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January 14, 2021

Statement by Mr. Massourakis and Mr. Spadafora on Israel
(Preliminary)
Executive Board Meeting
January 19, 2021

We thank staff for an informative set of reports and Mr. De Lannoy and Mr. Tsur for their candid Buff statement. We broadly agree with the thrust of the staff's appraisal and policy recommendations. We would like to offer a few additional comments for emphasis.

- **The Israeli economy is coping with the unprecedented impact of the COVID-19 pandemic, which resulted in a historic GDP contraction despite an appropriate policy response, relatively low vulnerabilities before the crisis and large fiscal and financial buffers**. Amid persistently high uncertainty – including from recent political instability – the outlook remains challenging and downside risks prevail. On a positive note, vaccinations seem to be off to a swift start.
- In view of a gradual and rather partial recovery, **we agree with staff that it is essential the 2021 budget preserve an fiscal stimulus** and be adjusted – while becoming more targeted – if downside risks materialize; for its part, fiscal consolidation should start only once the recovery is firmly established. In staff's view, with an output gap that is expected to close as early as 2025, the unemployment rate is projected to remain slightly higher than the pre-COVID level because of scarring effects. We thus support the staff's call on the authorities to put a premium on improving labor activation policies, strengthening the social safety net and fostering job-rich investment; fostering digitalization promises to be the avenue of choice to boost productivity.
- **The prompt and comprehensive response by the Bank of Israel has been critical to reverse market instability, restore confidence and sustain an adequate supply of credit to the economy**. Several reasons – such as low near-term inflation expectations, negative output gap projections and uncertainties on renewed lockdowns – justify the staff's recommendation that monetary accommodation through unconventional measures and liquidity support should be maintained. *In the face of the ongoing discussion on the availability of banks' capital buffers during the crisis, we would like to ask staff for an assessment of the extent of actual usage of capital buffers by Israeli banks, also*

considering the initial tightening of macroprudential standards at the beginning of the pandemic.

- **We share the staff's call on the authorities to see the current crisis also as an opportunity to tackle pre-COVID legacies that have stalled productivity and raised inequality and poverty. Structural policies should also aim to mitigate long-term scarring and strengthen the resilience of the economy**. It is notably unfortunate – but hardly surprising – that the impact of the pandemic on unemployment and furlough rates of low-productivity workers appears to be disproportionately larger than the output contraction. Addressing vulnerabilities in the labor market should thus take priority, notably by stepping up active labor market policies that can also be instrumental in limiting hysteresis effects.