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January 14, 2021

Statement by Mr. Palotai, Mr. Just, and Mr. Meizer on Israel
(Preliminary)
Executive Board Meeting
January 19, 2021

We thank staff for the high-quality report, and Mr. De Lannoy and Mr. Tsur for their informative Buff statement. While the Israeli economy has shown resilience in the face of the pandemic, the dissolution of parliament in December 2020, the growing political fragmentation as well as the third wave of the pandemic significantly weigh on the outlook. Therefore, both fiscal and monetary policies should remain accommodative until the recovery is well entrenched. Boosting productivity through investment in physical and human capital is also critical to raise potential growth. We broadly share staff`s appraisal and policy recommendations, and would like to offer the following remarks for emphasis.

We welcome the authorities' large fiscal stimulus to soften the impacts of the pandemic as well as their efforts for a swift and general COVID-19 vaccine rollout. The fiscal expansion was largely appropriate in 2020, while the dynamic information and communication sector could remain a key building block of resilience. The authorities should be vigilant about the long-term hysteresis effects on employment, and place greater focus on labor activation policies, considering the high unemployment and furlough rate, especially of low-skilled workers. Without such policies Israel may face a further increase in inequality and larger structural unemployment over the long term. *We note that the broad unemployment rate was not included in the staff report, while this rate has remained at double-digit levels. Staff`s comment are welcome.* The authorities should also stand ready to deploy additional support measures if required, primarily targeting viable companies and supporting households. We are concerned about Israel's political uncertainty and the lack of an orderly government budget. *Can staff elaborate to what extent the ad-hoc budget expansions for this year limit crisis management as well as the financing of long-term structural plans. Given the difference in views between the authorities and staff on the GDP and debt forecast, we would also appreciate if staff could further elaborate on whether the latest developments have brought the forecasts closer together, and if not, what are the* *reasons behind it? We also wonder if a rapid vaccine rollout can offset other uncertainties?* We positively note that Israel`s export and current account remained resilient.

We welcome the Bank of Israel`s (BoI) swift and effective responses to the pandemic, which not only stabilized financial markets and restored confidence, but also helped prevent a credit crunch. We commend the BoI for decisively expanding their policy tools and its balance sheet with the objective to maintain and support financial stability. A continuation of loose monetary conditions appears warranted not only by the low-inflation environment and negative output gap projections but also the sharp appreciation of the shekel. *Could staff provide more details on whether the fundamentals are going to remain supportive of a strong shekel and how to assess the impacts of the central bank's latest interventions and announcement on the exchange rate? Given that the macroprudential and supervisory requirements were also eased, could staff also provide more details on the length of these measures and how the authorities plan to rebuild these buffers?* Furthermore, we take positive note of the BoI's broad range of steps to sustain the flow of credit to households and businesses. We also welcome the results of the BoI`s sensitivity tests according to which Israeli banks would stay stable even under medium severity scenarios. Nevertheless, the likely increase in insolvencies and rising asset quality problems need to be monitored, even if credit losses have been limited to date.

Further progress on structural reforms is necessary to address labor market segmentation, increase productivity, tackle inequality and poverty as well as to strengthen the resilience of the economy. While we welcome that investment support measures have been part of the fiscal stimulus package in response to the COVID-19 crisis, we would see merit in scaling up these programs. We encourage the authorities to accelerate the implementation of their reform agenda to avoid a partial recovery. At the same time, preserving some fiscal space to face the uncertain path to recovery is critical, while fiscal consolidation should resume in a growth friendly way, along with well-targeted measures. We concur with staff that a tax reform could help rebuild pre-crisis buffers, while also addressing structural weaknesses. As staff flagged, the current crisis is also an opportunity to tackle pre-COVID legacies in Israel. *Although the authorities agreed on the need for structural reforms, it would also be helpful to know how the authorities would prioritize and sequence these measures, also considering the available fiscal space. Staff`s comments are welcome.*