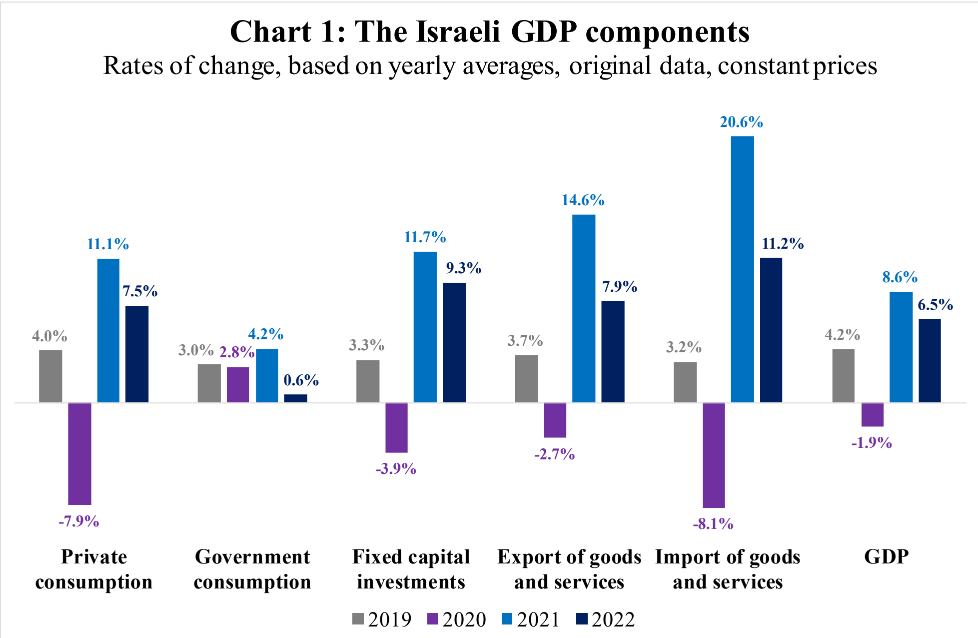
Leumi Economic Weekly

February 21, 2023

GDP increased in 2022 by a rate of 6.5% (on average); however, the growth rate during the year (Q4/Q4) was lower

According to the Central Bureau of Statistics (CBS), Israeli GDP increased 6.5% in 2022 (annual average, in real terms, original data in constant prices), following 8.6% growth in 2021. The latest figure is slightly above the preliminary estimates in the market, including those of the research department of the Bank of Israel (BoI), which estimated 6.3% growth in its revision from the beginning of January, an estimate that contributed to the decision by the Monetary Committee of the BoI to hike the interest rate 50bps (see details later in this survey).



Analysis of the growth rates according to the components of GDP shows that growth was broad across all components (see Chart 1). However, it is important to emphasize that growth was supported by a peak number of automobile purchases (for consumption, as well as for investment) in the fourth quarter of last year. This was due to advanced purchases prior to the revision to the government's green tax on certain automobiles, which came into effect in the beginning of 2023 and led to an increase in prices of many car models. Excluding this component, the growth in private consumption and investment in capital assets was more moderate.

Furthermore, it is important to note that these growth rates are based on the average annual level in 2022 compared to the average annual level in 2021. However, the first part of

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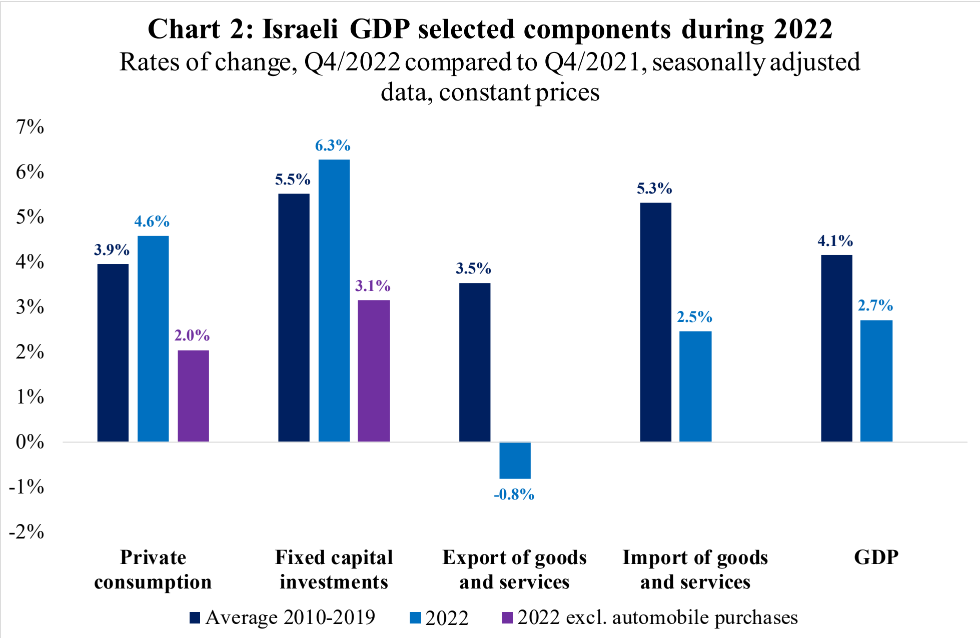
2021 was characterized by a relatively low level of activity due to the coronavirus crisis, while by the end of 2021 activity started to accelerate. In light of this, the average level in 2021 is substantially below that from the end of 2021, and throughout the whole period of 2022.



In light of the above, Chart 2 presents the rates of change of chosen components of growth <u>during</u> 2022, that is to say, a comparison of the final quarter of last year to the final quarter of 2021, and also the average annual rate in the years 2010-2019. <u>This comparison is likely to better reflect the pace of expansion in activity throughout 2022</u>. The chart shows that GDP increased 2.7% last year compared to the multi-year average rate of 4.1%. In addition, the export of goods and services according to this calculation contracted 0.8% compared to the average growth rate of 3.5%. It can also be seen in the chart that the growth rates of private consumption and investment in capital goods during 2022 indeed were higher compared to the long-term average, although when excluding the component involving automobile purchases, also these components increased by a slower rate than the average last year.

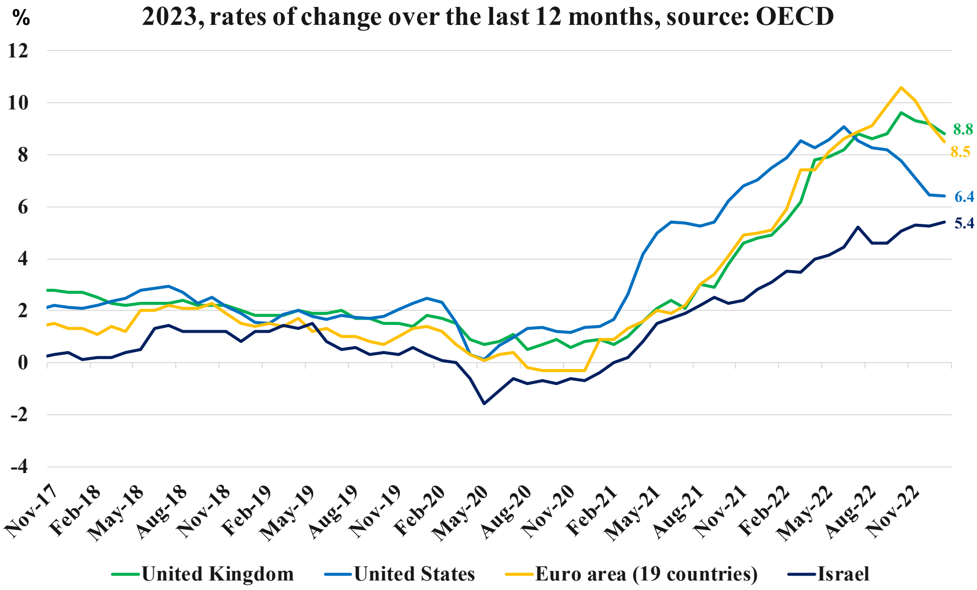
In summary, at first look, the national accounts data that were released look impressive; however, when excluding the effect of the advanced purchases of automobiles due to the changes in tax policy, and when taking into consideration the substantial differences among the quarters in 2021, the picture that arises from the GDP data of the fourth quarter is less positive, and is even weak relative to past years.

Looking ahead, according to our *<u>Bank Leumi</u>* forecasts, in our baseline scenario Israeli GDP is expected to grow 2.7% in 2023 (annual average), which is substantially below that registered in the two preceding years, and also low compared to the years preceding the COVID pandemic. The slowdown in the growth rate (according to the forecast) is the result of, among other things, contractionary monetary policy, the high inflation in the economy, and the expected slowdown in Israel's main trading partners.

The rise in inflation in Israel has not yet stopped; however, in our estimation, inflation reached its peak in January 2023

According to CBS data, in January 2023 the consumer price index (CPI) increased 0.3%. This increase was above the preliminary expectations of most forecasters, and led to an increase in the rate of inflation over the trailing 12-month period to 5.4%, the highest rate registered since 2008, this compared to 5.3% in the preceding month.

Chart 3: Consumer prices, Annual inflation, October 2017- January 2023, rates of change over the last 12 months, source: OECD



Notable price increases were registered in the following components: housing, food, health and other items, as well as in the private car and maintenance sub-component. Furthermore, a revision to electricity tariffs in Israel contributed to a rise in the electricity, gas, and water sub-component, part of which will be offset in the February CPI due to a planned moderate reduction in prices this month. On the other hand, notable price declines were registered in the clothing and footwear component, against the backdrop of end-of-winter season sales, and in the accommodation, leisure, and domestic trips sub-component.

Currently there are a number of factors supporting a moderation in inflation around the world, among them can be noted the monetary policy tightening by many central banks; the moderation in global supply chain pressures, which supports a drop in goods prices; the dissipation in the surplus demand for goods; and more. Consequently, within a large selection of countries we can already begin to identify a downward trend in the rate of inflation from the peaks registered during 2022.

As can be seen in Chart 3, which presents the development of inflation in Israel as well as in Israel's main trading partners, the inflation rate in the US reached its peak in June 2022, and since then fell by 2.7 percentage points. In the same manner, in the euro bloc and Britain the inflation rates peaked in October 2022, and since then fell by 2.1 percentage points (according to the initial figure for January 2023), and 0.8 percentage points, respectively. On the other hand, in Israel the inflation rate indeed fell temporarily after July 2022, yet as mentioned above, in January 2023 a new domestic peak was registered. Thus, among the countries that have been presented, Israel is the only one in which until now the inflation rate has not retreated from its peak.

However, it is important to note that in our estimation, already in the upcoming CPI it is expected that the inflation rate in Israel will decline by a relatively large degree. This is because the February 2023 CPI is expected to be substantially below the CPI from February 2022, which was extraordinarily high due to, among other reasons, a sharp upward spike in energy prices.

Looking ahead, for the moment, the rate of increase in prices in 2023 is expected to be greater than 3%, that is to say, at the upper border of the price stability target range or slightly higher. In the event the weakening of the shekel will continue, this will contribute to an upward revision in the inflation forecast. Also, the longer-term forecasts expect inflation to remain around the upper border of the target range. It appears that inflation in Israel is "sticky" and is still not declining, a matter that was taken into consideration by the members of the Monetary Committee during the decision to change the BoI interest rate (see details in the next section).

The BoI hiked the central bank interest rate above the consensus forecast to a level of 4.25%

The central bank interest rate was hiked 50bps, from 3.75% to 4.25%, in accordance with our forecast at *Bank Leumi*, this while the consensus forecast in the economy (the median forecast) indicated a hike of only 25bps.

According to the Monetary Committee, the main explanations for the interest rate hike of this magnitude include: the rise in the inflation environment and the fact that the inflation rate over the trailing 12-month period is above the upper border of the price stability target range, as well as in a wide range of components; Israel's robust economic activity; and the tight labor market. Indeed, the inflation expectations across all durations are located within the target range; however, as can be learned from the BoI decision, actual inflation has a very large weighting in the decision at this time compared to that of expected inflation and the inflation forecasts.

It was also noted in the Monetary Committee announcement that for five consecutive quarters the GDP level has been above the trendline that characterized the pre-coronavirus period. However, at the same time, it was emphasized that the end data indicate a slight moderation in the labor market and in Israeli economic activity. Apart from these developments, the committee referred also to the moderation in activity within the housing market, and to the volatility that has characterized the exchange rate of the shekel over the recent period.

Looking ahead, the BoI is expected to hike the central bank interest rate also in the upcoming decision, scheduled for the beginning of April. In our estimation, the Monetary Committee will hike the central bank rate by 25bps; however, in the event inflation will remain at its current level, or if it will continue to climb, resulting from a possible additional weakening of the shekel, then the next interest rate hike will likely be of a higher increment.

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