ISRAEL*

Strong growth is projected to continue, but to cool slightly through 2020. Expansionary fiscal policy and low interest rates will boost domestic demand. The current account will nevertheless remain in small surplus. Inflation will rise towards the centre of the Bank of Israel's target range.

The planned budget deficits are high for this stage of the cycle. Steady fiscal consolidation will be needed to reduce public debt relative to GDP and ensure room for manoeuvre in the next downturn. With inflation rising back into the target range and unemployment low, the monetary authorities should consider raising currently ultra-low interest rates gradually.

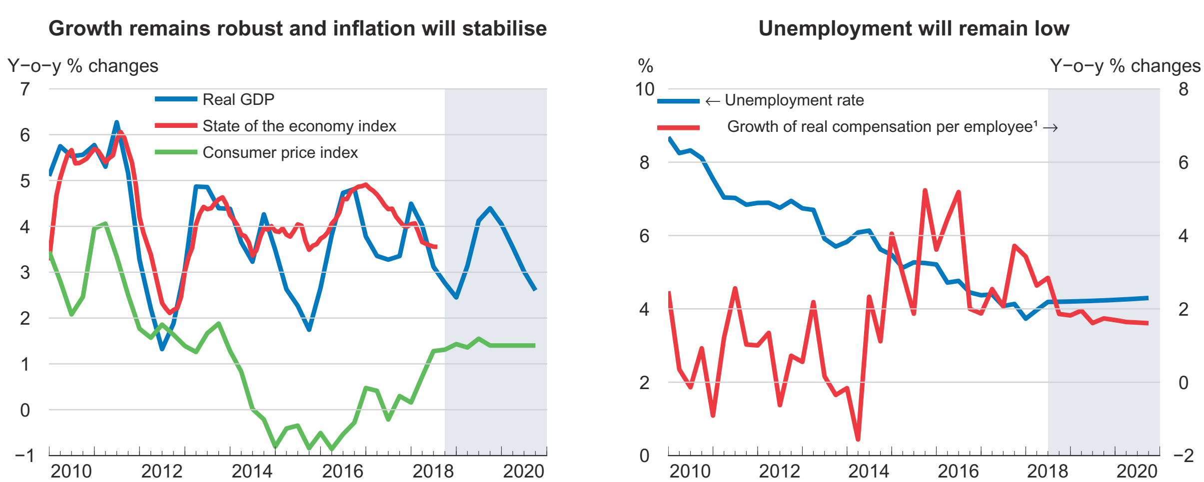
Underlying growth continues despite a mid-year blip

Underlying growth has remained strong despite a temporary slowdown in activity in mid-year. Housing investment has been falling quite fast, while other investment and consumer demand have remained buoyant. Unemployment has reached low levels, but is no longer declining. Inflation has trended up during the year as wage growth has picked up and energy prices have risen, but remains in the lower half of the central bank's 1-3% target range. The goods trade deficit has been rising, with strong import growth early in the year and rising energy prices.

Prudent fiscal policy is needed

Based on current commitments, higher government expenditure will boost growth through 2018-19. This increase in expenditure, which was partly fuelled by one-off

Israel



1. Deflated by the private consumption deflator.
Source: Bank of Israel; and OECD Economic Outlook 104 database.

StatLink http://dx.doi.org/10.1787/888933876879

* The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the west Bank under the terms of international law.

Israel: **Demand, output and prices**

	2015	2016	2017	2018	2019	2020
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 167.9	4.0	3.4	3.6	3.5	3.3
Private consumption	637.2	6.4	3.3	3.8	3.3	3.5
Government consumption	261.5	4.2	3.4	3.8	4.1	2.9
Gross fixed capital formation	221.6	12.8	2.9	3.1	3.0	2.6
Final domestic demand	1 120.3	7.1	3.2	3.6	3.4	3.2
Stockbuilding[1]	10.1	-0.4	0.2	1.3	0.2	0.0
Total domestic demand	1 130.4	6.7	3.4	5.0	3.6	3.1
Exports of goods and services	365.6	1.4	5.1	4.6	4.3	5.0
Imports of goods and services	328.1	10.2	5.0	9.7	4.7	4.4
Net exports[1]	37.5	-2.4	0.1	-1.3	-0.2	0.1
Memorandum items						
GDP deflator	_	1.0	0.2	-0.2	1.2	1.3
Consumer price index	_	-0.5	0.2	0.9	1.4	1.4
Core inflation index[2]	_	0.0	0.0	0.5	0.8	1.4
Unemployment rate (% of labour force)	_	4.8	4.2	4.0	4.1	4.1
General government financial balance[3] (% of GDP)	_	-1.4	-1.0	-3.0	-3.2	-3.0
General government gross debt (% of GDP)	_	62.0	60.4	61.6	62.1	62.5
Current account balance (% of GDP)	_	3.7	2.6	1.0	0.7	0.9

1. Contributions to changes in real GDP, actual amount in the first column.
2. Consumer price index excluding food and energy.
3. Excluding Bank of Israel profits and the implicit costs of CPI-indexed government bonds.

Source: OECD Economic Outlook 104 database.

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revenues, will make it more difficult for the government to meet its current fiscal targets. Furthermore, with a widening positive output gap, fiscal policy should avoid a pro-cyclical position, apart from measures to boost medium-term growth. Hence, expenditure cuts or tax hikes will be needed in the coming years to reduce the ratio of debt to GDP and to ensure sufficient room to manoeuvre in a possible downturn. The Bank of Israel has kept its policy rate at 0.1% since March 2015. With inflation back in the Bank's target range for the first time since 2013, still low unemployment and a widening positive output gap, a gradual increase of the interest rate, as projected, is needed.

Structural reforms to increase the labour market participation and productivity of disadvantaged groups, for example improved training of the Israeli-Arab and Ultra-Orthodox communities, as well as reforms targeting the functioning of product markets and public transport infrastructure, should be implemented to strengthen both supply conditions and social cohesion. Policies to close the relatively large gender wage gaps should also be pursued, for example by encouraging more female participation in science, technology, engineering or mathematical studies in secondary and tertiary education.

Growth is projected to stay robust

The projected increase in policy interest rates will help to slow private consumption and investment growth. Domestic demand will gradually decline, slowly raising unemployment rates towards long-term potential levels. In 2019, the development of new offshore gas fields is expected to reduce energy imports and boost the trade balance. Overall, these forces will support GDP growth which will nonetheless gradually decline towards more sustainable levels. Growing regional geopolitical tensions are a downside risk to the forecast, while a faster-than-expected development of offshore gas fields and new gas export deals could boost GDP growth.