



GLOBAL ECONOMY AND IMPLICATIONS FOR ISRAEL

Aaron Institute for Economic Policy Annual Conference

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Outline

**World economic
outlook (WEO)**

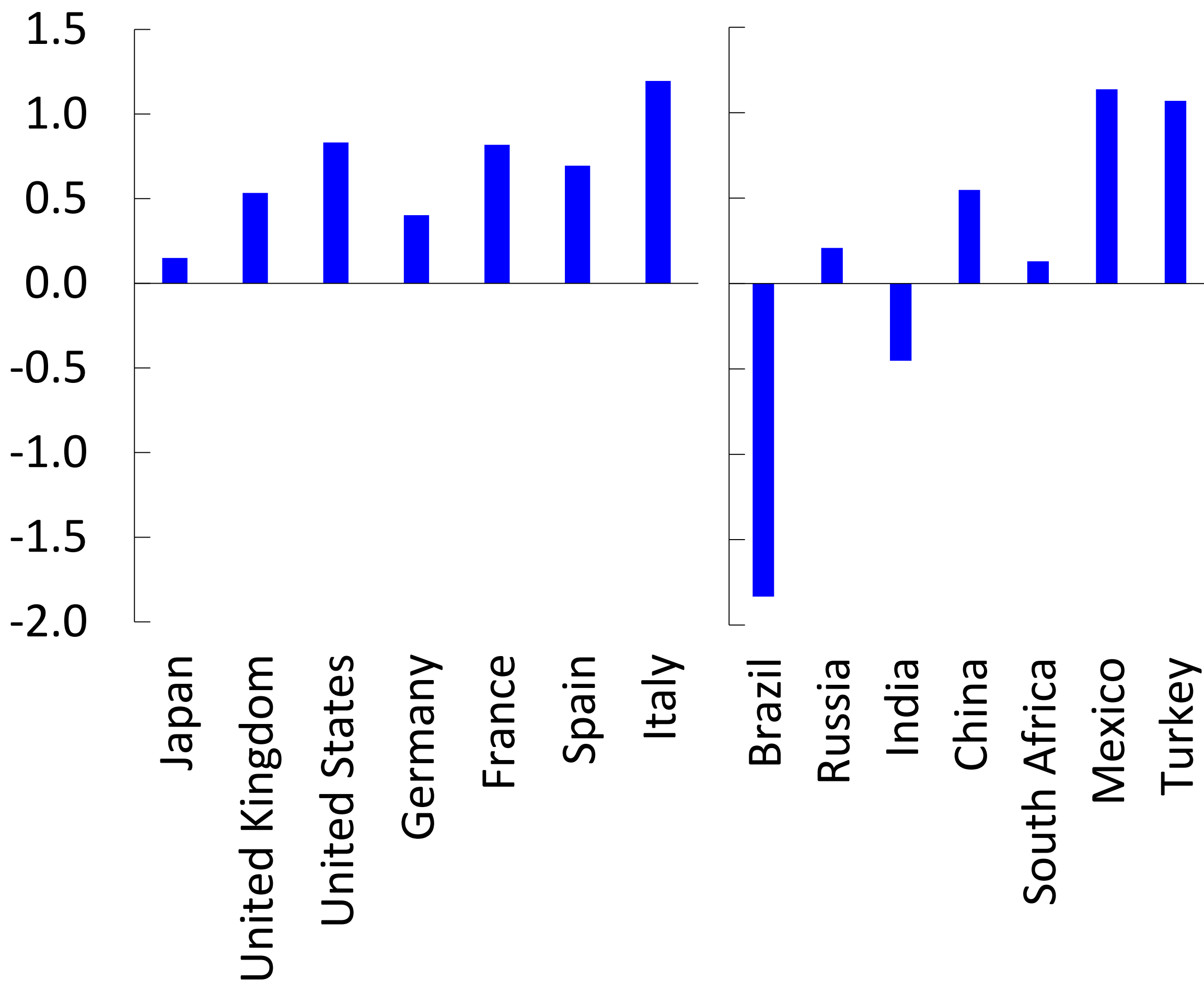
**Broader trends in
global economy**

Policy priorities for Israel

Market sentiment has improved since mid-2016

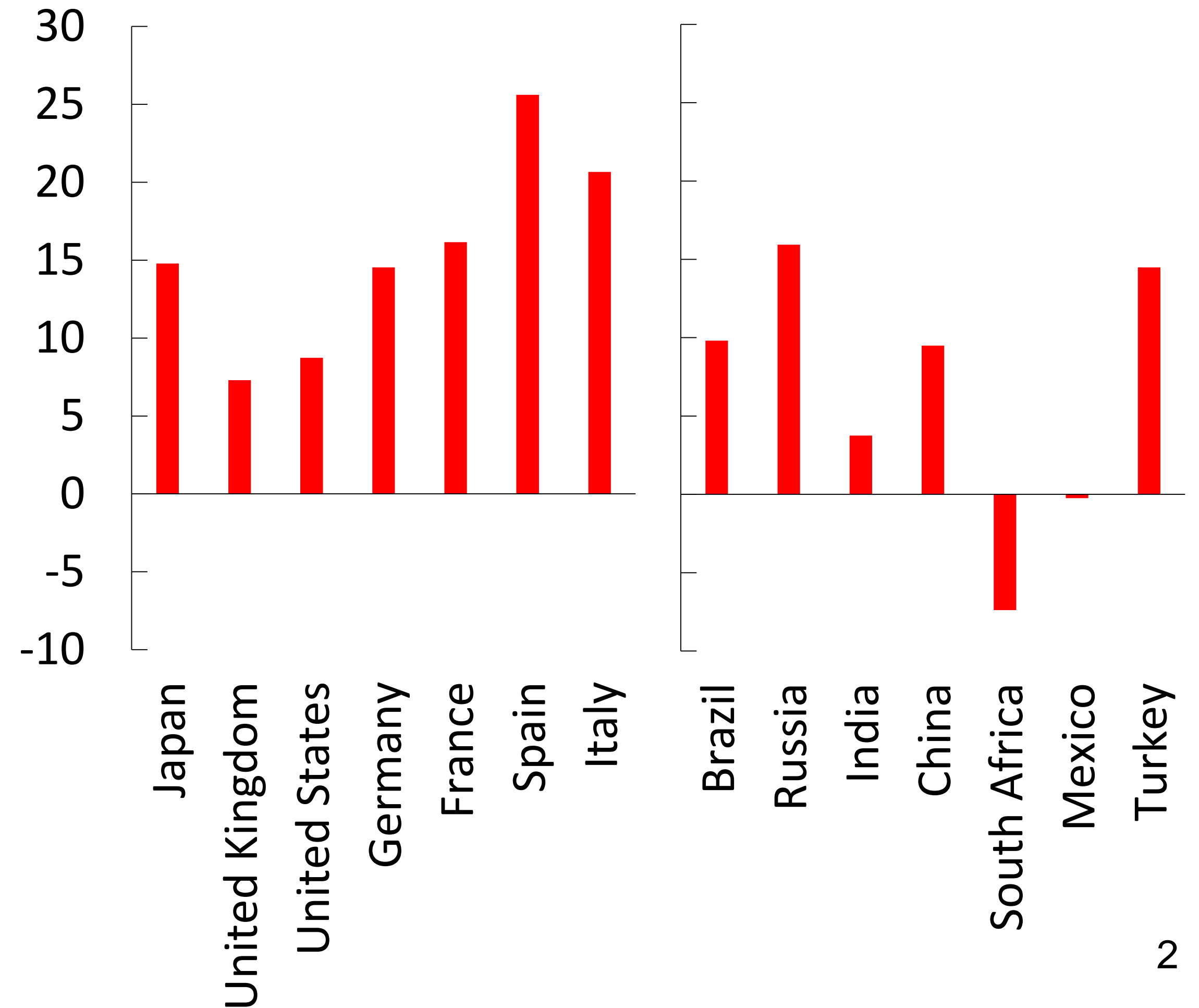
Change in bond yields since August 2016

(percentage points)



Equity price changes since August 2016

(percent)

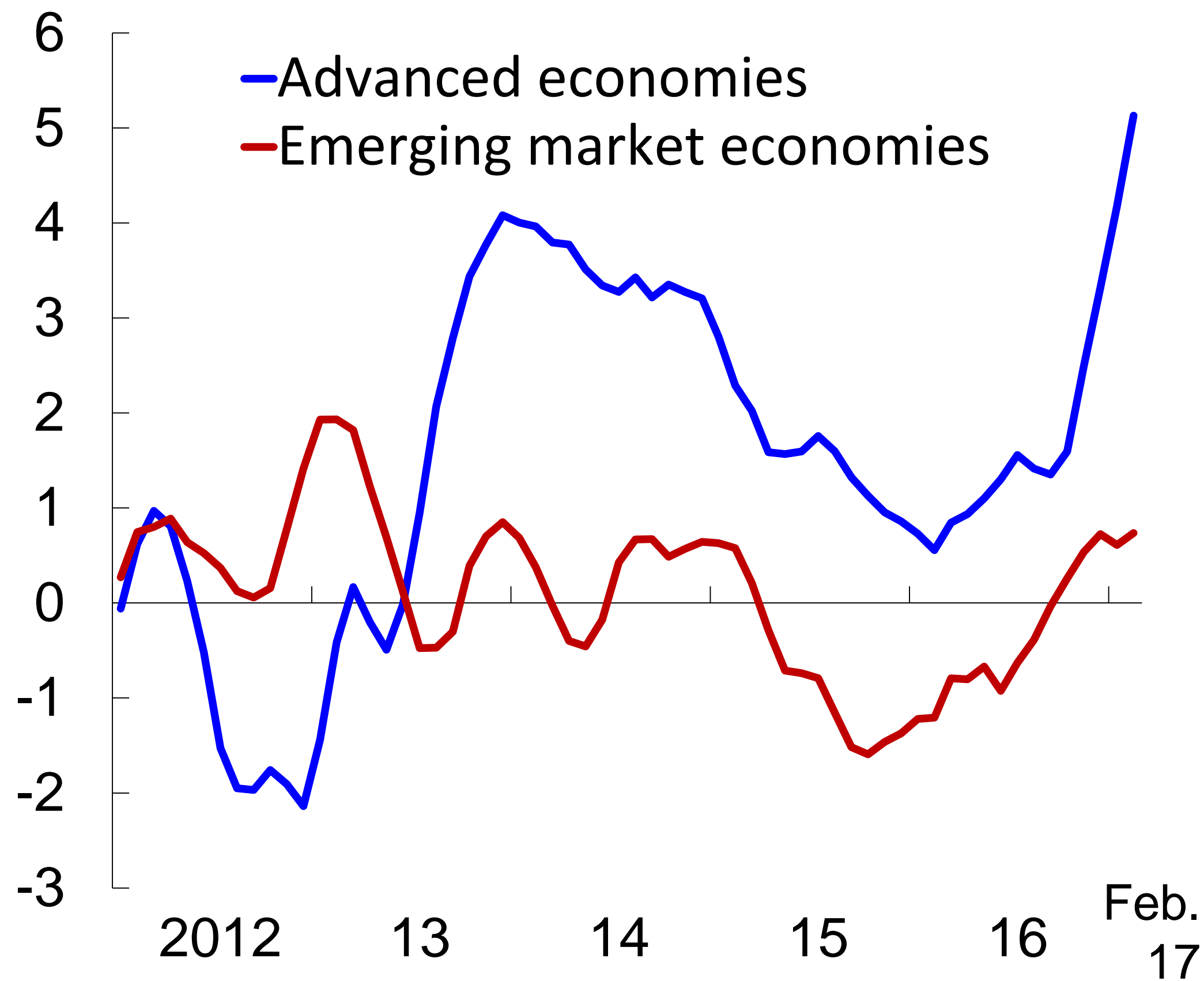


Source: IMF staff calculations.

Along with business and consumer confidence

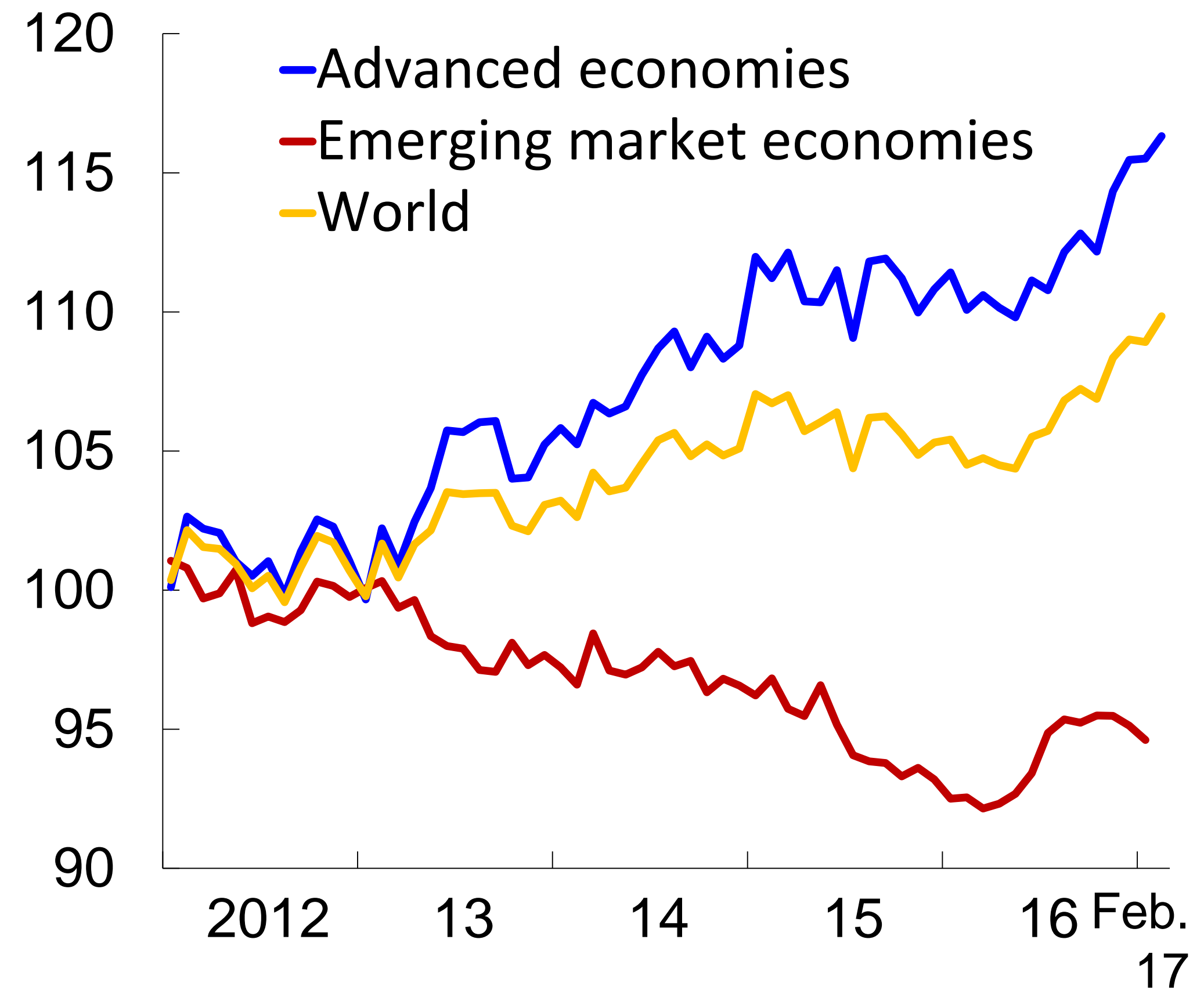
Manufacturing PMI

(three-month moving average; deviations from 50)



Consumer Confidence

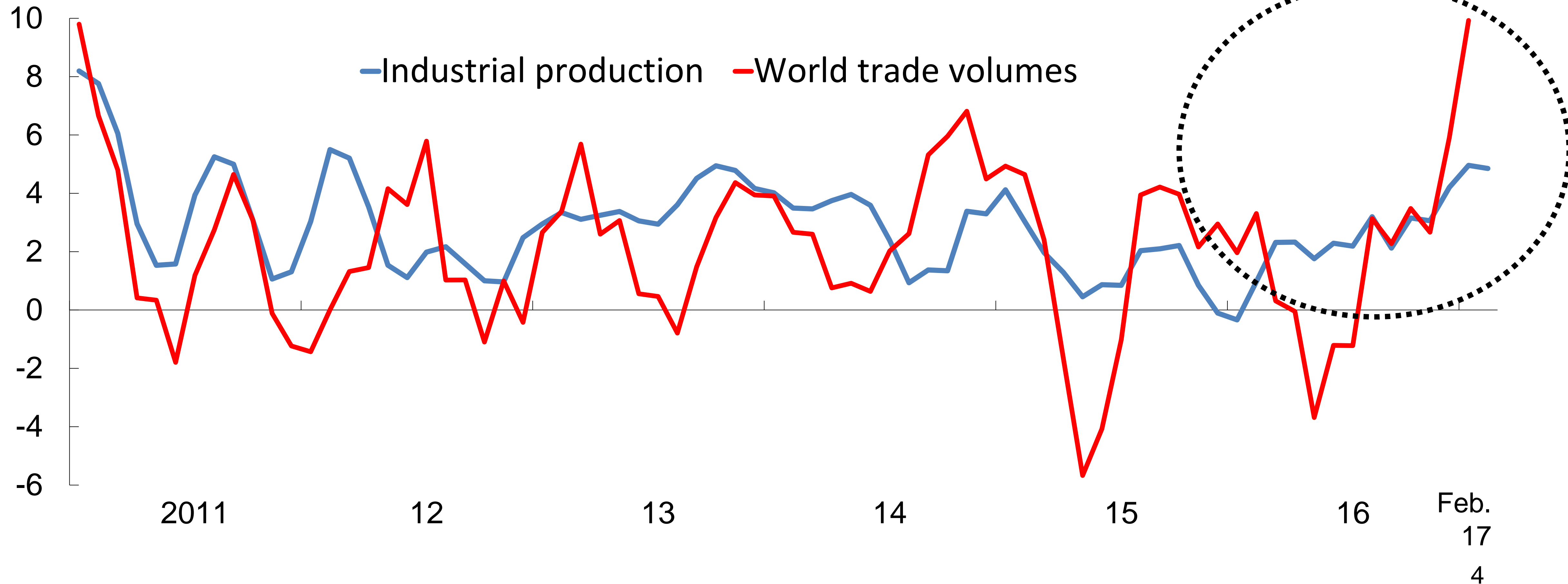
(index; 2010 = 100)



As global activity has begun picking up steam

World Trade and Industrial Production

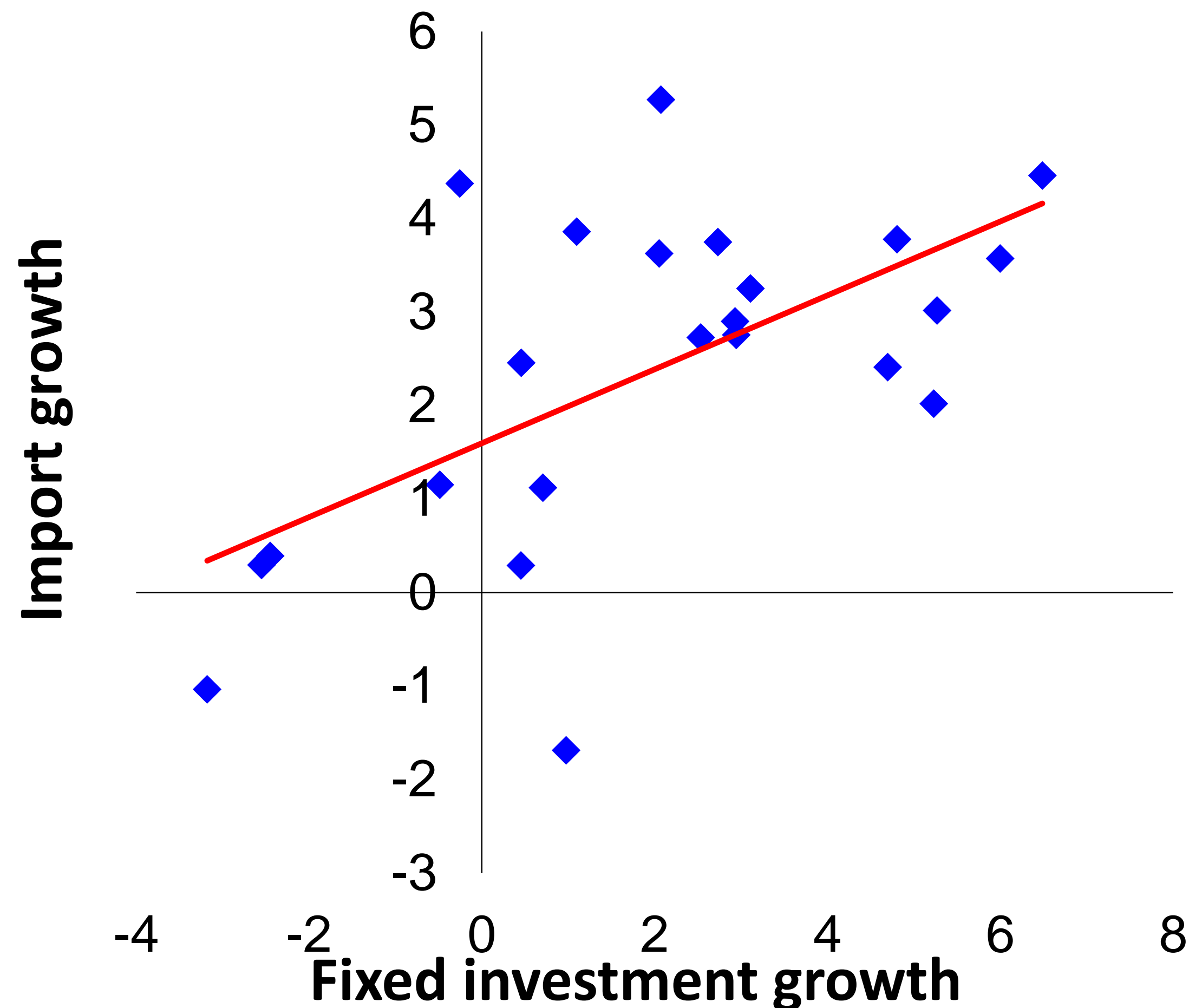
(three-month moving average; annualized percent change, unless noted otherwise)



Trade growth reflects improved investment

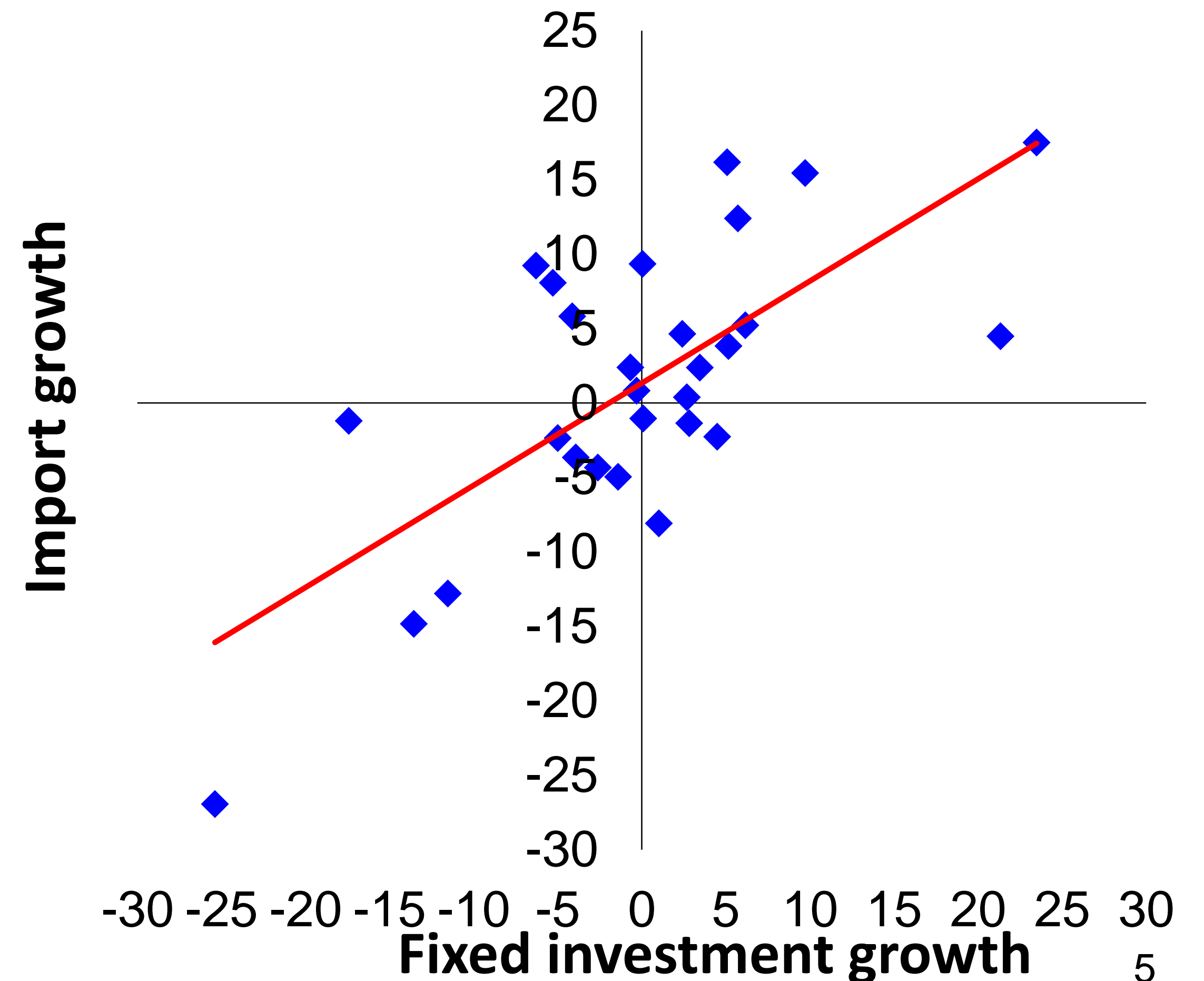
Advanced Economies

(percent; 2016)



Emerging Market and Developing Economies

(percent; 2016)



Forces shaping the outlook

Advanced economies

Emerging market and developing economies

Ongoing forces...

- Cyclical rebound & monetary stimulus
- Post-crisis repair varies
- Expansionary U.S. fiscal policy
- Rebalancing in China
- Adjustment to lower commodity prices
- Geopolitical and political factors

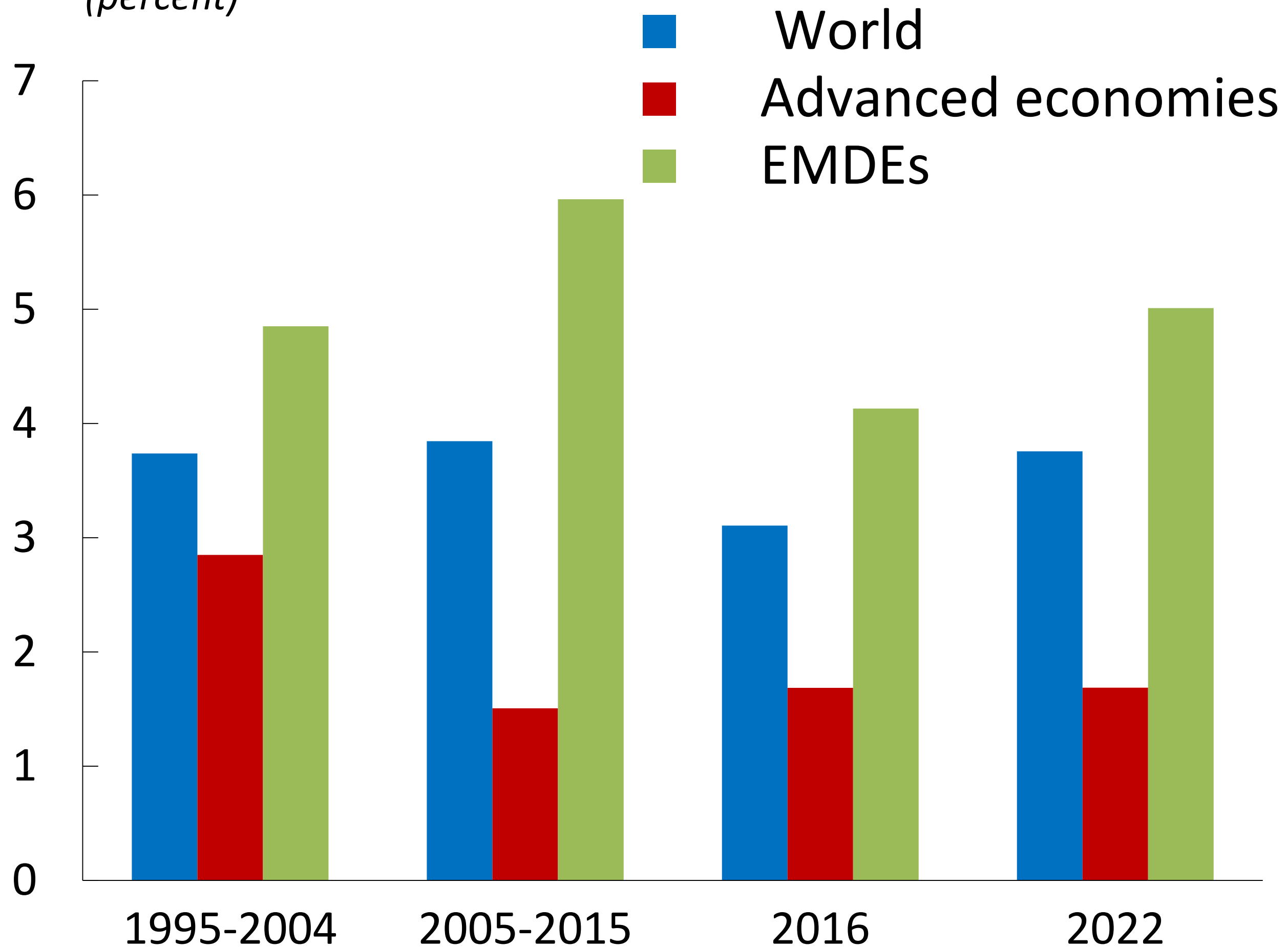
...overlaid on...

- Demographic headwinds
 - Weak productivity growth
- Demographic trends

World growth rises to 3.8% by 2022, from 3.1% in 2016, led by Emerging and Developing Economies

World GDP Growth

(percent)



Advanced Economies

Cyclical recovery in near term, subdued growth in medium term, at 1.7% in 2022.

Emerging Market and Developing Economies

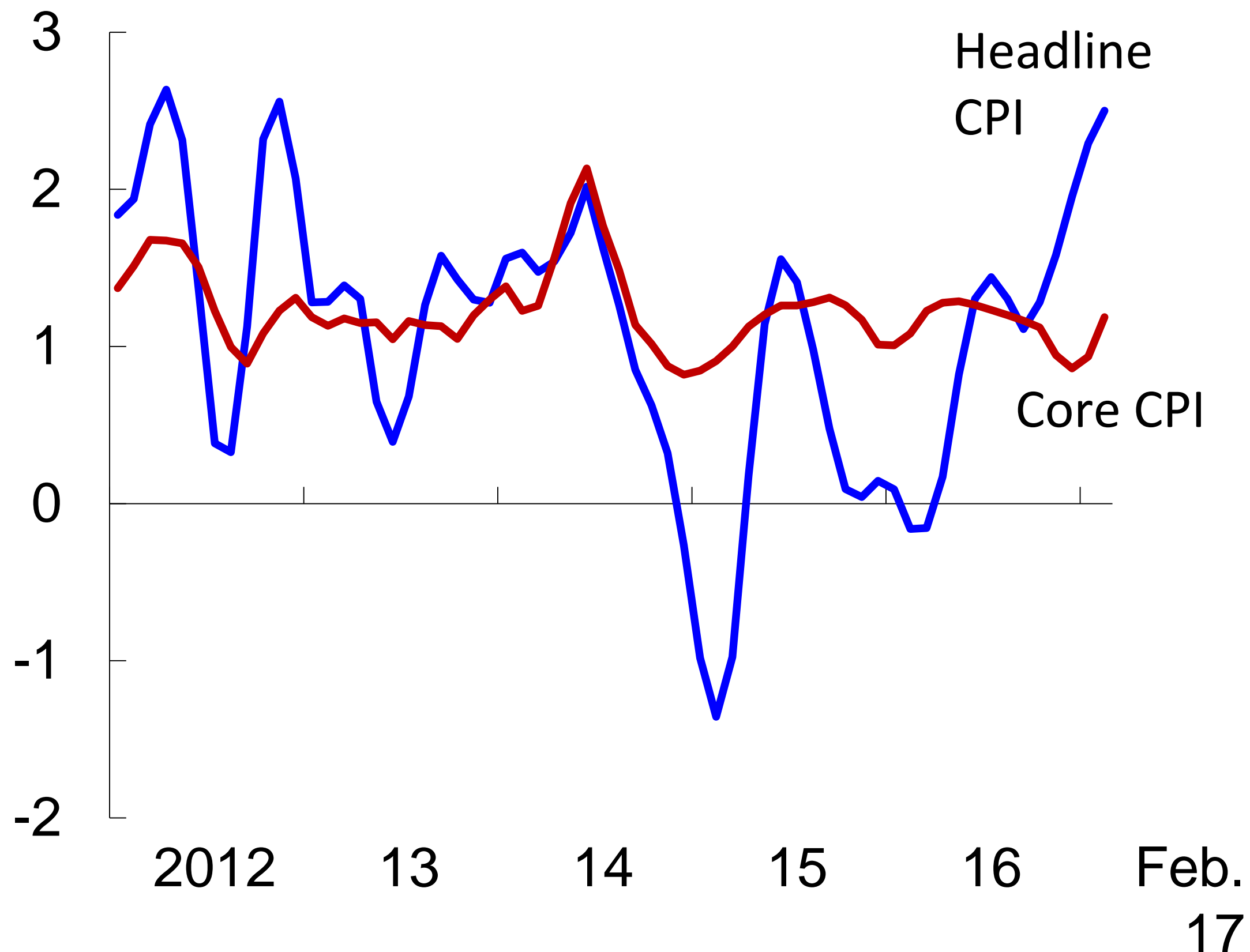
Stressed economies bottoming out, commodity importers generally projected to maintain high growth, overall growth of 5% by 2022.

Core inflation little changed even as headline inflation up recently

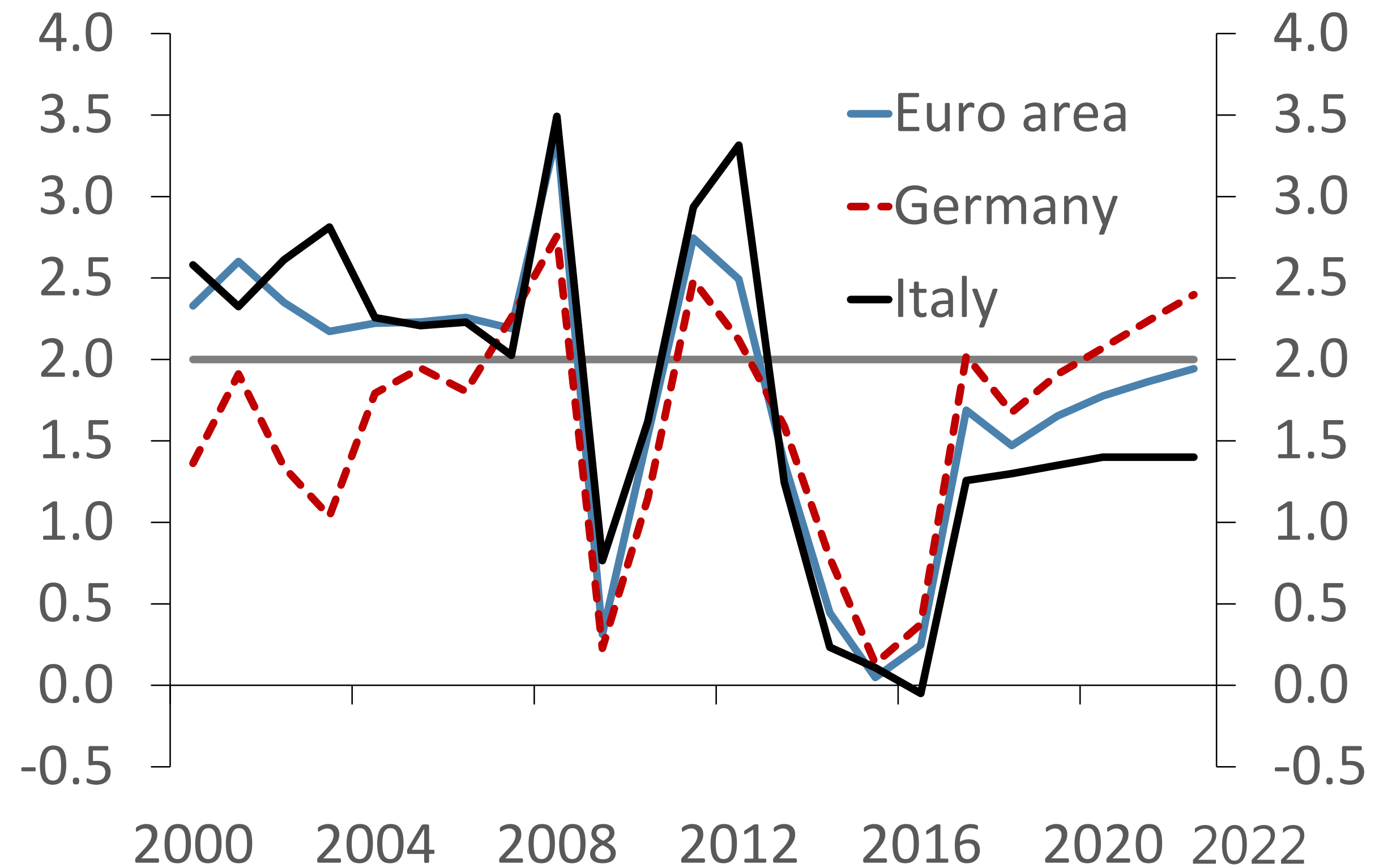
Euro Area inflation reaches 2% gradually, led by Germany

Advanced Economies

(three-month moving average; annualized percent change)



Euro Area Headline CPI Inflation



Source: World Economic Outlook, April 2017.

But global growth risks skewed to downside

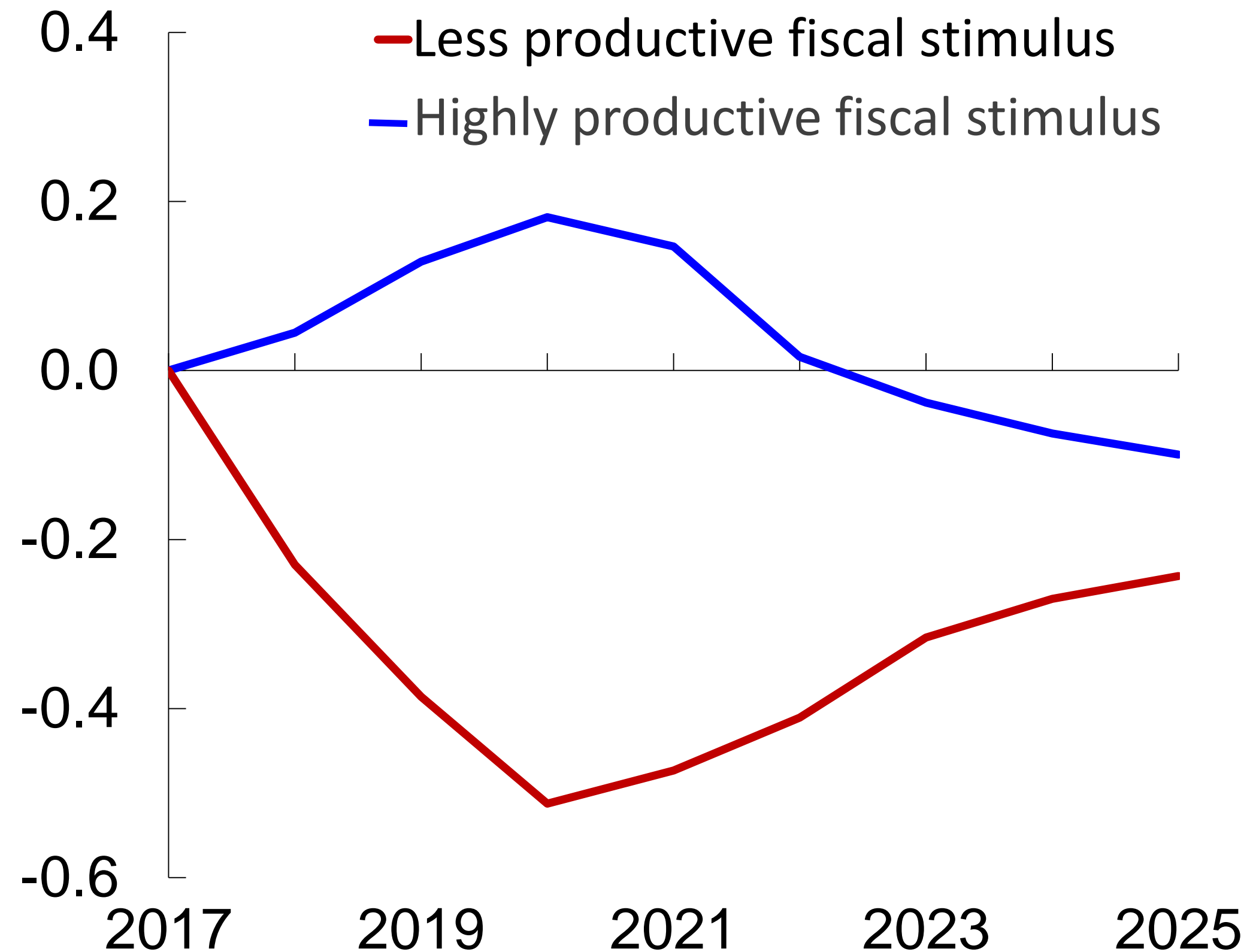
- ***Protectionism***. Inward-looking policies could hurt demand and productivity.
- ***U.S. macroeconomic policy mix***. Faster-than expected U.S. interest hikes and dollar appreciation could temper U.S. growth and stress vulnerable economies.
- ***Financial threats to EMs***. Some EM countries are exposed to sudden shifts in investor confidence. In China, continued reliance on credit and slow restructuring mean that the risk of an eventual disruptive adjustment is growing.
- ***Sharp rollback of financial regulation***. Higher risk of costly financial crises.
- ***Weak demand and balance sheets***. In parts of Europe, adverse feedback among low demand, low inflation, weak balance sheets, and anemic productivity growth.
- ***Non-economic shocks***. Geopolitical tensions, political discord, extreme weather events, and terrorism and security concerns.

Impact of U.S. Fiscal Stimulus on Other Economies: Depends on Supply-Side Effects and thus Interest Rate Reaction

Illustrative fiscal stimulus of 1% of GDP in 2018, and 2% of GDP in 2019-2021

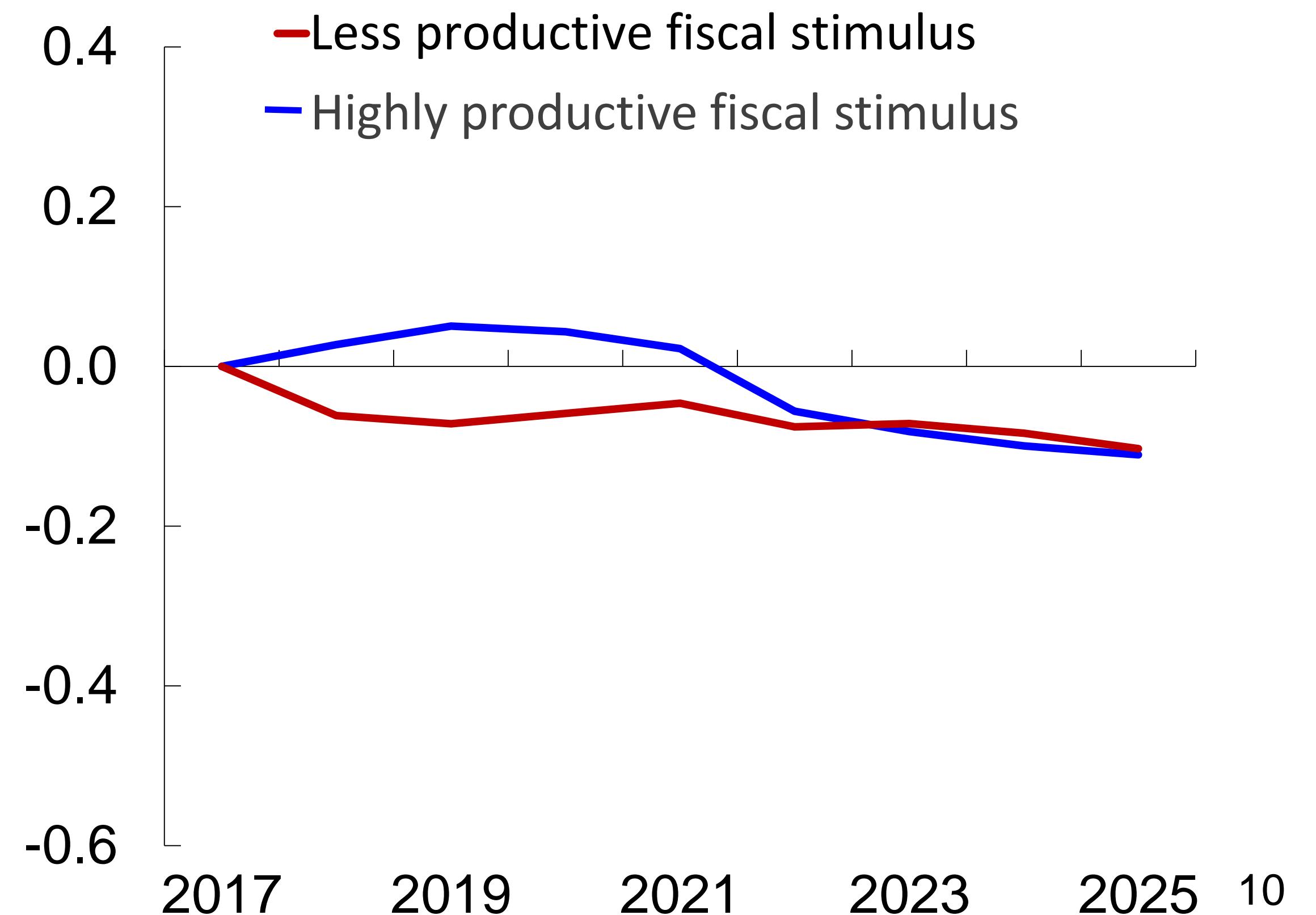
Advanced Economies Real GDP

(percent deviation from case with no change in U.S. fiscal policy)



Emerging Markets Real GDP

(percent deviation from case with no change in U.S. fiscal policy)



Implications of Global Outlook for Israel?

- **Export growth stronger:** about 4% in 2017-19, from almost flat in 2014-16
- **Real GDP growth solid:** about 3% in 2017-19
 - Employment growth about 2.5%, so unemployment remains below 5%
 - But productivity growth low, about 0.5%
- **Inflation rises:** low unemployment aids wage growth, higher global inflation
- **Interest rates rise in time:** yet low global interest rates may limit increase
- **Housing prices:** recent stability welcome, but potential for renewed upward pressures if interest rates remain low and supply gains are not lasting

Some Broader Trends in the Global Economy

- **Slowing international trade**

World Economic Outlook, Oct. 2016, Chapter 2

- **Declining productivity growth**

“Gone with the Headwinds: Global Productivity Growth”, *IMF Staff Discussion Note, SDN/17/04, April 2017*

- **Low interest rates**

Global Financial Stability Report, April 2017, Chapter 2

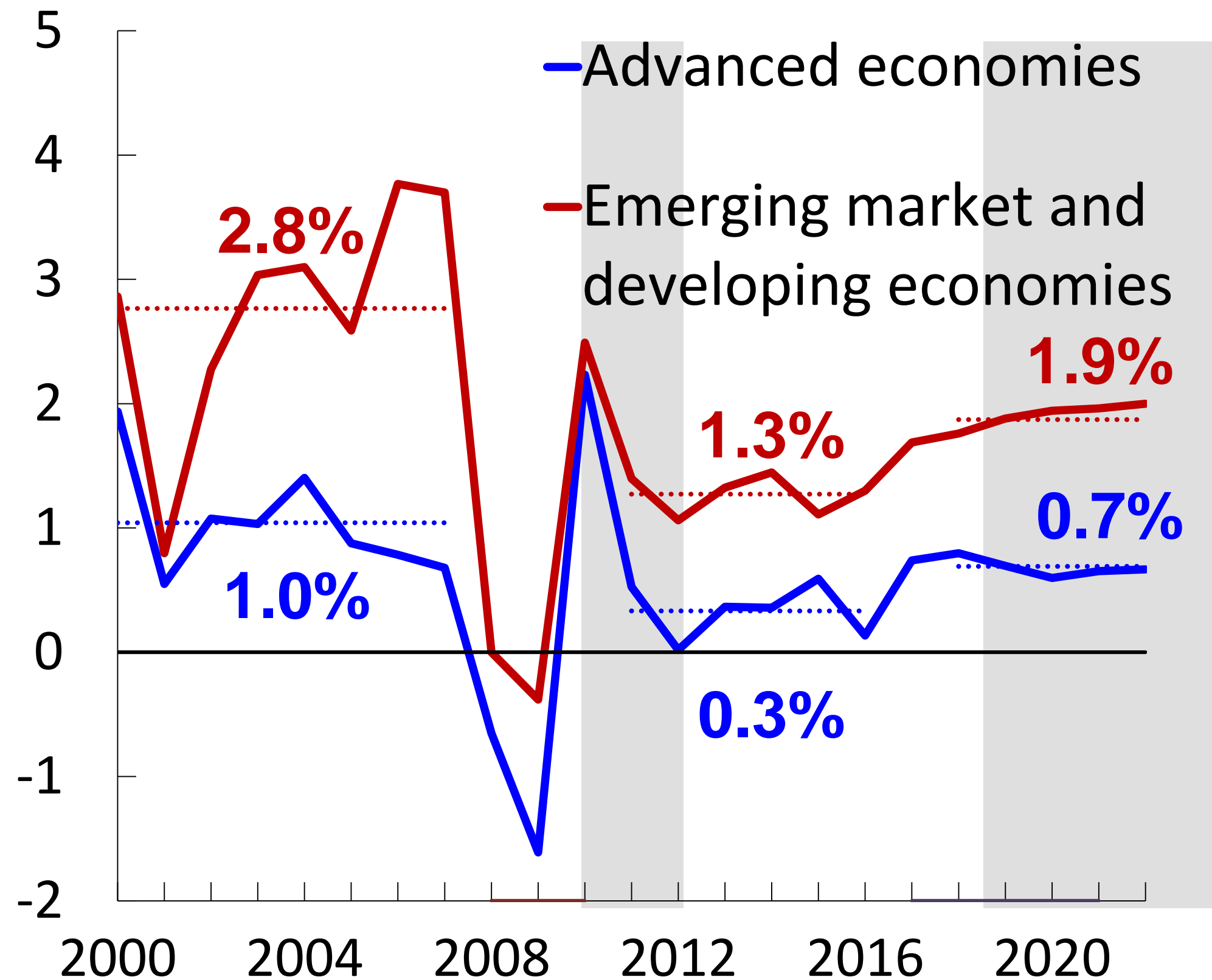
- **Falling labor share of income**

World Economic Outlook, April 2017, Chapter 3

Productivity Growth Has Slowed Around the World

Total Factor Productivity Growth, 2000–22

(PPP GDP-weighted; dashed lines indicate period average)



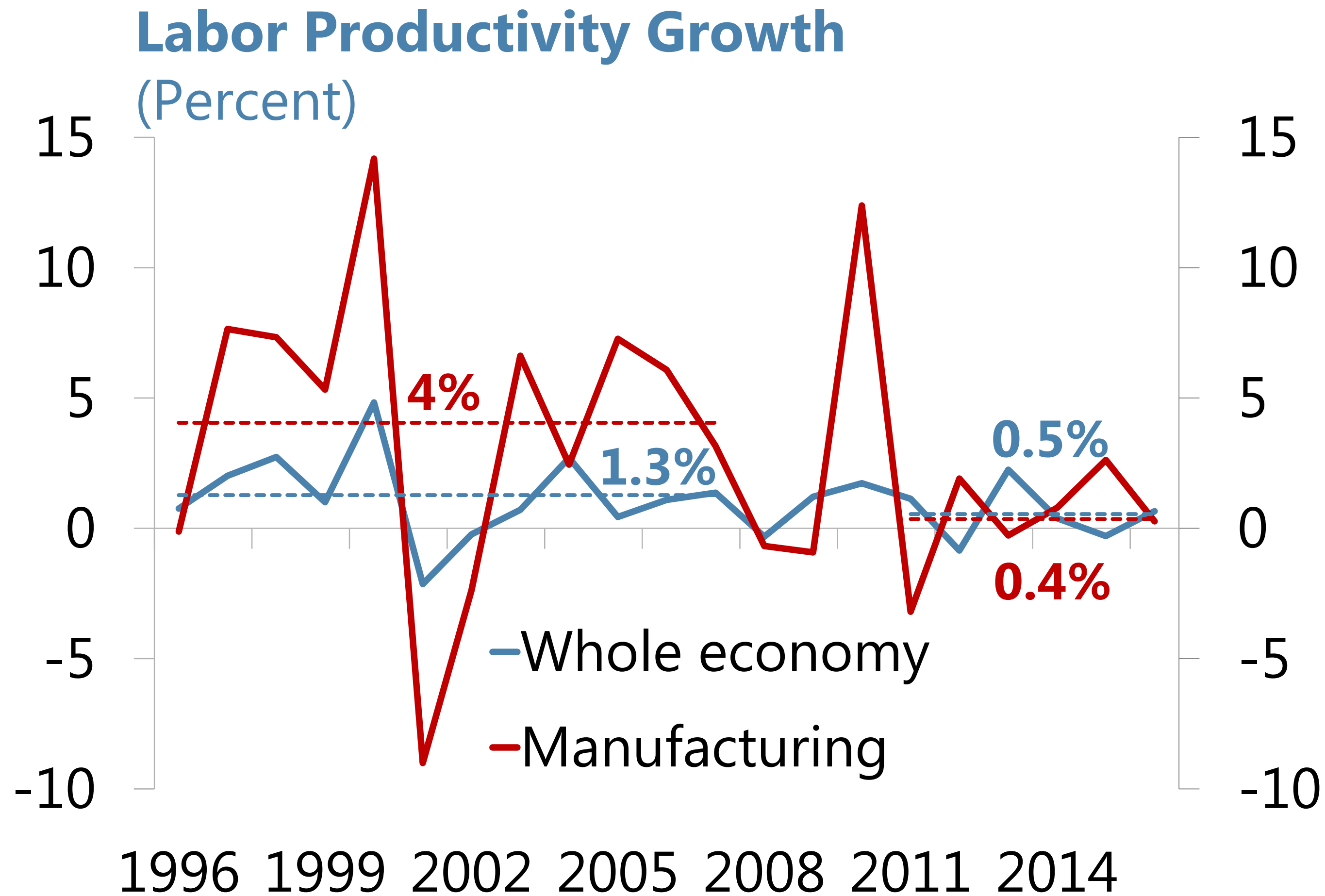
Partly a crisis legacy, as investment hit by:

- weak corporate balance sheets and tight credit
- weak aggregate demand
- uncertainty about economic policy

But structural headwinds continue to slow productivity:

- ICT boom waning
- aging workforce, slower human capital gains
- global trade integration slowing, e.g., China
- benefits of earlier EMDC reforms fading

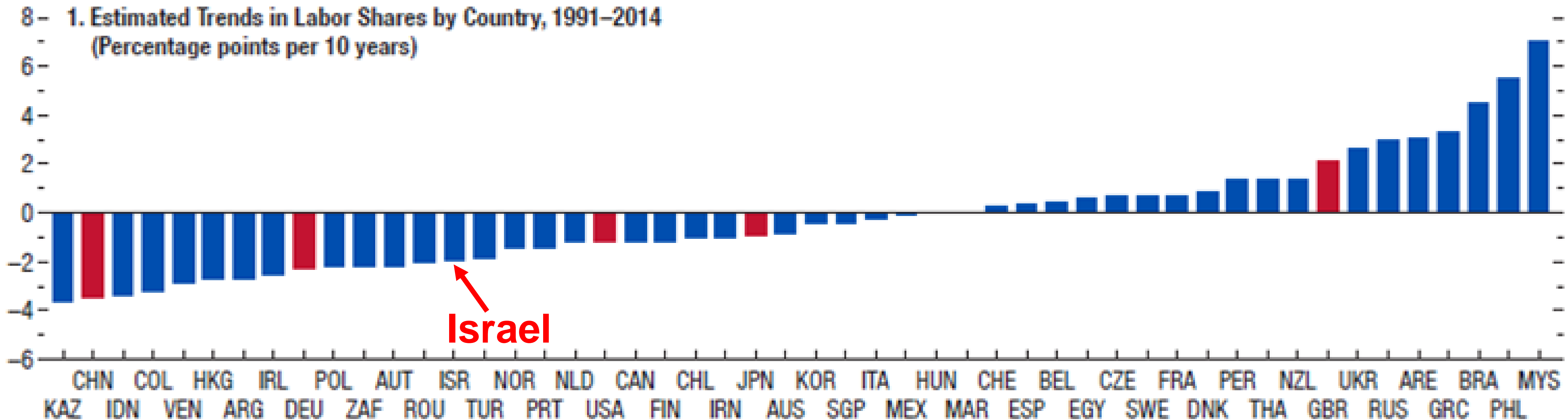
Israel's Labor Productivity Growth has also Slowed Primarily in Manufacturing



Productivity Growth %	1996 -2007	2011 -2016
Total	1.3	0.5
Manufacturing	4.0	0.4
Other	0.8	0.7

Labor's share of income has fallen in many countries including Israel

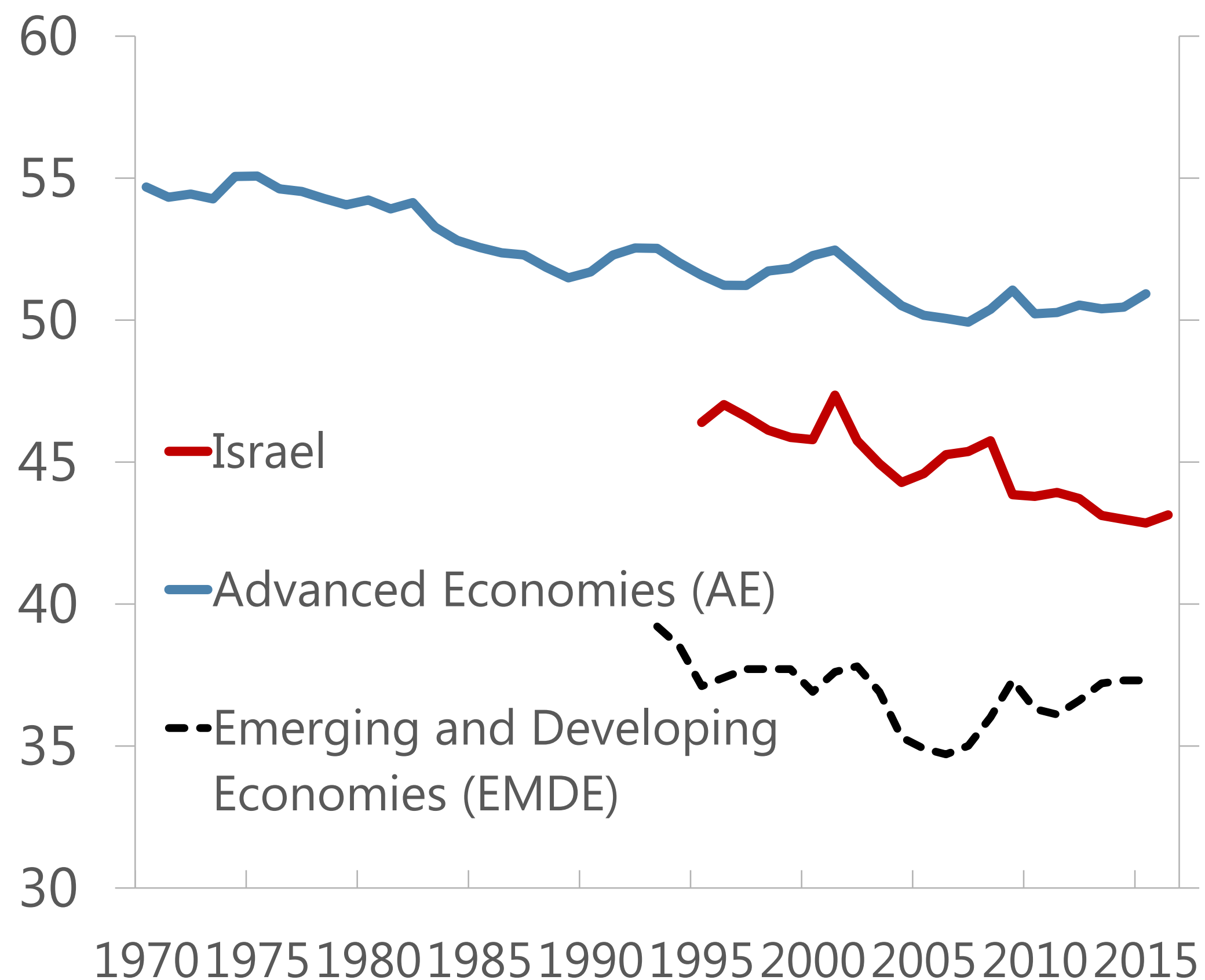
While the downward trend in the labor share of income is fairly broad based across countries and industries, there is tremendous diversity in its evolution.



Decline in Israel's labor share broadly in parallel with AE

But Israel's labor share decline continued post crisis?

Labor Share of Income
(Percent)



Source: World Economic Outlook, April 2017.

Ratio of Israeli Labor Share to Advanced Economy Labor Share (Index, 1995=100)

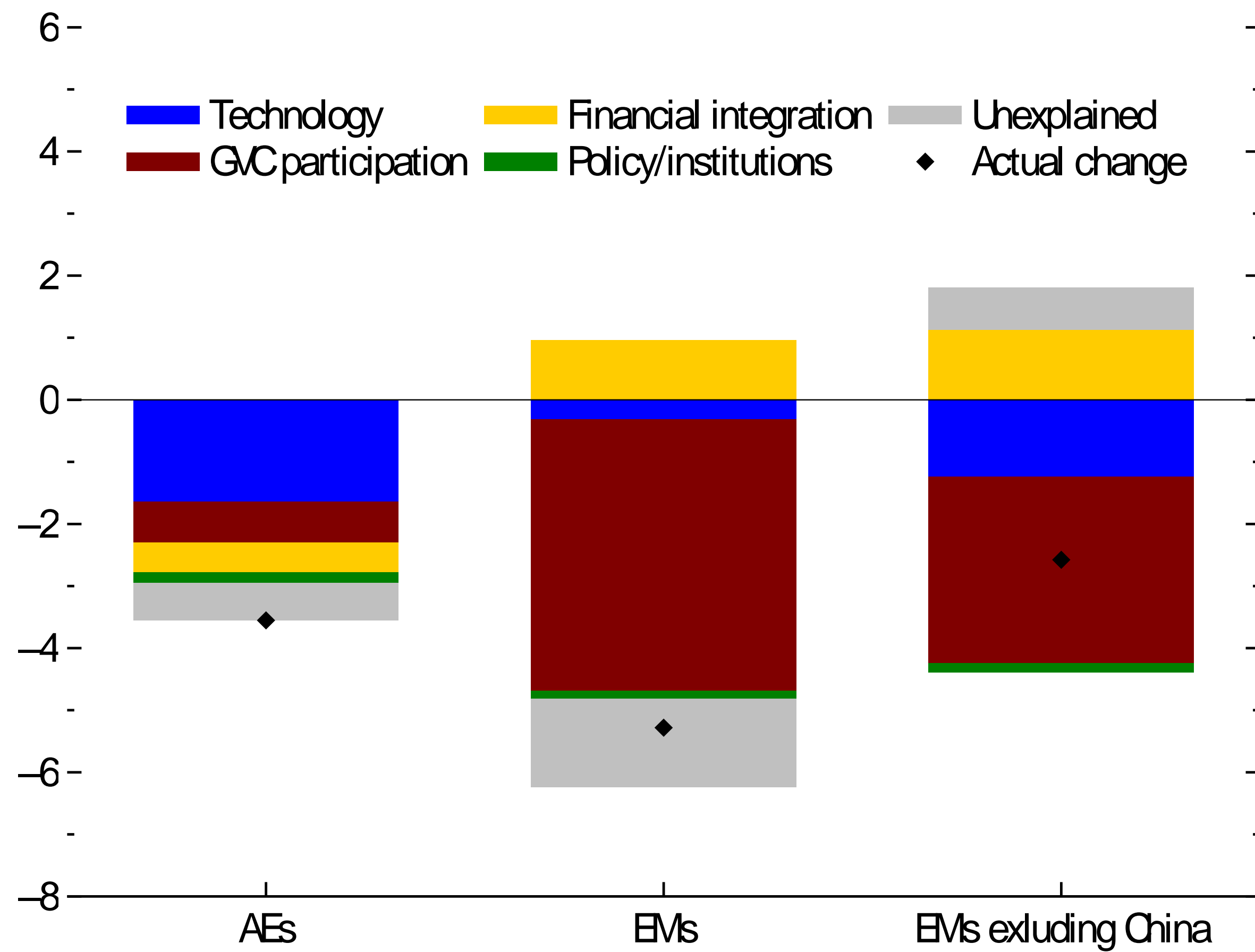


Sources: World Economic Outlook, April 2017; and Fund staff calculations.

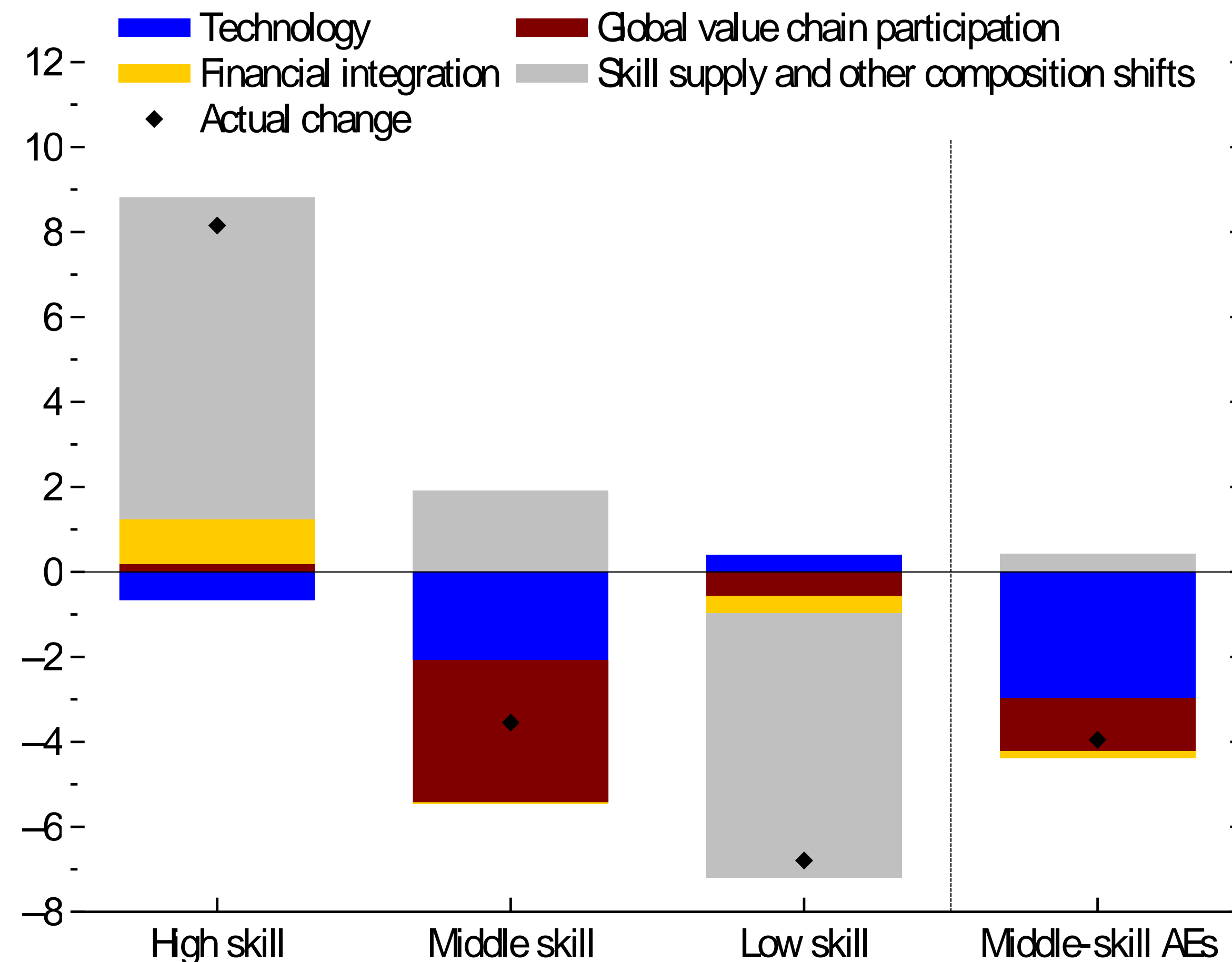
Technology key driver of declining labor shares in AEs, and Global Value Chain participation in EMs. “Hollowing out” of medium-skilled

Aggregate Results: Contributions to Aggregate Labor Share Changes, 1993–2014

(Deviation from regression constant)



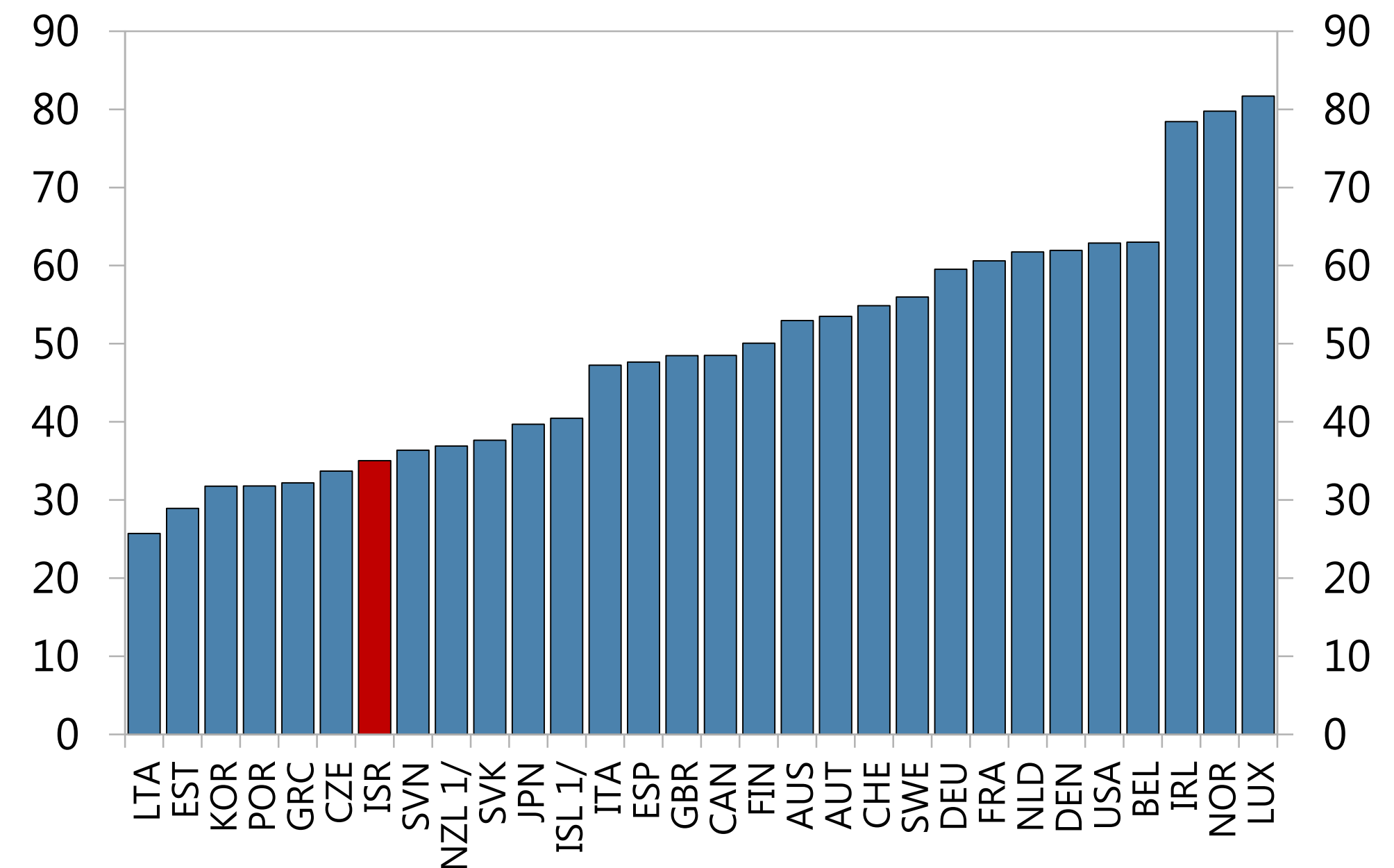
Contributions to Aggregate Labor Share Change by Skill, 1995–2009



Implications of broader trends for Israel

- Global productivity growth may remain below prior trends
 - Reduce Israel's productivity shortfalls to the major advanced economies to help sustain solid growth
- Technology appears to be reducing labor shares which constrains real wage growth
 - Improve the skills of Israel's labor force to limit these pressures on living standards

Labor Productivity Comparison, 2015
(GDP per hour worked, USD constant prices 2010PPPs)



Sources: OECD; and IMF staff calculation.
Note: 1/ 2014 data is used due to data availability.

Policies for strong and inclusive growth in Israel

Education and infrastructure investment

- Reform education to reduce achievement gaps
- Training to boost skills of those already in work
- Upgrade public transport infrastructure

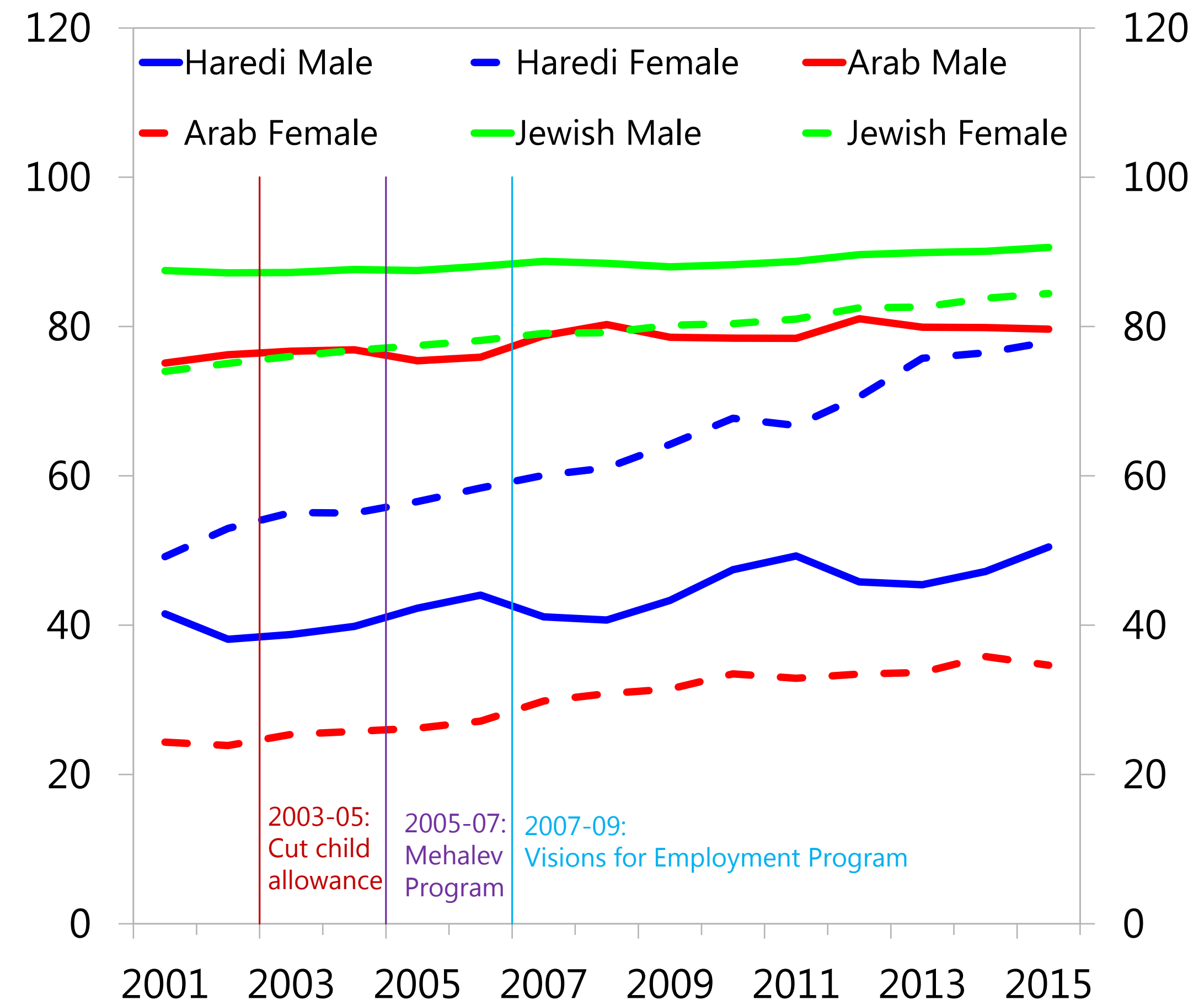
Product market reforms to boost productivity

- Lower barriers to external competition
- Reduce regulatory burden, e.g., “one-stop-shop”
- Reform state enterprises

Broaden labor participation

- Expand active labor market policies (ALMP)
- Enhance environment for job creation by SMEs
- Raise the EITC—welcome recent MoF proposal

Labor Force Participation Rate by Cohorts
(percent)




Sources: CBS; and IMF staff calculations.

Macroeconomic policies for global growth recovery subject to downside risks

Supportive environment for structural reforms while protecting fiscal buffers:

- **Monetary policy:** remain accommodative pending a durable rise in inflation
- **Fiscal policy:** ensure Israel has substantial fiscal space to help cushion shocks
 - Achieve central government deficit of around 2% of GDP over the cycle, which will keep public debt around 60% of GDP
 - Generate spending savings and revenue gains to enable enhanced investment in education and infrastructure, plus expanded ALMP and EITC.
- **Housing:** reforms to generate lasting supply gains to meet rising population needs
- **Macroprudential policy:** appropriately tight, Bank of Israel to monitor closely
- **Financial sector:** safeguard stability during reforms to promote efficiency



Thank you!

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Growth projections: Advanced economies

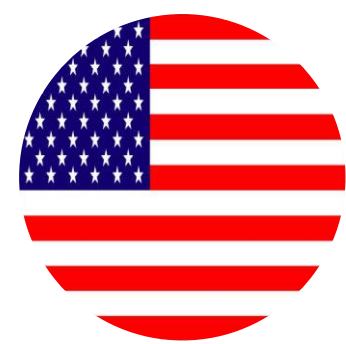
(percent change from a year earlier)



World



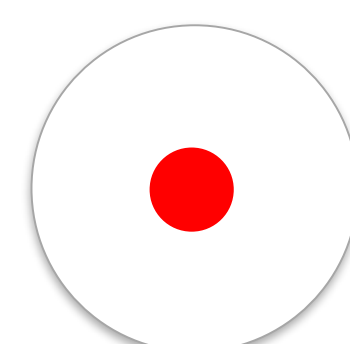
Advanced Economies



U.S.



U.K.



Japan



Euro Area



Germany



Canada



Other
Advanced
Asia

2016

3.1

1.7

1.6

1.8

1.0

1.7

1.8

1.4

2.3

2017

3.5

2.0

2.3

2.0

1.2

1.7

1.6

1.9

2.5

Revision
from Oct.
2016

0.1

0.2

0.1

0.9

0.6

0.2

0.2

0.0

0.0

2018

3.6

2.0

2.5

1.5

0.6

1.6

1.5

2.0

2.6

Revision
from Oct.
2016

0.0

0.2

0.4

-0.2

0.1

0.0

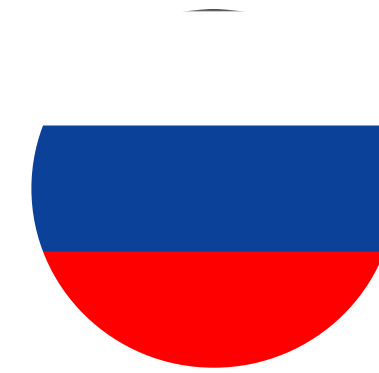
0.1

0.1

-0.1

Growth projections: Emerging markets and LIDCs

(percent change from a year earlier)



World

Emerging
Market and
Developing
Economies

China

India

Brazil

Russia

Commodity
Exporting
Economies

Low Income
Developing
Countries

2016

3.1

4.1

6.7

6.8

-3.6

-0.2

1.0

3.6

2017

3.5

4.5

6.6

7.2

0.2

1.4

2.3

4.7

Revision from
Oct. 2016

0.1

-0.1

0.4

-0.4

-0.3

0.3

-0.2

-0.2

2018

3.6

4.8

6.2

7.7

1.7

1.4

2.9

5.3

Revision from
Oct. 2016

0.0

0.0

0.2

0.0

0.2

0.2

-0.1

0.1