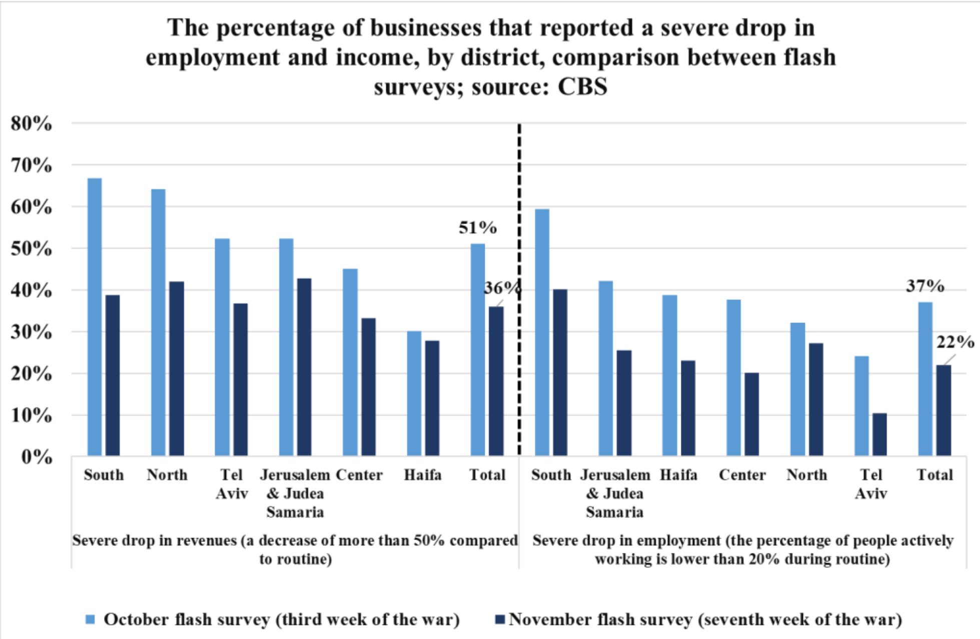
Leumi Economic Weekly

November 29, 2023

Flash survey on the state of Israeli businesses in November indicates an improvement in employment as well as in revenues compared to the preceding month

A flash survey conducted by the Central Bureau of Statistics (CBS) on the state of businesses in Israel under the shadow of the "Swords of Iron" War in November (in the seventh week of the war) shows that compared to the survey conducted in October (in the third week of the war) there has been a certain improvement in the state of businesses. This improvement is expressed in a decline in the downturn in employment and in the drop in revenues of local companies. Thus, the percentage of businesses that reported a severe downturn in employment (percentage of active workers that is less than 20% compared to normal times) fell from 37% in October to 22% in November (see accompanying chart), and the percentage of businesses that reported on employment levels above 80% compared to normal times increased from 24% in October to 37% in November. The improvement in the level of employment was registered in all districts throughout the country, although the change was relatively low in the Northern district. In addition, the percentage of businesses that indicated a severe downturn in employment in November, in the Northern and Southern districts, close to the lines of fighting, is high in a national comparison.



The percentage of businesses that reported a severe drop in employment and income, by district, comparison between flash surveys; source: CBS

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The percentage of businesses that reported a severe downturn in revenues (a decline of greater than 50% compared to normal times) fell as well, from 51% in October to 36% in November. The improvement in this index is reflected in all districts throughout the country, but is most notable in the Northern and Southern districts, in which the percentage of businesses reporting a severe downturn in revenues approached the national average. A sector analysis indicates a decline in the percentage of businesses in all sectors that have reported a severe downturn in employment. Especially notable declines occurred in the construction sector, from 62% of businesses in October to just 34% in November, in the food and beverages services sector, from 45% to 21%, and in the industrial sector (excluding high-tech), from 41% to 24%, in the same period.

The percentage of businesses that reported a severe downturn in revenues declined in all sectors, except for the health services sector, and in entertainment and leisure, while in the construction sector, as well as in the food and beverage services sector, there was a strong improvement in this index. According to the CBS, the rise in the percentage of businesses that reported a severe downturn in revenues in the health services sector as well as in entertainment and leisure derives from a seasonal rise in activity that occurs in normal times during this time of year, close to the Hannukah holiday time.

The survey also shows that the main factor behind the downturn in the activity of companies is the drop in demand for goods and services that are sold by businesses. This factor was indicated by 49% of companies, substantially greater than the percentage of businesses that indicated an absence of workers or a shortage of workers as the main factor, as reported by 19% of the businesses. Yet, in only the construction sector, the main factor that weighs on business activity is the shortage of workers, and this, against the backdrop of the prohibition against the entry into the country of Palestinian workers, which account for the main proportion of the total number of employees in the sector. In summary, the second flash survey on the state of businesses under the shadow of the "Swords of Iron" War indicates improvement in revenues and in the level of employment compared to October, with this apparently the result of a variety of factors, including: the adaptation by businesses to operate while the war wages on; a decrease in the threat of missiles and rockets on the home front; and a certain, even if partial, opening of the education system.

The Bank of Israel kept its benchmark interest rate unchanged; the growth forecast of the Research Department was revised downward

In its interest rate decision from November 27th, the Bank of Israel (BoI) kept its benchmark interest rate unchanged at 4.75%. This decision is in-line with our *Bank Leumi* expectation, as well as the consensus forecast. At the same time, the Research Department of the BoI revised, in an extraordinary session, its macro-economic forecasts for the years 2023-2024. The BoI noted that the war has significant economic consequences, both on real activity, and on the financial markets. The degree of uncertainty regarding the scope and the duration of the fighting is exceptional, and this also has implications regarding the degree of downturn in activity. The BoI stated that tools being operated by the central bank are helping at this time to achieve the bank's goals. Steps being taken include: a program including up to US$30bn for the sale of foreign currency; measures in the credit market by the banks and credit card companies, which adopted an outline for deferring loans; and a credit assistance program for small- and medium-sized business.

Inflation is moderating, equaling 3.7% over the past year. However, against the backdrop of declining demand, and alongside limitations on the supply side due to the war, there is also great uncertainty regarding the development of inflation in the coming period. The monetary committee estimates that current monetary policy supports the convergence of inflation toward the target level. It was also noted that following a sharp shekel depreciation in the opening weeks of the war, there was a subsequent substantial appreciation, and the shekel exchange rate moved downwards below its pre-war level. In the remarks of the central bank Governor, he pointed out that if the appreciation becomes entrenched, this will reduce inflationary pressures, and this will help to converge inflation to within the target range.

According to the BoI forecast, the inflation rate in the next four quarters (ending in the fourth quarter of 2024) is expected to equal 2.4%, that is to say, within the price stability target range. This represents a downward revision, this against the backdrop of the update to the working assumptions for the prolongation of the effects of the war into 2024, which is reflected in a more substantial downturn in the demand for consumption, as well as due to the appreciation of the shekel and the drop in oil prices that have occurred since the forecast was last published back in October.

Despite this situation, in which inflation is close to converging with the price stability target, and according to the capital markets as well as the forecast of the Research Department of the BoI, it will converge there soon, the BoI chose not to lower its interest rate. In remarks made by the Governor of the BoI, he referred to the fact that despite a certain decrease in the risk premium, it is still at a high level, and the current policy continues to focus on stabilizing the markets and reducing uncertainty, coupled with price stability, which is a central goal of the BoI. The Governor also stated that reckless use of the interest rate tool, in an environment of such great uncertainty and high volatility, can do more harm than good.

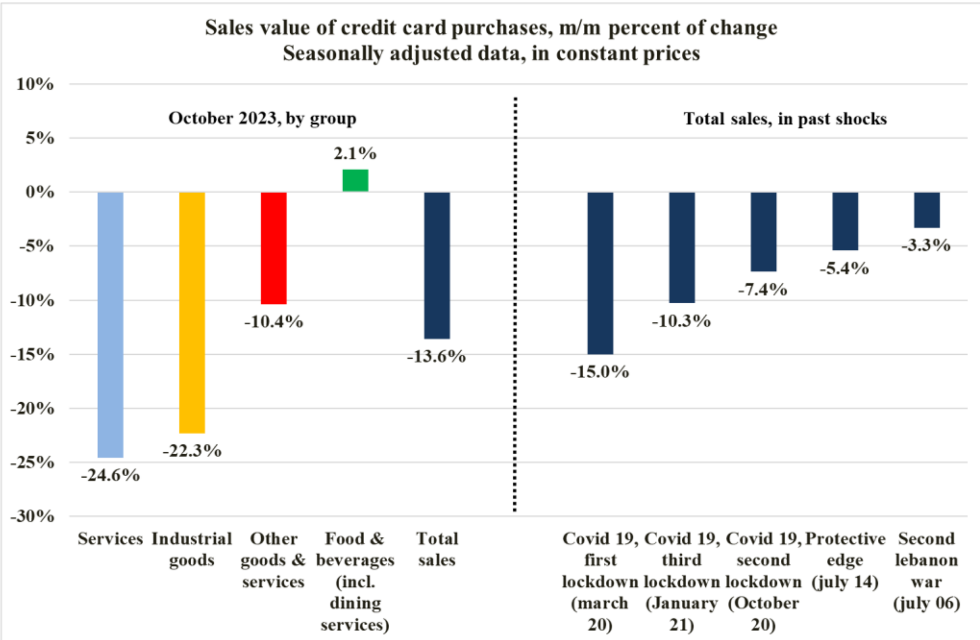
Looking ahead, as stability in the financial markets becomes more entrenched, and as the inflation environment continues to moderate towards the target range, then monetary policy will be able to focus more on supporting economic activity. However, the BoI is signaling quite clearly that it will lower the interest rate only at a later stage, and according to the Research Department's forecast, in the fourth quarter of 2024 the interest rate is expected to equal 3.75-4.00%, compared to its current level of 4.75%.

The Research Department revised downward its 2023-2024 growth forecasts. According to the new forecasts, on the assumption the war will be concentrated on the southern front only and the direct impact of the war on the economy will carry on into 2024 at a reduced intensity, then the GDP will grow 2.0% in both 2023 and in 2024 (instead of 2.3% and 2.8%, respectively, in the October forecast). The BoI estimates the "broad" unemployment rate for the main working age category (ages 25-64), which has increased in the fourth quarter of 2023, will remain at a high level also in 2024.

According to the forecast, the government budget deficit is expected to climb to 3.7% and 5.0% of GDP in 2023 and 2024, respectively. In light of this, the debt/GDP ratio for Israel at the end of 2024 is expected to increase to 66%. Government expenditures related to the war (gross, before excluding assistance from the US government and reducing other expenditures) are expected to amount to NIS 160bn through the end of 2025, and the loss in revenues is expected to equal NIS 35bn. The Governor of the BoI called in his remarks for the government to implement responsible fiscal policy, while taking into consideration the medium- and long-terms already now, which includes a reduction in expenses of a permanent nature with a low contribution to future growth. This comes against the backdrop of, among other things, the belief that defense expenditures will increase further beyond the war years, as will the interest payments on government debt.

Credit card purchases (in real terms) in October fell sharply compared to the preceding month, as well as compared to previous shocks

CBS data show that credit card purchases (seasonally adjusted data, in real terms) by individuals (at domestic businesses only) fell sharply in October, by 13.6% compared to the preceding month. This comes against the backdrop of, among other things, a general drop in demand, and disruptions to business activity in many regions of the country due to the “Swords of Iron” War.



Sharp real declines were registered in areas related to services (tourism, leisure and entertainment, and government services) as well as in manufactured goods (clothing and footwear, furniture, and electronic goods). Credit card purchases of other goods and services, the category with the largest weighting (representing 47% of total credit card purchases), fell by a more moderate rate, whereas credit card purchases of food and beverages (including services) increased moderately (see accompanying chart).

In an historical comparison, the decline registered in October 2023 is high relative to the declines registered in past shocks that occurred to the Israeli economy. Thus, the real rate of decline registered in October this year is slightly lower in intensity compared to the decline registered in March 2020, back when COVID restrictions were first imposed on the Israeli economy due to the pandemic. Yet, the latest decline is higher than that in the months in which the second and third COVID lockdowns occurred, and substantially higher than the rates of decline that occurred in previous periods of large military events, such as the “Second Lebanon War” and Operation “Protective Edge”. However, it is important to note that also the number of days during the month, in which the shock occurred, may also have a part in explaining the intensity of the decrease.

Nevertheless, according to the daily data on credit card purchases (in nominal terms, adjusted for seasonality), published by the BoI, the total volume of purchases on credit recovered throughout the month of November, from the lows reached at the end of October. This occurred apparently as households and businesses adjusted to activity during the time of war, and also in light of a certain decline in the intensity of the missile threat, and the opening of the educational system.

In summary, the data on credit card purchases dropped sharply, in real terms, in October, due to the “Swords of Iron” War, and by a sharp rate relative to the onset of past shocks that occurred to the Israeli economy. This fact likely indicates the sharp drop in private consumption in October. However, according to partial indications from the BoI data for the month of November, and on the assumption the war will not expand to additional fronts, it appears the peak in the decline in credit card purchases is behind us.

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