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Leumi Economic Weekly

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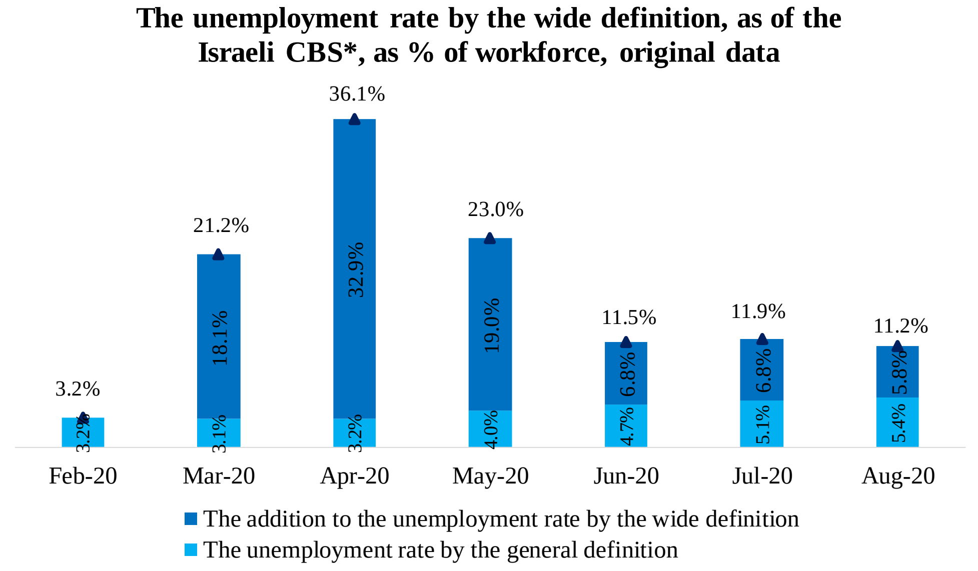
The unemployment rate according to its "broad" definition remains above 11%, also following the publication of the August data

The August employment data, based on workforce surveys, were recently published by the Central Bureau of Statistics (CBS).



* Unemployed persons, temporarily absent from work all week due to reasons related to the Coronavirus pandemic and stopped working due to dismissal or closure of the workplace in March-August 2020.

As we have noted in our previous surveys, the standard definition of the unemployment rate does not reflect in its entirety the scope of non-employment in the economy during the period of the coronavirus crisis, this due to technical reasons involving definitions and exclusions. In light of this, our analysis in this section relies on the detailed data tables of the CBS, which take into consideration all the workers in the economy whose employment has suffered due to the crisis, primarily: employees who have been temporarily absent from their places of work due to the coronavirus crisis (mainly furloughed employees) and workers who were laid off in March-August and are not currently participating in the workforce. In addition, we note that due to disruptions in the data series resulting from the coronavirus crisis, the analysis presented in this section relies on data that is not adjusted for seasonality.

As can be seen in the accompanying chart, the "broad" unemployment rate declined slightly in August to 11.2%, which is equivalent to 468,000 workers, compared to 11.9% in July. This is indeed a substantially lower unemployment rate compared to that in March-May, when rates climbed above 20%; however, the current rate is still much higher than the unemployment rate from before the breakout of the coronavirus crisis (3.2% in February, or 150,000 unemployed persons). At the same time, we note that the "standard" unemployment

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rate has been in a moderate uptrend since March, reflecting an increase in the number of unemployed persons (according to the CBS definition), with the return of the economy to activity. This development has led the gap between the "standard" unemployment rate and the "broad" unemployment rate to narrow; however, this gap is expected to close only after the return of the economy to full activity, and following the halt in unemployment payments to furloughed workers.

In summary, starting from June, with the renewed opening of the economy to relatively broad activity, there has been a step-down in the "broad" unemployment rate, which since this time has floated within a range between 11.2% - 11.9%. This is despite the renewed breakout of the coronavirus across the country since the beginning of July, since there was no heightened severity in the restrictions on activity through the end of August.

However, the government's decision to enter the economy into a shutdown during the entire upcoming Jewish holiday season (at least through October 11th) is expected to lead to a rise in the scope of non-employment during September-October. This is expected to be reflected in an increase in the "broad" unemployment rate. Looking ahead, in our opinion, the "standard" unemployment rate in the general economy (persons aged 15 and above) will reach an annual average of 7% in 2020-2021, or perhaps even higher in the event the restrictions on activity will continue throughout most of 2021.

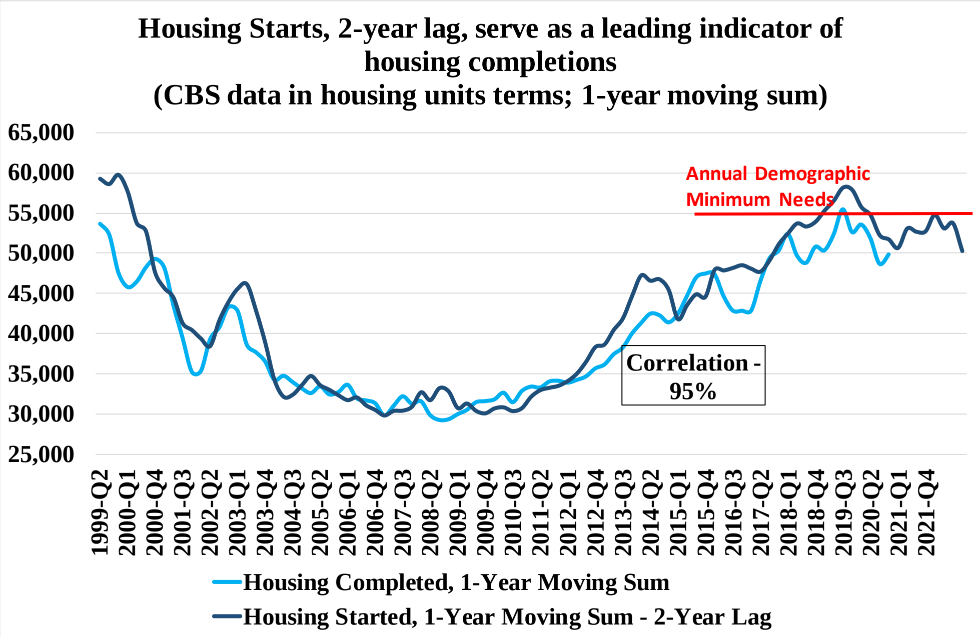
A decline in housing construction starts in the second quarter of the year against the backdrop of the coronavirus crisis

The CBS data show that housing construction starts fell sharply in the second quarter of 2020, equaling 9,450 units (original, unadjusted data) – the lowest figure since the third quarter of 2012. This figure reflects a 29% decline compared to the preceding quarter and a 27% drop compared to the second quarter of 2019. In light of this, the cumulative number of construction starts over the last four quarters declined to a level of 50,000 units. This is a low number compared to the figure from the preceding quarter (53,000 units); however, it remains near the minimum level of construction required to fulfill the needs of the economy, according out our estimations.

Construction starts have been negatively affected by the coronavirus crisis, this in light of the disruptions in planning and construction activity, and also against the backdrop of a decline in motivation to initiate new developments. This situation is expressed in, among other things, a lengthening in the average construction completion time for housing units to 30.6 months in the first half of 2020, compared to 29.5 months in 2019. These trends are likely to continue also in the coming months.

Looking ahead, the notable decline registered in the amount of residential land marketed by the Israel Land Authority (ILA) starting from 2019, which deepened in the first half of 2020, is expected to support a low number of construction starts also in the subsequent period. The fact that the government is operating without a confirmed budget for 2020 and the 2021 budget has still not even reached the confirmation process, coupled with the lack of clarity surrounding future government plans with respect to housing, represent factors that are weighing on residential construction activity.

Construction completions in the second quarter of 2020 stood at 12,300 units, reflecting a 3% increase compared to the preceding quarter and an 11% increase compared to the parallel period in 2019. However, analysis of the cumulative number of construction completions in the past year (ending with the second quarter of 2020) shows that the number of construction completions since the beginning of 2020 was below 50,000 units, and is the lowest since the end of 2017. This comes against the backdrop of, among other things, the lengthening in construction times and perhaps also a halt in projects. Looking ahead, in the short-term the annual rate of construction completions is likely to increase to slightly above 50,000 units, since construction starts (with a two-year lag) were at this level (see accompanying chart). In subsequent periods, a relatively substantial decline is expected in construction completions, in light of the low level of construction starts at the current time and looking forward.

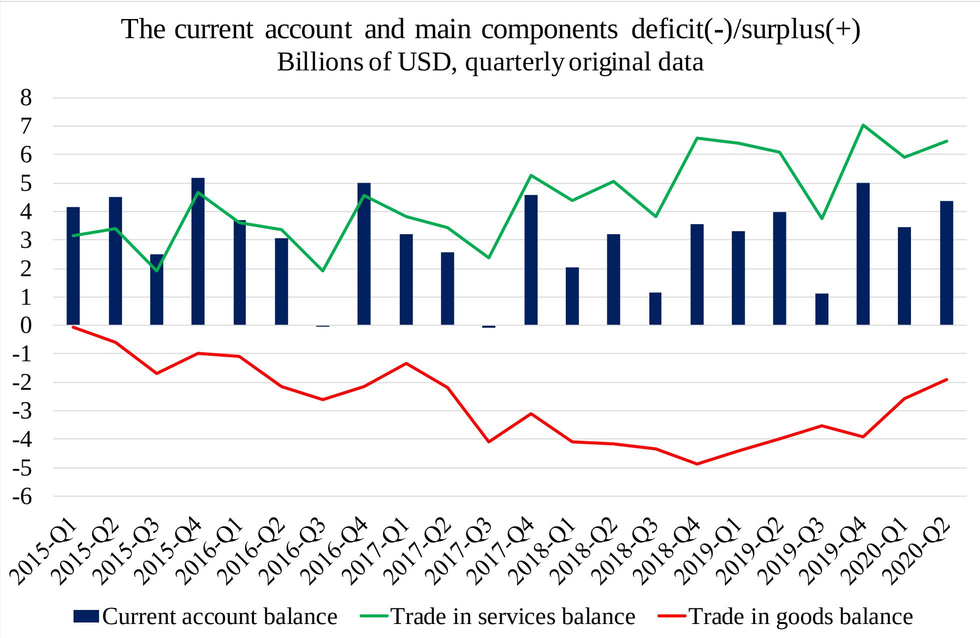


In summary, we estimate that in the short-term the indices on activity in the housing market are expected to moderate, but in the medium-term the shortage in new housing is expected to become more severe, with a recovery in demand and the decline in construction starts. Since the beginning of the coronavirus crisis, the number of transactions in the housing market has declined sharply, with respect to sales of both new and previously owned units. Against this backdrop, housing prices are indeed continuing to increase, yet at a slightly more moderate pace compared to pre-crisis levels. The weakness in demand is expected to continue as long as the coronavirus crisis continues, with an emphasis on its negative impact on the labor market and on household income levels. Consequently, the rate of increase in housing prices is likely to continue to moderate also in the coming months.

In the medium-term, there are expected to be renewed surplus demand pressures, against the backdrop of the economy's expected exit from the crisis over time, depending on a vaccination/cure for the virus. At the same time, the housing needs of the economy are continuing to consistently rise together with the increase in the country's demographics. On the other hand, as mentioned, the rate of construction is expected to remain relatively moderate and below the needs of the economy. These trends support an increase, perhaps even substantial, in housing prices in the future.

An increase in the current account surplus in the second quarter of 2020, due to an increase in the services account surplus and a decline in the goods account deficit

The second quarter of 2020 concluded with a US$4.4bn surplus (original, unadjusted data) in the current account of the balance of payments, following the US$3.5bn surplus in the first quarter, this according to the CBS data released in recent days. In terms of percentage of GDP, the upward trend in the current account surplus continued also in the second quarter of the year, as the surplus increased to more than 4% of GDP.



As can be seen in the accompanying chart, the increase in the current account in the second quarter of the year occurred against the backdrop of a decline in the deficit in the goods account, coupled with an increase in the surplus in the services account. This was the result of a sharper decline in goods imports than in exports; which occurred in parallel to a continued growth in services exports, led by the export of high-tech services.

On this regard, we note that the foreign trade data published in recent days indicate a renewed growth in imports in July – August (averaged) compared to the average from the second quarter of this year, and also a deepening in the decline in goods exports. That is to say, in the event the trends described will remain as such also following the publication of the September data, it appears the trade deficit is expected to increase in the third quarter of the year, and as such will support a slight offset of the current account surplus.

In summary, the surplus in the current account of the balance of payments is continuing to increase, representing a fundamental factor supporting the strength of the shekel, this together with a trend of capital inflows into the economy (financial, as well as real-direct). Looking ahead, in the baseline scenario, the surplus in the current account is expected to equal 5.0% of GDP in 2020-2021 compared to a level of 3.6% of GDP in 2019. In a scenario involving continued restrictions on economic activity during 2021, the surplus is expected to be lower.

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