Leumi Economic Weekly

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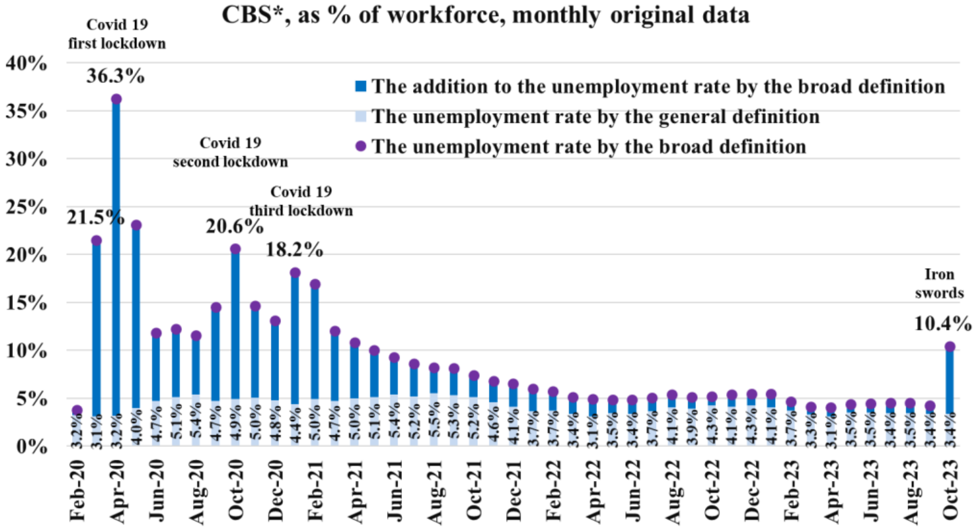
The "broad" unemployment rate spiked sharply upward in October against the backdrop of the development of the "Swords of Iron" War

The unemployment rate (for persons aged 15 and above, unadjusted data) according to its standard definition, which includes the number of <u>unemployed persons only</u>, equaled 3.4% in October this year, compared to 4.3% in October 2022, and unchanged compared to the preceding month (see accompanying chart), all this according to key data published by the Central Bureau of Statistics (CBS) from the workforce survey. This unemployment rate has remained stable over recent months, and is relatively low from an historical perspective. However, we emphasize that the "standard" unemployment rate does not reflect the impact that the war is having on the labor market.

The unemployment rate by the broad definition, as of the Israeli CBS*, as % of workforce, monthly original data



* Unemployed Persons, temporarily absent from work for economic reasons ,not participating in the labor force who stopped working due to dismissal during the last two years and discouraged workers

<u>The "broad" unemployment rate spiked upward in October 2023 to 10.4%, this compared to 4.2% in the preceding month and 5.2% in October 2022</u>. This broader rate includes in addition to the unemployed, also those who have been temporarily absent from their place of work due to economic reasons (including employees who have been furloughed or absent due to reduced activity at their place of work in view of the war), as well as those who have been released from their jobs over the past two years and who do not participate in the workforce, and also those who have given up looking for work. October's level is the highest broad unemployment rate registered since April 2021, immediately following

the lifting of restrictions on the economy within the framework of the "third lockdown" during the coronavirus pandemic, and reflects mainly an increase in the number of those temporarily absent from their place of work due to economic reasons (as previously mentioned, mainly against the backdrop of the development of the war). Yet, the latest figure is below the levels registered during the other COVID lockdowns.

According to CBS estimates, the number of employed persons who were temporarily absent from their jobs due to economic reasons increased from 12,000 in September to 279,000 in October. In addition, we note that the "broad" unemployment rate excluding those who have given up looking for work and those who were released from their jobs in the last two years, which apparently much better represents the impact of the "Swords of Iron" War on the labor market, stood at 9.6% in October, this compared to 3.6% in the preceding month and 4.5% in the parallel month last year.

In summary, the substantial increase in the "broad" unemployment rate, coupled with the decline in the demand for workers in most of the sectors of the economy (except for the construction sector, due to shortages in foreign workers), as reflected in the data on job openings in October, this in parallel to the decline registered in consumer confidence in October, is expected to weigh on demand for consumption by households. This comes in view of the drop in household income levels (the compensation for furloughed workers does not match the full salary levels) and the rise in the degree of uncertainty.

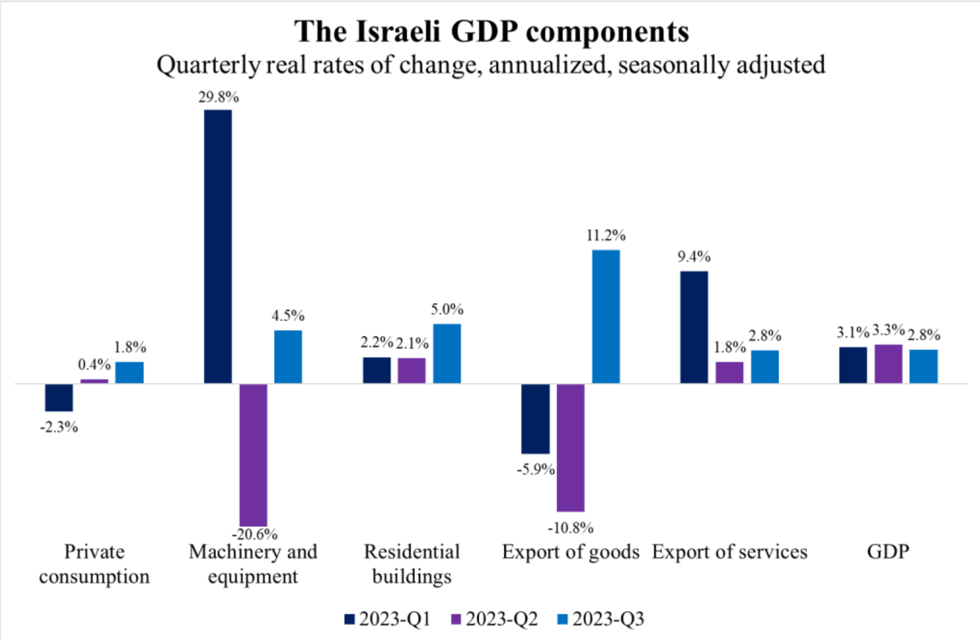
Looking ahead, in view of the expected downturn in regular activity in many segments of the business sector, which is expected to weigh on the financial strength of many companies, with an emphasis on small- and medium-sized businesses, the unemployment rate according to its standard definition is expected to climb as well in the near-term. Thus, in our estimation, the "standard" unemployment rate (for persons aged 15 and above) in 2023 is expected to average 3.6%, while next year it is expected to climb to an average of 4.6%; yet, in terms of the broader definition, the rate is expected to continue to be high, mainly in the near-term.

Israeli GDP increased 2.8% in the third quarter of the year, in annualized terms

According to CBS data, in the third quarter of the year, before the outbreak of the "Swords of Iron" War, local economic activity continued to expand, albeit at a slightly lower rate than that registered in the first two quarters of the year. Israeli GDP increased in the third quarter of 2023 by 2.8% (in real terms, adjusted for seasonality, in annualized terms).

Analysis of the growth rates according to components of GDP shows that growth in this quarter was supported mainly by an acceleration in the growth rate of exports of goods and services (with an emphasis on goods), and this despite the slowdown in global trade, and also by an increase in the growth rate of public consumption, and to a lesser extent also of private consumption (see accompanying chart). However, we emphasize that despite the rise in the rate of increase in private consumption, private consumption per capita contracted also in this quarter (by 0.1%), as occurred in four of the last five quarters, and this against the backdrop of the relatively high inflation and interest rate environments, which weigh on the purchasing power of households.

In addition, it should be noted that the growth rate of services exports was substantially below that of the past. Fixed capital formation slowed for the second consecutive quarter, growing by only a moderate rate of 1.2% (in annualized terms), this against the backdrop of a slowdown in the growth rate of investment in the industries, mainly due to a drop in investment in transportation vehicles. In contrast, investment in machinery and equipment increased, while investment in residential construction actually accelerated, despite a moderation in housing prices and the decline in the rate of new home sales.



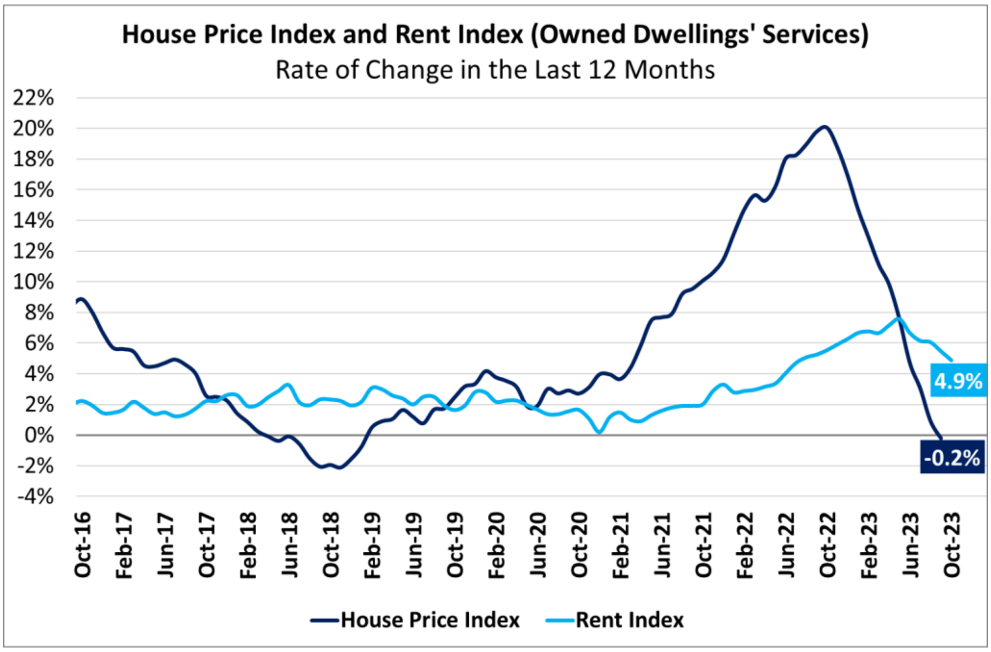
Looking ahead, we estimate that in the fourth quarter of 2023 GDP will drop sharply, by a double-digit rate (in annualized terms), in view of the impact of the "Swords of Iron" War on the level of uncertainty, the supply of workers, and overall demand, such that for all of 2023 GDP is expected to increase by 2.4%.

The October CPI increased in-line with expectations; inflation is expected to continue to moderate in the coming months, led by housing rental prices

The consumer price index (CPI) increased 0.5% in October 2023, in-line with preliminary estimates (the median of inflation forecasts). The rate of increase in prices over the trailing 12-month period slowed to 3.7%, compared to 3.8% in the preceding month. This comes in continuation of the trend of moderation in inflation that has occurred almost continuously since January 2023, back when inflation reached a peak of 5.4%.

The impact of the "Swords of Iron" War on the October 2023 CPI was mostly inflationary. Prices of fresh agricultural products (meat, poultry, and fish; fresh fruits and vegetables) increased at an accelerated pace compared to the seasonality that generally characterizes these prices in October each year, against the backdrop of reduced supply in light of the war (damage to agricultural infrastructure or restrictions on access to it, and shortages of foreign workers since the outbreak of war). The sharp depreciation of the shekel during the initial weeks of the fighting also pushed the CPI upward, particularly prices of expenditures for travel abroad. On the other hand, prices of goods the consumption of which declined sharply since the outbreak of the war demonstrated, at least for some goods, relative resilience in October (prices of clothing and footwear, furniture, and household equipment).

In our estimation, the deflationary effects of the war were still not fully reflected in the October CPI, in light of disruptions to the measurement of some of the CPI items against the backdrop of the war (such as: catering parties and other events, as well as recreation, holidays and trips in Israel); the methods for measuring other CPI items, which cause changes in their prices to be expressed only gradually (for example, prices of overseas flights and housing rentals); and likely also due to efforts of some suppliers to postpone as much as possible price declines in a period in which some of them are actually absorbing increased costs (the depreciation in the exchange rate, an extreme rise in shipping costs, worker shortages, etc.). In our estimation, the deflationary effects of the war will accumulate strength down the road and will become more dominant, in such a manner that will support later on a slowdown in the annual inflation rate.



One of the key CPI components that may push inflation down in the coming months is the owned dwellings' services sub-component (which measures housing rental prices in new and renewed contracts). Even before the outbreak of the war, this sub-component was moderating considerably, and this was expressed as well in the October CPI (contracts that began in September-October 2023, that is to say, they were signed just before the war). Thus, in October, owned dwelling services prices decreased 0.3% compared to September, thereby completing an annual increase of only 4.9%, the lowest annual rate of increase in 15 months (see accompanying chart).

In our estimation, the war will lead to further moderation in housing rental prices in the coming months. This comes against the backdrop of a short-term decline in the number of renter households (due to army recruitment, postponement to the start of the academic school year, etc.); the transition of short-term vacation apartments (AirBnB, etc.) to the regular rental market in view of the sharp drop in tourist entries to Israel since the outbreak of war; and expectations for a weakening in the purchasing power of renters, in light of the drop in economic activity and the placement of hundreds of thousands of workers on furlough.

Regarding the house price index of the CBS (which is not included in the CPI), this index fell over the last two months (August-September 2023) by 0.3% compared to the two preceding months (June-July 2023), in a manner that moved the annual rate of change in the house price index into negative territory (-0.2%), for the first time since the beginning of 2019. The downward trend in home prices, which started first and foremost due to the sharp rise in the interest rate environment in the economy, is expected to continue in the near-term also in view of the effects of the "Swords of Iron" War. This is because the war has led to a notable downturn in consumer confidence and in the willingness of consumers to carry out large purchases in the current period. This downturn in sentiment is expressed in the number of home purchases in October, which according to the initial figures of the Ministry of Finance (MoF), fell sharply, possibly even to a level below that registered at the beginning of the coronavirus crisis.

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