



## Israel: The collapse of the coalition poses risks to fiscal reforms

Israel heads for its fifth election in three years as the ruling coalition collapses. Lapid will take over from Bennet as interim PM, and new election is likely to take place late October. As the government lost its majority in the parliament in April, the risk of the coalition collapsing has increased in recent months. However, the collapse was more abrupt than expected. We expect the immediate market reaction to be limited as the shekel and Israeli rates are usually not led by political developments. That said, we believe that the collapse of the ruling coalition has increased the medium-term risks around fiscal reforms and fiscal discipline.

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The reason behind the collapse of the ruling coalition was the inability of the government to renew regulations in Israeli law for the Jewish settlers in the West Bank. Both the junior ruling Arab party (Ra'am) and former PM Netanyahu's opposition Likud party, which usually favors the Israeli settlers in the West Bank in the past, opposed the bill to renew the required regulations for the Jewish settlers in the West Bank.

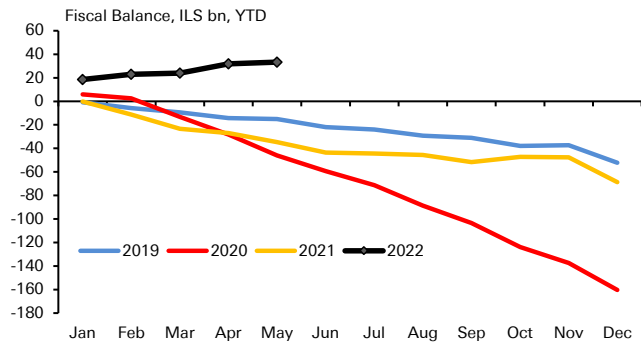
**What's next?** The latest polls suggest that former PM Netanyahu's Likud party is the most popular party, but it is unlikely to win a majority to form its own government. Although it is hard to predict what's next, we believe that the political stalemate is more likely again in Israel after one-year break.

Under Bennett's government, MinFin Lieberman has been a fiscal hawk, and he successfully implemented a scale-down in fiscal support in the last 12 months. The 12-month rolling budget deficit declined from its highest level of 12.2% of GDP in February 2021 to only 0.04% of GDP as of May 2022, thanks to strong tax revenue and the gradual decline of Coronavirus-related spending. We think that the collapse of the government will delay the fiscal reforms such as increasing competition in food sector, the approval of the 2023 budget, and some public infrastructure projects this year. Although these developments may reduce the government deficit in the near-term, the collapse of the ruling coalition has significantly increased the medium-term fiscal risks in Israel.

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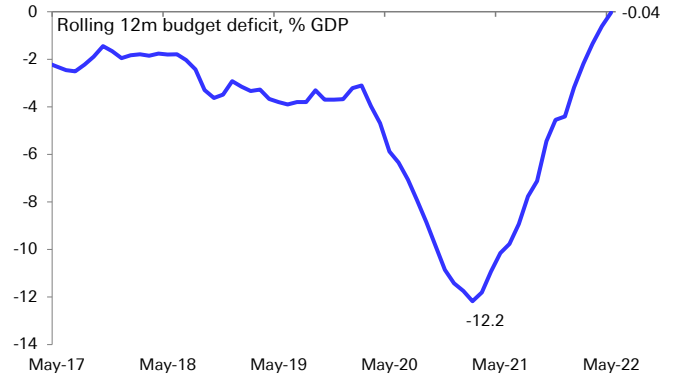


Figure 1: Israeli government posted surpluses in the first five months of this year



Source : Ministry of Finance, Deutsche Bank

Figure 2: Budget deficit narrows to only 0.04% of GDP as of May 2022 from -12.2% in February 2021



Source : Ministry of Finance, Deutsche Bank

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# Appendix 1

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