree from changes in the short-term expectations, which are affected mainly by developments in the present, as expressed in the relatively high positive correlation between them. The placement of the 10-year inflation expectations within the price stability target range indicates the high degree of credibility of the Bank of Israel (BoI) in the eyes of the market, and this is despite the fact that during the 20 years that have passed since the price stability target range was introduced in Israel, inflation has landed within this target range only 30% of the time.

In summary, the high degree of credibility of the BoI in the eyes of the markets represents a factor of utmost importance in the effectiveness of monetary policy, and therefore it is very important to recognize this and to maintain this situation. The fact that the BoI holds a high degree of credibility in the eyes of the markets is important even more so at the current time, as the central bank is implementing measures (interest rate hikes), similar to many central banks around the world, in an effort to overcome inflation that is currently above the upper border of the target range. And it is important to emphasize that the BoI is dealing with a relatively high inflation environment, in a period overwhelmed by uncertainty (domestic and global) that is expressed in, among other ways, shekel weakness, coupled with high volatility, and without any substantial measures to lower the cost of living in the country by the current government.

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