**BANK OF ISRAEL**
Office of the Spokesperson and Economic Information

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# Research Department Staff Forecast, April 2021


## Abstract

This document presents the macroeconomic staff forecast formulated by the Bank of Israel Research Department in April 2021 concerning the main macroeconomic variables—GDP, inflation, and the interest rate. The forecasts published throughout the COVID-19 crisis contained two scenarios, in view of the high level of uncertainty throughout the crisis. In view of the progress of the vaccination campaign and the decline in morbidity in recent months, this forecast contains a single main scenario based on the assumption that there will be no significant worsening of morbidity within the forecast range that would make it necessary for the government to reimpose restrictions on economic activity with significant macroeconomic implications.

According to the forecast, GDP is expected to grow by 6.3 percent in 2021 and by 5.0 percent in 2022, while the broad unemployment rate is expected to decline to 6 percent by the end of 2022. The GDP level during these years is expected to be higher than in the "rapid inoculation" scenario from the forecast published in January, and in 2022 it is expected to be just 1.4 percent lower than the level expected according to the precrisis trend. The inflation rate in the coming four quarters (ending in the first quarter of 2022) is expected to be 1.1 percent, and inflation in 2022 is expected to be 1.2 percent—both higher than the rates in the rapid inoculation scenario from the January forecast. According to this forecast, the monetary interest rate is expected to be 0.1 percent one year from now.

There is significant uncertainty regarding the policy path that the incoming government will adopt. As part of the forecast, we assume that the "COVID boxes" that were approved will not be fully utilized thanks to the economic recovery, and that the government will not approve additional boxes. In addition, we assume that within the basic budget, which does not include the "COVID boxes", the government will adjust its expenditures to the expenditure ceiling set out by law[1], and that from 2022 onward, it will also act to gradually reduce the structural deficit. Under these assumptions, the government deficit is expected to be 8.2 percent of GDP in 2021, and 3.6 percent of GDP in 2022. The debt to GDP ratio is expected to be about 77 percent in each of these two years.


[1] In 2021, this means an increase of the budget by about NIS 6 billion, beyond the interim budget currently set out by the law, and beyond the "COVID boxes".

**The Forecast**

In this forecast, as in the recent forecasts published, special emphasis is placed on an analysis of the volume of activity in the economy as a result of government restrictions to fight the spread of the virus. In addition, the forecast contains information from various other indicators and models. The Bank's DSGE (Dynamic Stochastic General Equilibrium) model developed in the Research Department—a structural model based on microeconomic foundations—was used to combine them into a coherent macroeconomic forecast of real and nominal variables.[2]

**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 by foreign investment houses. Accordingly, we assume that GDP growth in the advanced economies will be 5.1 percent in 2021 and 3.6 percent in 2022—higher than the assessment upon which the previous forecast was based. The forecasts of world trade were also revised upward, with growth of 8.4 percent expected in 2021 and growth of 6.5 percent expected in 2022. The forecast of inflation in the advanced economies was revised upward to 2.0 percent in 2021 and 1.7 percent in 2022. The average interest rate of the central banks is expected to increase to about 0.2 percent by the end of 2022, similar to the assessments upon which the January forecast was based. Since the publication of the January forecast, the price of Brent crude oil increased from about $51 to about $66 per barrel.

**b. Real activity in Israel**

In view of the progress in the vaccination campaign and the decline in morbidity, the forecast focuses on a single baseline scenario that is similar in essence to the rapid inoculation scenario from the January forecast. In particular, we assume that there will be no significant worsening of morbidity within the forecast range that would make it necessary for the government to reimpose restrictions on economic activity with significant macroeconomic implications. Under this assumption, our assessment is that **GDP will increase by 6.3 percent in 2021 and by 5.0 percent in 2022** (Table 1).

Growth in 2020 was higher than our assessment in the January forecast, showing that from the second lockdown onward, epidemiological restrictions on economic activity had less of an impact on GDP than we previously estimated. Therefore, the forecast GDP levels for 2021 and 2022 were revised upward relative to the rapid inoculation scenario in the January forecast, and the forecast deviation of GDP from the precrisis trend was accordingly lowered. The closure of the gap with the trend is reflected in a slightly more moderate projected growth rate in 2022 compared with the rapid inoculation scenario from the January forecast, as the contraction in GDP in 2020 turned out to be more moderate. The growth forecast for 2021 remained unchanged. The convergence of the GDP level to the precrisis trend is expected to be accompanied by a gradual decline in the broad unemployment rate, but to a higher level than what prevailed prior to the crisis (an average of 7.5 percent in the final quarter of 2021 and an average of 6.0 percent in the final quarter of 2022).

[2] An explanation of the macroeconomic forecasts formulated by the Research Department, as well as a survey of the models upon which it is based, appear in Inflation Report number 31 (for the second quarter of 2010), Section 3c. 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.

In 2020, private consumption contracted sharply, due to the lockdowns and restrictions on activity that mainly affected the domestic trade and services industries, and despite the increase in households' disposable income during the year.[3] Accordingly, the removal of the restrictions in 2021 is expected to be reflected first and foremost in a recovery of private consumption, which is the most dominant factor in reducing the deviation of GDP from the trend this year. However, in 2022, the level of private consumption is expected to remain lower than the precrisis trend in view of the higher unemployment rate and a reduction in government transfers, which are expected to reduce households' disposable income compared to the precrisis trend.

Investment growth is also expected to recover during the forecast period, but the level of investments is expected to remain below the precrisis trend in view of the vast uncertainty the business sector will face in the coming period. Exports were only moderately affected in 2020, and are therefore expected to increase at a rate similar to their precrisis growth rate.

**Table 1**
**Research Department Staff Forecast for 2021–2022**
(rates of change, percent[a], unless stated otherwise)

| | 2020 | Forecast for 2021 | Change from the rapid inoculation scenario in the previous forecast | Forecast for 2022 | Change from the rapid inoculation scenario in the previous forecast |
|---|---|---|---|---|---|
| **GDP** | **-2.6** | **6.3** | **0.0** | **5.0** | **-0.8** |
| Private consumption | -9.5 | 11.0 | -1.5 | 7.0 | -1.0 |
| Fixed capital formation (excl. ships and aircraft) | -3.5 | 5.5 | 2.0 | 4.5 | -4.0 |
| Public consumption (excl. defense imports) | 2.9 | 4.0 | -2.5 | 2.5 | 3.5 |
| Exports (excl. diamonds and startups) | 1.3 | 4.0 | 1.0 | 4.0 | -0.5 |
| Civilian imports (excl. diamonds, ships, and aircraft) | -8.0 | 11.0 | 0.0 | 6.0 | -1.5 |
| **GDP deviation from the precrisis trend (percent)** | **-5.9** | **-3.1** | **1.2** | **-1.4** | **0.5** |
| Broad unemployment rate[b] - average for the year | 15.7 | 9.9 | 0.3 | 6.6 | 0.4 |
| **Broad unemployment rate[b] – fourth quarter** | **16.1** | **7.5** | **-0.2** | **6.0** | **0.6** |
| Government deficit (percent of GDP) | 11.6 | 8.2 | 0.2 | 3.6 | 0.0 |
| Inflation[c] | -0.7 | 1.3 | 0.7 | 1.2 | 0.3 |

[a] In the forecast of National Accounts components, the rate of change is rounded to the nearest half percentage point.
[b] Unemployment rate among those aged 15 and over. In accordance with the Central Bureau of Statistics broad definition, the unemployment rate includes the unemployed under the normal definition (someone who has not worked, wanted to work, was available for work, and looked for work), as well as employees temporarily absent for an entire week for reasons having to do with COVID-19 (including those on furlough), and those not participating in the labor force 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.

[3] In 2020, gross private disposable income grew by 3.9 percent, with about 40 percent of the growth due to an increase in transfer payments to households. For more information on the development of disposable income and its effect on private consumption, see Chapter 2 of the Bank of Israel *Annual Report* for 2020.

### c. Inflation and interest rates

According to our assessment, **inflation in the next four quarters (ending in the first quarter of 2022) is expected to be 1.1 percent** (Table 2)**. In 2021 and 2022, it is expected to be 1.3 and 1.2 percent, respectively** (Table 1)**.** The forecast was revised upward relative to the rapid inoculation scenario from the January forecast in view of the Consumer Price Index readings that were obtained since then, which were higher than we had forecast, and in view of the increases in global commodity prices and inflation forecasts, which are expected to contribute to an increase in the inflation of tradable goods prices during the forecast period.

Our assessment is that in the short term, there will be a number of forces working to increase inflation in the prices of nontradable goods and services as well. First, in view of the relaxation of restrictions on activity, we expect an increase in demand for services that were restricted in the past year (such as restaurants, leisure, and internal tourism). Second, household's accumulated savings during the past year are expected to contribute to this demand. The effect of these forces is expected to be significant in the short term, but to subside later in the forecast period. In particular, our assessment is that inflation in the prices of nontradable goods and services will increase gradually until the end of 2022, but to a level that is slightly lower than what was prevalent prior to the crisis. This is because the unemployment level is expected to remain higher, and government support is expected to decline, such that total household disposable income is expected to be lower than the precrisis trend.

Our assessment is that **the interest rate will be 0.1 percent in a year** (Table 2). The low level of the interest rate, which is part of the set of tools used by the Bank of Israel to deal with the crisis and the exit from it, supports the recovery of demand and the entrenchment of inflation within the target range. If further accommodation is necessary beyond the accommodation of the monetary interest rate, the Bank of Israel will be able to use existing or additional policy tools.

Table 2 shows that the Research Department's staff forecast regarding inflation and the interest rate in one year is similar to the average of the private forecasters' projections, and slightly lower than expectations derived from the capital market. We emphasize that in view of the close proximity of the forecast's publication date to the publication of the March CPI, the forecasters' projections and expectations derived from the capital market in Table 2 are those that were obtained prior to the publication of the CPI.

**Table 2**
**Inflation and interest rate forecasts for the coming year**

(percent)

| | Bank of Israel Research Department | Capital markets[a] | Private forecasters[b] |
|---|---|---|---|
| Inflation rate[c] (range of forecasts) | 1.1 | 1.5 | 1.0 (0.2–1.4) |
| Interest rate[d] (range of forecasts) | 0.10 | 0.13 | 0.09 (-0.1–0.1) |

a) Average expectations in the week prior to the publication of the March CPI. Inflation expectations are seasonally adjusted.
b) The average of forecasts published prior to the publication of the March CPI.
c) Inflation rate in the coming year. Research Department: in the four quarters ending in the first quarter of 2022.
d) The interest rate one year from now. (Research Department: in the first quarter of 2022.) Expectations derived from the capital market are based on the Telbor market.
SOURCE: Bank of Israel.

## d. Main risks to the forecast

As stated, in view of the data accumulated since the publication of the previous forecast, this forecast focuses on a main scenario that is similar in nature to the rapid inoculation scenario from the January forecast. However, our assessment is that the risks to the success of the vaccination campaign have not completely disappeared. For instance, the risk of the development of a rotation that is resistant to the vaccination or that will be reflected in more serious morbidity among the unvaccinated population remains. It also may turn out that the vaccine will be effective for a shorter amount of time than currently expected. Our assessment is that if these risks are realized, the government will take steps to limit activity, similar to the slow inoculation scenario from the January forecast. However, in view of the data from the second and third lockdown periods, our assessment is that such restrictions will have a limited effect on macroeconomic activity. In addition to the morbidity risks, there is significant uncertainty regarding the timing of the passage of the budgets for 2021 and 2022, as well as the nature of those budgets, and regarding measures the incoming government will take in all areas of its activity.