BANK OF ISRAEL
Office of the Spokesperson and Economic Information

July 4, 2022

Research Department Staff Forecast, July 2022

Abstract

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in July 2022[1] concerning the main macroeconomic variables—GDP, inflation, and the interest rate.

According to the forecast, GDP is expected to grow by 5.0 percent in 2022, and by 3.5 percent in 2023. The inflation rate in the coming four quarters (ending in the second quarter of 2023) is expected to be 3.3 percent. The inflation rate in 2022 is expected to be 4.5 percent, and inflation in 2023 is expected to be 2.4 percent. According to the forecast, the monetary interest rate is expected to average 2.75 percent in the second quarter of 2023.

The Forecast

The Bank of Israel Research Department compiles a staff forecast of macroeconomic developments on a quarterly basis. The staff forecast is based on several models, various data sources, and assessments based on economists' judgment. The Bank's DSGE (Dynamic Stochastic General Equilibrium) model developed in the Research Department—a structural model based on microeconomic foundations—plays a primary role in formulating the macroeconomic forecast.[2] The model provides a framework for analyzing the forces that have an effect on the economy, and allows information from various sources to be combined into a macroeconomic forecast of real and nominal variables, with an internally consistent "economic story".

a. The global environment

Our assessments of expected developments in the global economy are based mainly on projections by international institutions (the International Monetary Fund and the OECD) and foreign investment houses. We assume that GDP growth in the advanced economies will be about 2.7 percent in 2022, and 1.9 percent in 2023 (about 0.3 percentage points lower than in the previous forecast for each year). The inflation rate in the advanced economies is forecast to be

[1] The forecast was presented to the Bank of Israel Monetary Committee on July 3, 2022, prior to the decision on the interest rate made on July 4, 2022.
[2] A Discussion Paper on the DSGE model is available on the Bank of Israel website, under the title: "MOISE: A DSGE Model for the Israeli Economy," Discussion Paper No. 2012.06.

6.7 percent in 2022 (compared with 5.0 percent in the previous forecast) and 2.3 percent in 2023 (compared with 2.0 percent in the previous forecast). The increase in the inflation forecast was accompanied by a significant revision of the global interest rate forecast, such that the average interest rate in the advanced economies is expected to be 2.2 percent in 2022 (compared with 1.1 percent in the previous forecast) and 2.4 percent in 2023 (compared with 1.6 percent in the previous forecast). The average price of Brent oil traded at an average of about $118 per barrel in June, higher than at the time of the previous forecast (about $100 per barrel).

b. Real activity in Israel

GDP is expected to increase by 5.0 percent in 2022, and 3.5 percent in 2023 (Table 1). The growth forecasts for 2022 and for 2023 were lowered by 0.5 percentage points in view of the expectation of more restrictive monetary policy, and due to the price increases on imported products and inputs, which serve to moderate private consumption and investment. These factors also led to a reduction in the import forecast for 2023, after a slight upward revision for 2022 due to National Accounts data, which were higher than expected in the first quarter of the year. The forecast for exports in 2023 was also revised downward due to the decline in the global growth forecast. In the labor market, our assessment is that the unemployment rate will be 3.3 percent in 2022 and 3.5 percent in 2023, and that the employment rate (ages 25–64) will be 78.3 percent in 2022 and 77.7 percent in 2023, such that in 2023, the employment rate will be similar to the 2019 average. It should be noted that the starting point for the forecast (the second quarter of 2022) shows an economy that has closed the activity gaps that were created during the COVID-19 period (meaning that it closed the GDP deviation from the precrisis trend), with a tight labor market at high employment levels. Even after lowering the growth forecast, we do not forecast weakness in GDP or employment.

Regarding the State budget, in view of higher-than-expected tax revenues, the deficit is expected to be lower than our assessment in the previous forecast. The deficit is expected to be 0.7 percent of GDP in 2022, and 1.2 percent of GDP in 2023.

c. Inflation and interest rates

According to our assessment, **inflation in the next four quarters (ending in the second quarter of 2023) is expected to be 3.3 percent** (Table 2). Inflation in 2022 is expected to be 4.5 percent—one percentage point higher than in our previous forecast. Inflation in 2023 is expected to be 2.4 percent 0.5 percentage points higher than in our previous forecast. The upward revision of the forecasts is mainly due to an upward revision in the global inflation forecast and the depreciation of the shekel since the last forecast.

The inflation forecast reflects the assessment that both the domestic components of the CPI and the imported components will increase at a rate higher than 3 percent during most of the period of the forecast, and will moderate toward its end. The relatively high projected increase in the domestic components of the CPI is due to our assessment that demand will be strong in view of the tight labor market. The high projected increase in the imported components is due to the high global inflation forecast and to the lagged effects of the depreciation of the last few months. Our assessment, based on the forecasts of foreign investment houses, is that global inflation will slow to about 2 percent during 2023, and that inflation in the imported components will therefore moderate significantly in 2023.

Table 1

Research Department Staff Forecast for 2022–2023

(rates of change, percent[a], unless stated otherwise)

	2021	Forecast for 2022	Change from the April forecast	Forecast for 2023	Change from the April forecast
GDP	**8.2**	**5.0**	**-0.5**	**3.5**	**-0.5**
Private consumption	11.7	7.5	-0.5	4.5	-0.5
Fixed capital formation (excl. ships and aircraft)	11.4	5.0	0.0	3.0	-1.0
Public consumption (excl. defense imports)	3.3	4.0	0.0	3.0	0.0
Exports (excl. diamonds and startups)	10.8	3.0	0.0	2.5	-0.5
Civilian imports (excl. diamonds, ships, and aircraft)	18.4	7.5	0.5	3.0	-1.5
GDP deviation from the precrisis trend (percent)	**-1.8**	**-0.6**	**0.4**	**-0.9**	**-1.0**
Unemployment rate (average for the year, age 25–64)	4.6	3.3	-0.2	3.5	0.1
Employment rate (average for the year, ages 25–64)	**75.7**	**78.3**	**-**	**77.7**	**-**
Government deficit (percent of GDP)	4.4	0.7	-0.7	1.2	-1.1
Debt to GDP ratio (percent)	69	66	-1	64	-1
Inflation (percent)[b]	2.5	4.5	1.0	2.4	0.5

[a] In the forecast of National Accounts components, the rate of change is rounded to the nearest half percentage point.

[b] The average of the Consumer Price Index in the last quarter of the year compared with the average in the last quarter of the previous year.

Our assessment is that **the interest rate will be 2.75 percent in the second quarter of 2023** (Table 2). This assessment reflects a marked increase from its current level, due to the inflation forecast that is higher than the upper bound of the target range in the coming quarters, together with expectations of a continued high level of activity, and in view of a marked increase in global interest rates.

Table 2 shows that the Research Department's staff forecast regarding inflation in one year is similar to the average of the private forecasters' projections and slightly lower than expectations derived from the capital market. The Research Department's forecast regarding the interest rate in one year is higher than the average of the professional forecasters and lower than the expected interest rate derived from the capital market.

Table 2
Inflation forecast for the coming year and interest rate forecast for one year from now

(percent)

	Bank of Israel Research Department	Capital markets[a]	Private forecasters[b]
Inflation rate[c] (range of forecasts)	3.3	3.5	3.3 (2.6–3.7)
Interest rate[d] (range of forecasts)	2.75	3.2	2.3 (1.00–3.00)

a) Inflation expectations are seasonally adjusted (weekly average, June 27, 2022–July 3, 2022).
b) The average of forecasts published following the publication of the Consumer Price Index for May.
c) Inflation rate in the coming year. Research Department: in the four quarters ending in the second quarter of 2023.
d) The interest rate one year from now. (Research Department: in the second quarter of 2023.) Expectations derived from the capital market are based on the Telbor market (weekly average, June 24, 2022 to June 30, 2022).
SOURCE: Bank of Israel.

d. Main risks to the forecast

Global developments pose a significant risk to the forecast. The current forecast assumes that global inflation will slow rapidly, so that in 2023 it is expected to return to around 2 percent. If global inflation remains high in 2023, it is expected to have a direct effect on domestic developments through more expensive imports to the Israeli economy, and an indirect effect through the implications of continued high global inflation for the monetary policies that will be adopted in the major economies. In addition, there is significant uncertainty regarding the central banks' ability to restrain inflation without there being a strong impact on activity and without large shocks in the financial markets. Negative scenarios such as these may have a marked effect on the Israeli economy in general, and on the high-tech industry in particular.

In terms of risks in the domestic environment, we note the political uncertainty in Israel that may have an impact on economic developments and on fiscal policy in the forecast's range. We also note the possibility of worsening COVID-19 morbidity that may delay the economy's return to full operation.