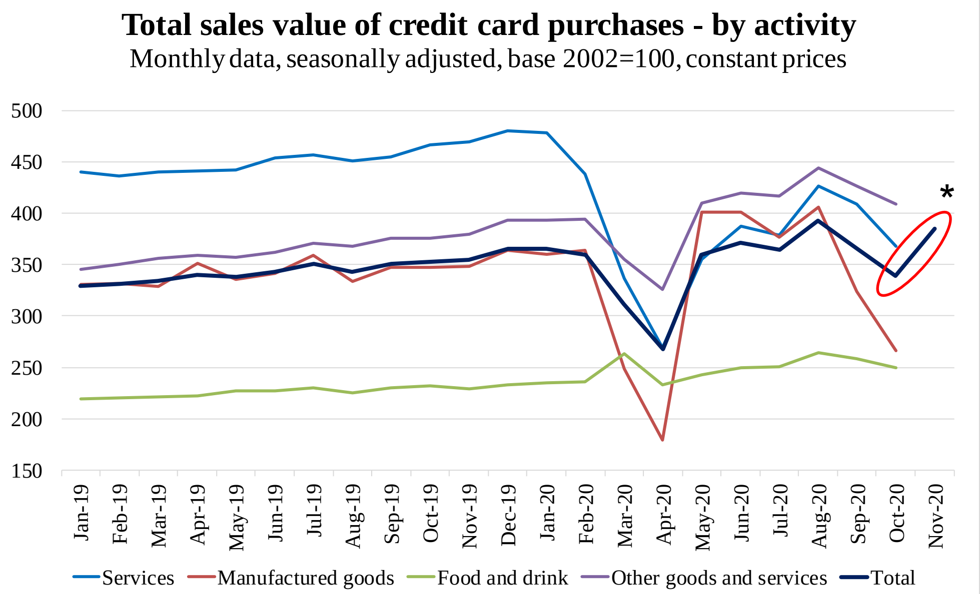
Leumi Economic Weekly

December 3, 2020

Total credit card purchases fell sharply in October, against the backdrop of the country's second economic shutdown, yet increased sharply in November

The Central Bureau of Statistics (CBS) published the data on credit card purchases by private individuals for October. It is important to note the CBS data are adjusted for seasonality (and are in fixed prices); therefore, it is possible to make comparisons between the months of the year using this data. This is in contrast to the weekly data on credit card expenditures published by the Bank of Israel (BoI).

The CBS data show that October was characterized by declines in the volume of purchases, against the backdrop of the second economic shutdown, which started on September 18, just at the beginning of a three-week Jewish holiday period. Total purchases in October were 7.3% below September's total, and 5.7% below the sum of purchases in February this year, prior to the outbreak of the coronavirus crisis.



* Leumi's economics department seasonally adjusted estimation for November , based on BOI data.

Analysis of the different sectors of activity shows that in October declines occurred in the purchases of each category (see accompanying chart), with an emphasis on manufactured goods (clothing and shoes, furniture, and electronic goods) and services (tourism, flights, leisure and entertainment, and more). The volume of purchases in the manufactured goods category was 26.6% below the level in February, and the sum of purchases in the services category was 16% lower.

BANK LEUMI LE-ISRAEL, THE CAPITAL MARKETS DIVISION
The Economics Sector, P.O.Box 2, Tel Aviv 61000
Ph: 972-76-885-8737, Fax: 972-77-895-8737, e-mail: Gilbu@bll.co.il
http://english.leumi.co.il/Home/

However, the BoI data show credit card expenditures increased sharply (more than 20%, without adjusting for seasonality) in November, against the backdrop of the initiation of the gradual exit process from the country's second economic shutdown, led by the purchases of clothing, furniture, and electronic items (manufactured goods). In light of this, also after taking into consideration seasonal factors, it appears a substantial increase ("correction") is expected in purchases within this category in November. On the other hand, the volume of purchases in the services sectors is still expected to remain substantially below the pre-crisis levels, since the activity of these sectors remains subject to severe restrictions, with an emphasis on the prohibition of congregating and social distancing.

In summary, the data on credit card purchases show that since the beginning of the crisis, activity has tended to react quickly and to increase substantially parallel to the removal of restrictions, with an equally quick downturn in activity occurring when restrictions are imposed. This indicates that the most significant limitation on activity at the present time is a supply constraint and not a demand constraint, due in part to government support for the households negatively affected by the crisis. According to our estimates on the volume of purchases adjusted for seasonality for November, which are based on the BoI data, it appears a double-digit rate of increase is expected in total credit card purchases (see accompanying chart). As long as the process of exiting from the economic shutdown continues, then purchase activity in most of the sectors (excluding the services sectors) is expected to increase.

The BoI kept its interest rate unchanged at 0.1%; at the same time, the central bank moderated the expected extent of the decline in 2020 GDP

The Monetary Committee of the BoI decided in its meeting on November 30, 2020 to keep the central bank interest rate unchanged at a level of 0.1%.

Within the framework of the interest rate decision, the BoI issued an interim update on its assessment of the situation regarding economic activity in the second half of 2020, including the period of the second economic shutdown (which lasted from mid-September through mid-October). The BoI noted the rapid recovery in economic activity in the third quarter, before the second shutdown, as reflected in the national accounts data. In addition, the BoI noted that the damage to economic activity resulting from the second economic shutdown was more moderate than the damage experienced in the first shutdown earlier in the year; however, the exit from the second shutdown is slower, with notable differences in the damage to activity across the various sectors of the economy. On this regard, we note that the composite state-of-the-economy index for October remained stable, this following a number of months of increases, and thus reflects a slowdown in activity in the fourth quarter of the year.

	Growth forecast for the Israeli economy	
	2020	2021
Leumi	**(-3.9%)**	**4.9%**
BoI	(-4.5%) – (-5.0%)	1.0% – 6.5%
Ministry of Finance	(-4.2%) – (-4.8%)	2.4% – 4.5%
OECD	(-4.2%)	2.3%

In the words of the BoI, "*The positive results in coronavirus vaccine tests are increasing optimism regarding the rapid return of the economy to a path of growth in the coming year. However, the adverse impact on the economy, and particularly on the labor market, is expected to be prolonged, and the Committee will therefore continue to utilize a range of tools in order to increase the extent of the monetary policy accommodation and to ensure the continued orderly functioning of the financial markets. The Committee will expand the use of the existing tools, including the interest rate tool, and will operate additional ones, to the extent that it assesses that it is necessary in order to achieve the monetary policy goals and to moderate the adverse economic impact resulting from the crisis.*"

That is to say, the BoI is emphasizing the possibility for the implementation of additional measures later on, including an interest rate cut, yet with an emphasis on credit and liquidity. The BoI also noted the low level of inflation, as well as the continuing appreciation of the shekel. Under these circumstances it appears the policy of monetary expansion will continue over time.

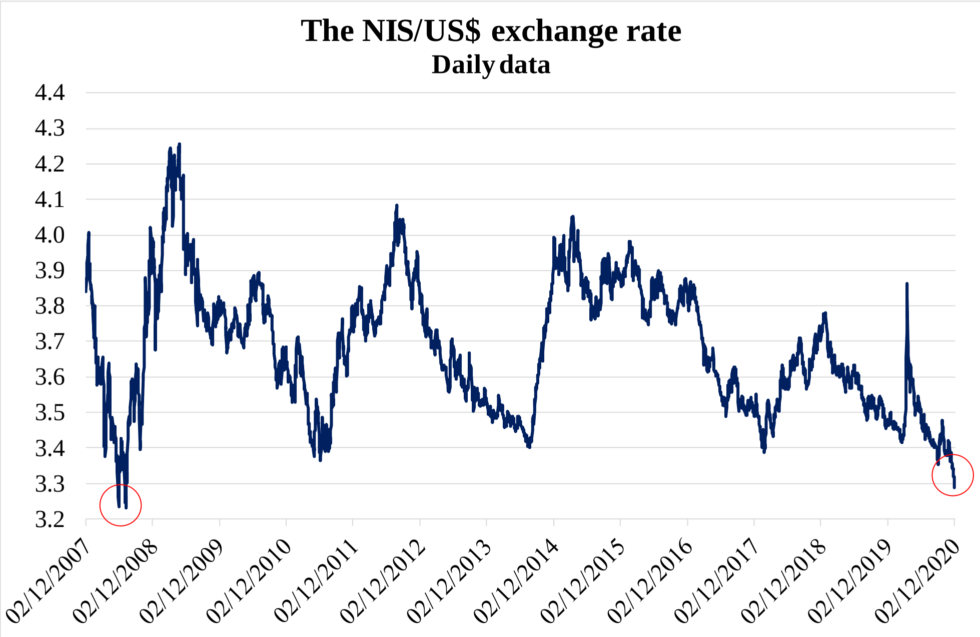
The BoI noted that its research division moderated the extent of the expected decline in 2020 GDP to a range between 4.5%-5.0%, after the publication of the growth data for the third quarter of this year. Regarding 2021, the BoI kept its forecast range very wide, between 1.0%-6.5%, depending on the extent to which the pandemic is brought under control. In parallel, other institutions revised their growth forecasts for the local economy, including *Bank Leumi* (see accompanying table). The Ministry of Finance (MoF) released a revised forecast, which is expected to be used as the basis for the 2021 budget proposal, according to which GDP is expected to contract by a rate of 4.2%-4.8% in 2020, depending on the scenario (baseline / pessimistic), and to increase afterwards by a rate of 2.4%-4.5%. The OECD forecasts more moderate damage to global GDP in 2020, compared to its previous forecast, and regarding Israel the forecast is for a decline of 4.2%, and afterward growth by a moderate rate of 2.3% in 2021, since the organization forecasts that the process of recovery will continue into 2022.

In our opinion, the rate of decline in the 2020 GDP expected by the BoI seems high, and is inconsistent with the known data for the first 10-11 months of the year. In particular, the BoI noted that the gradual lifting of the restrictions of the second shutdown and the different seasonality effects have recently led to an increase in credit card purchase volumes to above their pre-crisis levels. These data, together with other data, such as the revenues in the sectors of the economy, the GDP data for the first three quarters of the year, and the population mobility data released by the BoI, are consistent with a rate of decline in 2020 GDP by a more moderate rate than that forecast by the BoI.

In our baseline scenario, we forecast a 3.9% decline in 2020 GDP, which is very similar to the estimates of the MoF and the OECD, followed by growth at a rate of 4.9% in 2021 (same as the forecast of the International Monetary Fund). These are positive growth performance figures for Israel compared to the OECD average, due to the larger contribution of net foreign trade activity (exports minus imports) to growth, with an emphasis on an increase in Israel's high-tech exports, in parallel to the expected reduction in imports. Furthermore, Israel GDP growth in 2021 is expected to be positively affected by the continued development of the country's natural gas sector.

The shekel continues to strengthen, approaching an historic peak level, this despite the coronavirus crisis

The strengthening trend of the shekel is continuing even further, despite the negative consequences of the coronavirus crisis on the Israeli economy. In November, the shekel appreciated 1.4% vis-à-vis the currency basket, and year-to-date (January-November) the shekel has strengthened 3.7%, toward a record high in historic terms, this in continuation of the 8.1% appreciation in 2019.



The strengthening of the shekel vis-à-vis the currency basket has occurred as a result of the shekel's appreciation vis-à-vis the dollar, and also vis-à-vis the UK sterling. During November, the shekel strengthened by a sharp rate of 3.3%, and year-to-date it has appreciated 4.3% vis-à-vis the dollar. The current level of the shekel/dollar exchange rate stands at below NIS 3.30 (NIS 3.289 on December 2), with this being the lowest level recorded since 2008 (see accompanying chart), which led for the first time to the implementation of the foreign exchange purchasing policy of the BoI, the goal of which is to weaken the shekel and in this manner assist Israeli exporters and provide support to maintaining inflation within the price stability target range.

The on-going strengthening of the shekel since the beginning of the year has led the BoI to purchase large sums of foreign currency; however, in recent months the pace of the central bank's purchases has moderated. Thus, in October the BoI purchased US$0.53bn in foreign currency, yet year-to-date the volume of foreign currency purchases stands at US$14.96bn. Consequently, the BoI's foreign currency reserves reached a total equaling US$160.75bn, which is equivalent to 40.4% of GDP.

In summary, the shekel is expected to remain strong in the coming months. The fundamental factors supporting the shekel's strength are expected to continue their current trends. Thus, the continuing surplus in the current account of Israel's balance of payments, against the backdrop of a notable surplus in the services account, is expected to grow in the coming years, this in parallel to continuing capital inflows into the economy, with an emphasis on large volumes of foreign direct investment (FDI). In addition, Israel's entrance into the World Global Bond Index (WGBI) also supports demand for the shekel due to the purchase of Israeli government bonds in the local market by foreign institutions, which have increased their holdings from 5.5% at year-end 2019 to 7.6% in October this year. It is also important to note that it is likely the positive developments in the geo-political arena, which contributed to an improvement in Israel's diplomatic standing in the region, with positive economic possibilities, support as well the strength of the shekel.

Authors: Dr. Gil Michael Bufman and Yaniv Bar