

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

Press release

June 9, 2024

**Remarks by the Bank of Israel Governor at the cabinet meeting on the numerator**

Bank of Israel Governor Prof. Amir Yaron discussed the issue of the numerator at today’s cabinet discussion on the topic. The following are the main points of his remarks:

* The publication of the numerator is an important component of the preparation of the 2025 budget, since it provides perspective regarding the expected developments of revenue and expenditures over a range of a number of years. Fiscal resilience, which is necessary for economic stability, is not measured over one year, but by planning and implementation for a number of years forward. This planning is important in making budgetary decisions, particularly during a period characterized by high uncertainty, such as we are now experiencing.
* The current macroeconomic and fiscal environment is complex, including the current inflation and interest rate environment, significant budgetary needs due to the war, and tremendous economic uncertainty in view of the war, alongside uncertainty regarding the war’s duration and impacts. These are reflected in the price of Israel’s debt in the markets, which has increased since the start of the war. Under these conditions, a policy of fiscal responsibility and conservatism is necessary, since the markets and international credit rating agencies are closely examining us. As we emphasized during the discussions on the revised budget for 2024, we believe that a responsible policy must be reflected at the very lease in a stable debt to GDP path (following its jump due to the high expenses of the war at its outset).
* The numerator, as presented by the Ministry of Finance, makes it clear that significant adjustments will be necessary when building the 2025 budget, in order to converge at least to stabilizing the debt to GDP ratio in the coming years. According to the assessments presented in the numerator document, the budget deficit between 2025 and 2027 is expected to decline gradually from 5.2 percent of GDP to 3.7 percent of GDP, assuming that the risks detailed in the document do not come to pass. However, deficits of this size are not consistent with even long-term stability of the debt to GDP ratio. While there were considerable adjustments made as part of the amendment to the 2024 budget, particularly the correct decision to raise the VAT rate, many of the other measures did not reflect structural and continuing adjustments, as we pointed out then, which makes it necessary to include additional measures in the coming budgets.
* As I have noted, the numerator document emphasizes the need for significant adjustment measures in the 2025 budget in order to converge toward stability in the debt to GDP ratio in the coming years. These adjustments must be made in an informed and measured manner, while avoiding harm to growth engines that are important to the economy such as investment in high-quality education for all population sectors and development of high-quality infrastructure, with an emphasis on public transit. These investments have the potential to increase productivity, raise the level of human capital in the economy, and contribute to sustainable long-term growth.
* Moreover, we must take into account that the numerator does not include some of the coalition budgets, which have become considerable amounts directed to issues that do not necessary encourage growth. If the government wants to renew these budgets, it could increase the challenge in making the necessary adjustments and require additional measures beyond that is presented in the numerator document.
* Beyond the baseline scenario presented in the numerator, the document presents a number of prominent risks that may worsen the fiscal situation. First, there is a budgetary risk derived from a possible expansion of the war to additional and more intense spheres. Second, while the growth forecast on which the numerator document is based is reasonable under the assumptions mentioned in it, there is a risk that an extension of the current war situation, with all of its economic, diplomatic, and social implications, will lead to a more significant impact to GDP in the intermediate term. Finally, there is uncertainty regarding defense expenditures in view of the war—both those derived directly from the costs of the fighting, which may be higher than the Ministry of Finance’s assumptions, and those derived from decisions that may be made regarding the long-term strengthening of the IDF. This balance of risks emphasizes the need to be fiscally responsible during the current period.
* At this opportunity, it is worth noting the importance of moving forward with the establishment of the public committee to examine the defense budget, as the Bank recommended back in January.
* With regard to the work of the Committee, the defense and civilian costs of the war amount to hundreds of billions of shekels, and the future defense budget is expected to grow in a permanent fashion. Therefore, it is worth having the committee examine these processes with an overall, multiyear view, including the composition of the budget and the constant demand that the defense establishment be streamlined. The committee will need to formulate recommendations that properly balance security needs with the budgetary challenges and the various needs of the economy. A prosperous economy needs defense, and defense needs a prosperous economy.