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

We would like to thank staff for their insightful report and Mr. De Lannoy and Mr. Tsur for their instructive buff statement, particularly on recent developments. We commend the authorities for their fiscal response, enabled by robust buffers going into the crisis, and the Bank of Israel's measures to maintain credibility and credit flow. We note and welcome the recent developments on the vaccine roll-out which, coupled with historic peace accords, improve the outlook and might create space for structural reform efforts when the political situation stabilizes.

We agree with staff's assessment that the fiscal response has been appropriate and encourage the authorities to pass a new budget when the political situation allows. The stimulus of 10.25% of GDP across health, employment and infrastructure has helped to mitigate the impact of the crisis, although we note that unemployment has increased. At the point it is possible to pass a new budget, we anticipate there will be greater visibility on the impact of the vaccine roll-out on the economy, but encourage the authorities to ensure that fiscal withdrawal adequately supports the economy and countenances the impact of longer than expected disruptions. We agree with staff that fiscal consolidation should only start once the recovery is firmly established and should focus on medium-term debt vulnerabilities and generating inclusive growth, particularly tax reforms that balance incentivizing labor market participation and raising revenue.

We welcome the Bank of Israel's fast and effective response, including its willingness to adopt unconventional measures via asset purchase given limited space to reduce interest rates. Alongside this, measures to ease macroprudential and supervisory requirements – facilitated by banks substantial capacity to face large shocks, have succeeded in providing liquid, preserving credit flow and maintaining stability. Nevertheless, we wonder if monetary policy should be eased further: although inflation expectations remain within the target band, actual inflation has persistently undershot the target over the past six years and is currently negative and staff do not expect the output gap to be closed until 2025.

The authorities are described as emphasizing unemployment over inflation, but it is not clear from the papers that there is a trade-off here – loosening policy should help close the output gap at a preferable pace, reduce unemployment and raise inflation to target. *Could staff elaborate further on why the authorities perceive there to be a trade-off between inflation and unemployment at the current juncture, and could staff explain why they are not advising a faster closing of the output gap and earlier return of inflation to target?*

While scarring is projected to be relatively limited due to the higher share of the ICT sector in Israel's value added, it remains imperative that structural reforms address vulnerabilities in the labor market. The impact of furloughing and job losses are unevenly distributed, concentrated in contact-intensive sectors. A consequence of this is that Arab workers, part-timer workers and those with low skills have been disproportionately impacted. Measures that assist reskilling, digitalization and address the educational losses resulting from lockdowns, will all be critical to ensure that there is not a long-term increase in structural unemployment.