Israel

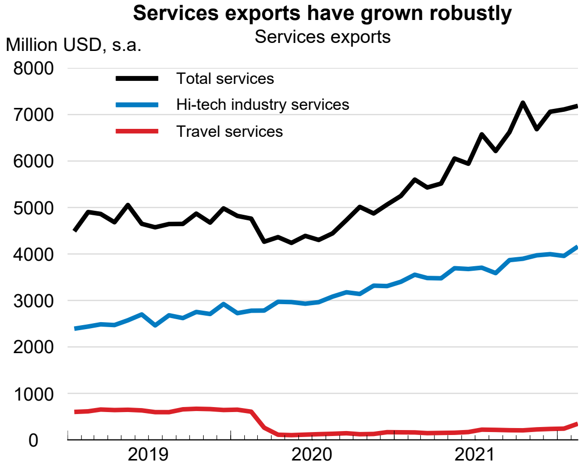
GDP is projected to grow by 4.8% in 2022 and 3.4% in 2023. The strength of the high-tech sector will continue, with exports and investment growing at a robust, albeit more moderate, pace. The strong labour market recovery will support consumption growth. Inflation should gradually slow but slightly exceed the upper bound of central bank's target range in 2023. Risks are skewed to the downside, related to a prolonged war in Ukraine, new strains of the corona virus, internal political uncertainty and an intensification of security incidents.

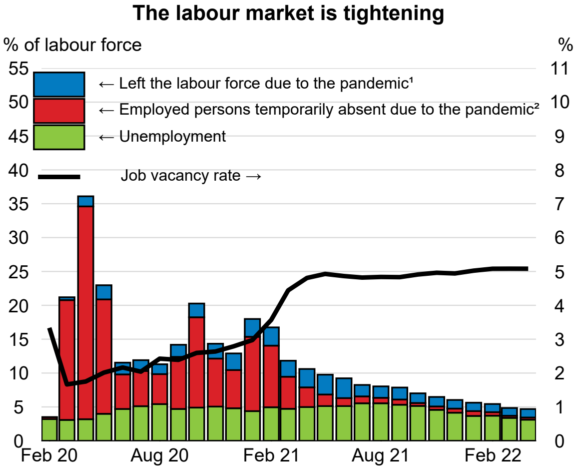
The advanced stage of the recovery and consumer price inflation exceeding the central bank's target range, call for a continuation of the gradual tightening of monetary policy. Fiscal policy support should be temporary and well targeted to households and firms most affected by the increase in the cost of living, so as not to add to inflationary pressures. In the medium term, putting public debt on a downward trajectory while allowing for productivity-enhancing investment calls for further efforts to enhance spending efficiency and increase tax revenue.

The economic recovery is well-advanced

After exceptionally strong growth in the fourth quarter of 2021, GDP contracted by 0.4% (non-annualised) in the first quarter of 2022. Credit card data and service exports suggest robust underlying growth momentum. The labour market has largely recovered with unemployment and employment rates close to pre-pandemic levels. A high vacancy rate suggests continued strong labour demand with some labour shortages evident in particular in the high-tech sector. Consumer price inflation, at 4% in April, exceeded the central bank's target range (1-3%), due to rising energy and food prices and price increases of other components (notably housing). Inflation has been mitigated by the trend currency appreciation, but more recently the shekel has depreciated. Wage increases in the public sector have been moderate so far.

Israel





1. Series includes persons not in the labour force who stopped working due to dismissal or closure of the workplace since March 2020. Data not available before March 2020.
2. This includes employees on unpaid leave, employees who were absent during the week due to reduced workload, work stoppage or other reasons related to the pandemic and excludes quarantined persons.
Source: Israel Central Bureau of Statistics; and OECD calculations.

StatLink https://stat.link/lf0w1d

Israel: Demand, output and prices

Israel	2018	2019	2020	2021	2022	2023
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 341.6	3.7	-2.1	7.9	4.8	3.4
Private consumption	731.2	4.0	-9.2	11.6	6.7	4.2
Government consumption	305.3	2.7	2.5	2.9	1.2	0.5
Gross fixed capital formation	286.1	3.0	-4.0	10.9	7.3	4.7
Final domestic demand	1 322.6	3.5	-5.3	9.3	5.5	3.4
Stockbuilding[1]	7.8	0.2	1.1	0.3	0.2	-0.2
Total domestic demand	1 330.4	3.7	-4.2	9.4	5.7	3.1
Exports of goods and services	402.4	3.7	-1.9	12.8	5.2	3.9
Imports of goods and services	391.3	3.3	-9.4	19.6	10.9	3.2
Net exports[1]	11.2	0.1	2.0	-1.0	-1.2	0.3
Memorandum items						
GDP deflator	_	1.9	0.9	3.0	3.1	2.2
Consumer price index	_	0.8	-0.6	1.5	4.0	3.3
Core inflation index[2]	_	0.7	-0.1	1.2	3.0	2.9
Unemployment rate (% of labour force)	_	3.8	4.3	5.0	3.7	3.6
Household saving ratio, gross (% of disposable income)	_	3.8	12.9	6.9	2.5	1.9
General government financial balance (% of GDP)	_	-3.9	-10.8	-3.8	-1.9	-2.2
General government gross debt (% of GDP)	_	59.5	71.7	68.7	65.8	64.7
Current account balance (% of GDP)	_	3.4	5.4	4.6	3.3	3.3

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
Source: OECD Economic Outlook 111 database.

StatLink https://stat.link/985mar

The impact of the war in Ukraine on the Israeli economy is likely limited to indirect effects via higher world energy and food inflation and lower demand from trading partners. Direct trade volumes with Russia and Ukraine only account for around 1% of total trade. Israel is also largely self-sufficient in natural gas, which accounts for around 40% of total energy supply. In contrast, the conflict may boost defence exports.

Macroeconomic policy normalisation is underway

The central bank raised the policy rate twice in April and May 2022 from 0.1% to 0.75%, after having ended its quantitative easing programmes at the end of 2021. The projections assume a continuation of the gradual monetary policy normalisation cycle with additional increases of the policy rate projected until the end of 2023. With strong revenue growth and the phasing-out of COVID-19-related spending, the budget deficit narrowed significantly in 2021. Revenue growth is likely to moderate in the coming years as some exceptional factors related to high financial and real estate valuations, strong import growth as well as increased profits in the high-tech sector dissipate. The government recently adopted a programme to mitigate the increase in the cost of living, including by expanding the earned income tax credit and child tax allowances, the suspension of the coal excise tax in 2022, and some reductions in custom tariffs. The estimated fiscal costs of the programme is around NIS 5.2 billion in 2022 (0.3% of GDP). A budget for 2023 has not yet been adopted and the projections assume a broadly neutral fiscal policy stance in 2023.

GDP will continue to grow robustly

After a very strong rebound in 2021, GDP is projected to grow at a more moderate pace in 2022 and 2023. Strong investment in the high-tech sector is projected to continue and, together with increasing tourist inflows will support service exports. Government support will mitigate the impact of inflation on households' disposable income. Inflation should gradually slow as monetary policy is tightening, but energy prices will remain elevated due to the EU embargo on Russian oil. A prolonged conflict in Ukraine could adversely affect the economy through more persistent inflation and lower demand from trading partners. New strains of the coronavirus, internal political instability and an increase in security incidents could heighten uncertainty, weighing on consumption and investment. On the upside, growth could be stronger if the high-tech boom continues unabated.

Macroeconomic policy should remain flexible

The gradual and data-driven normalisation of monetary policy should continue in order to bring inflation back into the target range. Fiscal policy should remain flexible, and additional targeted and temporary support to the most vulnerable households may be needed if inflation proves persistent. The abolition of the coal excise tax and reduction of transport fuel excise taxes are not well targeted and should be temporary as planned, so as not to compromise environmental goals. Expanding renewable energy would support energy security. Ensuring timely and effective implementation of the government's plans to boost infrastructure investment and investment in Israeli-Arab communities, and streamline regulations can boost productivity and lower socio-economic gaps. With extraordinary tax revenues dissipating, putting public debt on a downward trajectory while making these investments requires additional efforts to enhance spending efficiency, including by further digitising government services, and to increase tax revenues, including by broadening tax bases and reducing tax expenditures.