BANK OF ISRAEL
Office of the Spokesperson and Economic Information

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Research Department Staff Forecast, April 2022

Abstract

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

According to the forecast, GDP is expected to grow by 5.5 percent in 2022, and by 4.0 percent in 2023, such that in 2023, the level of GDP will develop similar to the precrisis trend. The inflation rate in the coming four quarters (ending in the first quarter of 2023) is expected to be 3.1 percent. The inflation rate in 2022 is expected to be 3.6 percent, 2 percentage points higher than in the previous forecast, and inflation in 2023 is expected to be 2 percent. According to the forecast, the monetary interest rate is expected to be 1.5 percent one year from now (in the first 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 moderate by about 0.9 percentage points in 2022 relative to the previous forecast, to 3.0 percent, and that in 2023 it will be 2.3 percent (about 0.2 percentage points lower than in the previous forecast). Most of the revision is explained by assessments by the international institutions regarding the effects of the war in Ukraine and the sanctions that have been imposed: the loss of about 1 percentage point from growth in the advanced economies during the coming year.

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[1] The forecast was presented to the Bank of Israel Monetary Committee on April 10, 2022, prior to the decision on the interest rate made on April 11, 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.

The inflation rate in the advanced economies is forecast to be 5.0 percent in 2022 and 2.0 percent in 2023—including a contribution of about 2 percentage points during the coming year as a result of the war. The average interest rates of the central banks are expected to be very high relative to the January forecast, at about 1.3 percent in one year from now (compared with 0.3 percent in the previous forecast). At the end of 2022, the interest rate is expected to be and 1.1 percent (compared with 0.3 percent in the previous forecast), and at the end of 2023 it is expected to be 1.6 percent (compared with 0.6 percent in the previous forecast). The average price of Brent oil has been very volatile in recent weeks, and was about $98 per barrel in the first quarter, about 24 percent higher than the average price in the fourth quarter.

b. Real activity in Israel

GDP is expected to increase by 5.5 percent in 2022, and 4.0 percent in 2023 (Table 1). We note that the second estimate for the fourth quarter of 2021 indicates a growth rate of 17.6 percent in annual terms, which is significantly higher than our assessment of 6.3 percent in the January forecast. It is likely that fourth quarter growth was anomalous, and that in the coming quarters, growth will be more moderate. While the high growth in 2022 reflects a return to the precrisis trend, our assessment is that in 2023, GDP will develop similarly to the precrisis trend, and the (adjusted) employment rate will be similar to its precrisis level of about 61 percent.

In our assessment, the war in Ukraine and the sanctions on exports are not expected to have a significant impact. First, Israel's direct trade with Russia and Ukraine amounts to only about 1 percent of Israel's total trade. In addition, while an impact to exports is expected due to the moderation of world trade, it is expected to be offset by growth in the export of goods that are substitutions for Russian goods (such as potash) and the potential of increased defense exports. In addition, we assume that the increased immigration will have a limited macroeconomic effect

Table 1
Research Department Staff Forecast for 2022–2023

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

	2021	Forecast for 2022	Change from the January forecast	Forecast for 2023	Change from the January forecast	
GDP	**8.2**	**5.5**	**0.0**	**4.0**	**-1.0**	
Private consumption	11.7	8.0	0.0	5.0	0.0	
Fixed capital formation (excl. ships and aircraft)	11.4	5.0	-1.0	4.0	-4.0	
Public consumption (excl. defense imports)	3.3	4.0	1.5	3.0	0.0	
Exports (excl. diamonds and startups)	10.8	3.0	0.0	3.0	-2.5	
Civilian imports (excl. diamonds, ships, and aircraft)	18.4	7.0	-1.0	4.5	-2.0	
GDP deviation from the precrisis trend (percent)	**-1.8**	**-0.2**	**1.5**	**0.1**	**0.7**	
Unemployment rate[b] (average for the year, aged 25–64)	4.6	3.5	-0.4	3.4	-0.2	
Adjusted employment rate[b] (average for the year)	**57.0**	**60.7**	**0.5**	**61.0**	**0.4**	
Government deficit (percent of GDP)	4.4	1.4	-2.2	2.3	-1.1	
Debt to GDP ratio (percent)	69	67	-2	65	-4	
Inflation (percent)[c]	2.5	3.6	2.0	2.0	0.0	

[a] In the forecast of National Accounts components, the rate of change is rounded to the nearest half percentage point.
[b] The adjusted employment rate among those aged 15+. The adjusted employment rate does not include employees temporarily absent for an entire week for reasons having to do with COVID-19.
[c] 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.

Regarding fiscal policy, the deficit in 2022 is expected to be 1.4 percent of GDP—lower than the deficit ceiling and than our assessment in the previous forecast, in view of tax revenue that is much higher than expected. Due to the optimistic revenue forecast for 2023, no tax increases are expected. The deficit in 2023 will be affected greatly by the size of the budget upon which the government will decide.

c. Inflation and interest rates

According to our assessment, **inflation in the next four quarters (ending in the first quarter of 2023) is expected to be 3.1 percent** (Table 2). **Inflation in 2023 is expected to be 2.0 percent**. Our assessment of inflation in the first quarter of 2022 was revised upward by 0.8 percentage points, in accordance with developments

Regarding the domestic component of the CPI, while our assessment is that wages in the next two years are expected to increase in accordance with the trend, partly due to the update of public sector wage agreements, our assessment is that the GDP labor share will remain stable and that there will be no wage pressures on inflation. Regarding the housing component, our assessment is that it will increase at a rate similar to that of the overall CPI, or slightly above it, since we believe that the short-term forces that led to the moderation of real rents in the past year in view of the COVID-19 pandemic are subsiding, and that the component will again be in line with the long-term pace.

We expect that imported inflation, which accelerated recently, will slow later in the forecast's horizon. In terms of our assessment in the previous forecast (under the assumption of a stable exchange rate), the shekel depreciated by 1.6 percent against the basket of currencies in the first quarter of 2022 (average of the first quarter of 2022 against the average of the fourth quarter of 2021, in quarterly terms). This depreciation supports the upward revision in the inflation forecast for 2022. In addition, in view of the war in Ukraine and supply chain problems around the world, the increase in energy and commodity prices accelerated. This forecast expects that these prices will stabilize, and that the pace of imported inflation will decline accordingly. The inflation forecasts for the advanced economies indicate 2 percent in 2023.

Our assessment is that **the interest rate will be 1.5 percent in one year** (Table 2). The increases that have taken place in actual and expected inflation, which had led to a low real interest rate, reflect stronger monetary accommodation than in the past. This, together with the continued marked improvements in activity and in the labor market and the acceleration of expected interest rate increases abroad, support a path of gradual increases in the interest rate. This is in line with the Monetary Committee's assessment that the conditions allow for the start of a gradual process of raising the interest rate.

Table 2 shows that the Research Department's staff forecast regarding inflation in one year is slightly higher than the average of the private forecasters' projections and 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 similar to 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)	3.1	3.2	2.9 (1.2–3.5)
Interest rate[d] (range of forecasts)	1.5	1.55	0.92 (0.25–1.50)

a) Inflation expectations are seasonally adjusted (weekly average, April 4, 2022–April 10, 2022).
b) The average of forecasts published following the publication of the Consumer Price Index for February.
c) Inflation rate in the coming year. Research Department: in the four quarters ending in the first quarter of 2023.
d) The interest rate one year from now. (Research Department: in the first quarter of 2023.) Expectations derived from the capital market are based on the Telbor market (weekly average, April 2, 2022 to April 8. 2022).
SOURCE: Bank of Israel.

d. Main risks to the forecast

The main risks to the forecast are from potential developments in Ukraine and related sanctions, which may affect the development of global growth, trade, and inflation, and accordingly the development of the Israeli economy. Continued volatility in the prices of energy and commodities may be reflected in significant price changes and a restraining impact on activity and on investments. In addition, due to the war, if the wave of immigration is larger than expected, it may have implications for activity and inflation in the economy.

Another risk is the return of COVID-19 morbidity, which may delay the economy's return to full activity (mainly incoming tourism and the consumption of domestic services). In addition, an increase in security incidents may also have an impact on the development of consumption and economic activity. Lastly, it should be noted that political instability in Israel may have an impact on economic developments and on fiscal policy within the forecast's horizon.