GRAY/21/192

January 14, 2021

Statement by Mr. Buissé, Mr. Rozan, and Mr. Roman on Israel
(Preliminary)
Executive Board Meeting
January 19, 2021

I would like to thank staff for their insightful report and Mr De Lannoy and Mr Tsur for their instructive buff statement.

The Israeli economy entered the COVID-19 pandemic with a strong position, after several years of prudent macroeconomic policy making, strong growth and low unemployment. The authorities' swift and decisive actions helped mitigate the economic fallout and protect livelihoods and businesses. Accommodative policies should be maintained as long as growth is not firmly entrenched, given the fiscal space. Recovery measures should aim at further addressing the challenges the country has to face, in particular the duality of the economy and inequalities in certain segments of the population. We broadly share staff's assessment and wish to highlight the following points.

On the back of solid growth over the past decade, contraction of the economic activity was significant, though we note that real output contraction was somewhat milder than that of other advanced economies, reflecting the small share of heavily affected sectors in gross value added. While the rise in new COVID-19 cases in December and early-January necessitated imposing a third nation-wide lockdown, on the upside, we note that early widespread vaccine distribution could boost confidence in the near term, allow activity to resume faster, and prevent medium-term scarring. In this context, we wonder if the upside scenario has not become more central as a result of this strategy. *Staff comments would be welcome.*

We share staff's appraisal that the volume of fiscal support has been adequate thus far and should be extended for as long as is needed to protect livelihoods and limit economic and social scarring. Support for households (benefits for unemployed and furloughed workers and grants for the self-employed) and businesses (notably guaranteed loans for SMEs) helped soften the impact of the pandemic. It will be important that fiscal policy remain supportive in 2021, notwithstanding the political uncertainty and the need to rely on an interim budget. The authorities do have policy space, and fiscal consolidation should be undertaken only once the recovery is on firm ground. We agree with staff's assessment that it will have to be primarily based on revenues measures, and especially tax reform, to restore fiscal buffers while also ensuring more inclusive growth. We encourage the authorities to start planning for this, in particular through the reform of personal income tax rates; also, profit-based corporate tax incentives could be scaled back.

On the monetary side, both conventional and unconventional measures taken by the Central Bank were timely and appropriate. Easing of macroprudential and supervisory requirements also helped provide liquidity and limit volatility. Even though 5- and 10-year inflation expectations remain anchored within the 1–3 percent inflation target band, we note that the price level declined in May and has remained suppressed since then, and that near-term inflation expectations are below target, deserving close monitoring. On the currency side, we would welcome further analysis by staff on the level of the shekel, which has appreciated over the past few years, on the back of the very dynamic tech ecosystem, with negative side effects on more traditional sectors. *Staff elaboration on how policy makers could address the impact of the exchange rate on these sectors would be welcome.*

On the financial sector, we share staff's assessment that Banks' capital remains strong, with substantial capacity to face large and prolonged shocks and we concur with the recommendation that the level of minimum regulatory capital should not be lowered further (unless downside risks materialize), and structural buffers should eventually be restored.

We share staff's views that structural policies are needed to strengthen the resilience of the economy and address inequalities between low-skilled and high-skilled workers. Working on addressing the duality of the Israeli economy would be important and could be a focus of future article IV – in this regard, we welcome the indications in the buff statement of the authorities on the measures taken to increase productivity. Labor activation policies, improved digital penetration, and education reforms should be pursued. More investment in infrastructures would support the recovery and help create jobs, in a context where the stock of public capital is below that of peer countries and has long been due for an upgrade. Lastly, while the staff report only refer to competition from the standpoint of public procurement, we wonder if more analysis should not be pursued more generally. Past OECD work had evidenced deficiencies in the structure of the Israel economy in this regard, with relatively high concentration in certain sectors. *Staff comments would be welcome.*