ISRAEL*

After picking up to 4% in 2016, growth is projected to be around 3¼ per cent in 2017-18. Inflation is projected to firm up gradually. The maintenance of expansionary monetary and fiscal policies and projected wage increases will continue to shore up domestic demand.

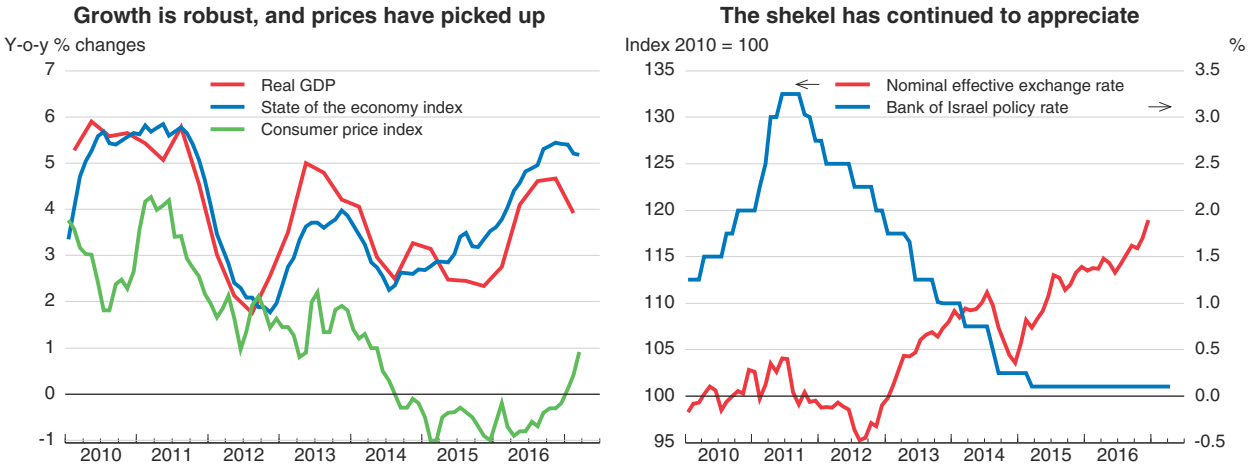
As inflation increases, the central bank is projected to gradually withdraw monetary stimulus. Despite having abated somewhat, ongoing tensions in the property market continue to require the authorities' attention to preserve a robust banking sector. With the economy at full employment, the budgetary expansion projected in 2017 could increase labour market tensions and slow the decline in government debt. Measures taken or announced in welfare, housing and transport should promote more inclusive growth.

Continued product market reforms are needed to stimulate productivity and pay in the sheltered sector where many of the lowest-skilled workers are employed. Increased external competition, especially in the agricultural and food sectors, would reduce the cost of living. Less restrictive import procedures, with lower non-tariff barriers, would deepen integration into global value chains, which is relatively limited. To ensure a better sharing of the benefits of this integration, a more effective education system, facilitating the integration of disadvantaged groups, would be desirable.

After a strong but transitory surge in late 2016, growth has eased

A slowdown occurred in early 2017, after the export rebound and the sharp pick-up of car sales in end-2016 that stimulated consumption and investment ahead of the introduction of new tax rules on polluting cars. Business investment and private spending

Israel



Source: Bank of Israel; and OECD Economic Outlook 101 database.

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* 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**

	2013	2014	2015	2016	2017	2018
	Current prices NIS billion	Percentage changes, volume (2015 prices)				
GDP at market prices	1 059.1	3.2	2.6	4.0	3.2	3.3
Private consumption	585.3	4.2	4.4	6.3	2.0	3.5
Government consumption	238.4	3.6	3.2	3.8	3.2	2.5
Gross fixed capital formation	215.4	0.0	0.1	11.2	2.2	6.4
Final domestic demand	1 039.1	3.2	3.2	6.7	2.3	3.9
Stockbuilding[1]	- 3.9	0.6	0.6	-0.7	-0.4	0.1
Total domestic demand	1 035.2	3.8	3.9	5.9	1.9	3.9
Exports of goods and services	353.6	1.5	-4.0	3.0	5.6	3.8
Imports of goods and services	329.7	3.8	-0.4	9.4	1.8	6.3
Net exports[1]	23.9	-0.7	-1.2	-1.7	1.2	-0.5
Memorandum items						
GDP deflator	_	1.1	2.7	1.1	1.2	2.0
Consumer price index	_	0.5	-0.6	-0.5	1.0	1.7
Private consumption deflator	_	0.6	-0.6	-0.2	1.2	1.8
Unemployment rate[2]	_	5.9	5.3	4.8	4.3	4.3
General government financial balance[3,4]	_	-3.2	-2.1	-2.1	-2.7	-2.7
General government gross debt[3]	_	66.0	64.1	62.2	62.4	62.1
Current account balance[3]	_	4.0	4.3	3.6	4.3	3.8

1. Contributions to changes in real GDP, actual amount in the first column.
2. Employment and unemployment data prior to Q1 2012 are derived from a quarterly labour-force survey that has since been replaced by a monthly survey, which included a number of methodological changes. The data prior to Q1 2012 have been adjusted to be compatible with the new series.
3. As a percentage of GDP.
4. Excluding Bank of Israel profits and the implicit costs of CPI-indexed government bonds.

Source: OECD Economic Outlook 101 database.

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on durables weakened sharply in early 2017. Conversely, exports have been holding up well to the rising shekel thanks to a strong performance in tourism and other services. Job creation has remained robust, and unemployment, which stood at 4.3% at the beginning of 2017, is at record lows. Wages have been picking up, but inflation remains low, owing partly to weakening import prices in the wake of the shekel appreciation.

Structural reforms are needed to complement accommodative macroeconomic policies

Monetary policy remains very accommodative, with the Bank of Israel's official rate remaining unchanged at 0.1% since March 2015. The Bank has been more interventionist in the currency market in recent months to contain the surge in the shekel, which seems partly caused by speculation. In the first quarter of 2017, the shekel effective appreciation reached 7.5% over one year. The rise in property prices has slowed but most recently has been still around 5% year on year. With the expected gradual rise in inflation, a progressive increase in policy interest rates is included in the projections.

The budget deficit reached 2.1% of GDP in 2016, and the budget plans assume a further rise to 2.9% of GDP in 2017 and 2018, based on a sharp increase in public spending. With the economy running at full capacity, this budgetary expansion should reinforce price increases and stimulate growth only moderately, but make it more inclusive by increasing

spending on housing for young families and transport. These developments would be further enhanced in the event that the additional measures, worth some 0.3% of GDP, recently announced by the Minister of Finance (but not included in the projections) to increase the employment rate of parents of young children and raise invalidity pensions were to be adopted. The need remains to step up reforms to promote competition in the sheltered sectors in order to leverage these measures, increase productivity and pay, and reduce the cost of living.

Growth should remain brisk

Supported by accommodative macroeconomic policies, growth should remain strong in 2017 and 2018 despite the negative impact of the currency appreciation on exports. With the ongoing resilience of the labour market and new minimum wage increases, consumer spending is projected to pick up and become again the main economic driver after a weak start to 2017. Increased capacity pressures, persistently low interest rates and government measures to improve transport infrastructure should also stimulate investment. Unemployment should remain low, and inflation should edge up to around 2% by 2018, driven by higher wages.

These projections would nevertheless be weakened if the shekel were to appreciate further still, or if the geopolitical situation or external climate were to deteriorate, for example in the event of problematic Brexit negotiations or a global return to protectionist policies. Conversely, domestic demand, buoyed by the recently announced budgetary measures, could be more robust than expected, which would further boost employment rates and salaries.