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**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

October 3, 2022

**Press release:**

**Remarks by the Governor of the Bank of Israel at the press briefing on monetary policy held today at the Bank of Israel**

Good afternoon.

Yesterday and today, the Monetary Committee held discussions at the Bank of Israel in order to decide on monetary policy. At the end of the discussions, the Monetary Committee decided to increase the interest rate by 0.75 percentage points, to 2.75 percent.

As we begin a new year, 5783, in the Hebrew calendar, I can say that from my position as Governor of the Bank of Israel, and from a macroeconomic perspective, Israel’s economy is in a good place, certainly relative to that of the other advanced economies. The Israeli economy is robust and at a high level of activity. The labor market is tight and around full employment. At the same time, there are quite a few challenges, and I will expand upon some of them in a bit. To mention the main ones in brief, I note that inflation—which has surged around the world, and can be seen here as well, even if to a smaller extent compared to worldwide—is a process that adversely impacts the economy, and particularly weaker population groups, and we need to rein it in and bring it back to within the target range. All of us here at the Bank of Israel, and my colleagues on the Monetary Committee, are determined to do this and are taking steps to that end. Other challenges include the economy’s ability to cope with the global slowdown that is expected in the short term in view of the energy crisis and the monetary tightening worldwide; the issue of housing prices, which beyond being an economic problem is also a significant social issue; and an additional challenge is the political uncertainty, the economic ramifications of which include the delays in medium-term and long-term investments. There is a need to promote investment in infrastructures that are important to economic growth and to increased productivity in coming years.

Let me expand somewhat on the issue of inflation. Inflation in Israel, as in many countries, has risen above the upper bound of our target range. To deal with the rise in inflation, we on the Bank of Israel’s Monetary Committee continue to move forward with the process of monetary contraction, while taking measured steps and examining the range of economic developments in Israel and worldwide. We know that the process of increasing the interest rate takes some time to show its results. We are determined to return the inflation rate to within the target range and the steps we are taking today and in the recent period—particularly what is known in professional terminology as “front loading” of the interest rate hikes—emphasize that. As noted, we are not alone in this process. Inflation has deviated from the target in many other countries and the central banks are taking similar steps. With that, inflation in Israel is markedly lower compared to most OECD countries. Recall that the Bank of Israel was among the first to switch to a policy of monetary contraction, already half way through 2021. Later on, we accelerated the process, in view of the developments in Ukraine and Russia. The steps we are taking are a continuation of the same policy line being led by the Monetary Committee for some time already.

The current inflation also derives from domestic factors based on heightened demand. We see in the recent inflation updates additional processes of accelerating prices that derive as well from demand for domestic goods and services. Of course, inflation is also impacted by factors that are external to the Israeli economy and that involve considerable uncertainty, such as the energy crisis and the war in Ukraine, alongside continued disruptions in global supply chains. This is a feature that is in line with small open economies, such as Israel’s, in which the prices of many items, particularly tradable goods, are set in a manner that is external to the economy. We are working to moderate the impacts of these processes, in order to anchor the inflation rate within the target range. I emphasize this, despite the relatively low CPI data in August. Recall that this CPI print is a single observation while our policy is in line with a continued process.

Inflation expectations and forecasts provide us with an important view of how the various market participants see the economic situation, and what their forecasts are regarding our policy. All this impacts on consumer and corporate behavior and their conduct from a forward-looking view—which in and of itself impacts on economic activity and inflation. Short-term inflationary expectations in Israel are around the upper bound of the target, while medium-term and long-term expectations remain within the target. These make up part of the overall inflation environment—the same environment that receives considerable weight when the Monetary Committee moves toward a decision. The anchoring of inflation expectations within the price stability target is one of the main parameters in the monetary policy and orderly economic activity.

The exchange rate is an important transmission mechanism for monetary policy. In the recent period, the foreign exchange market has been highly volatile, with the dollar strengthening worldwide. The exchange rate of the shekel vis-à-vis the dollar hovered around NIS 3.5/$ at the beginning of the past quarter, declined to NIS 3.2/$ during the quarter, and then rose back to above NIS 3.5/$ recently. Recall that changes in the exchange rate are frequent and their direction changes often. In Israel, this market is impacted as well by investments of institutional investors abroad and by financial market results, while in contrast there are offsetting impacts such as the high tech sector and the investments in it.

I would like now to touch on the housing issue. Rents are also reflected in inflation developments and we follow them very closely. However, beyond their impact on inflation, housing prices are a significant economic issue on their own. The increase in prices at a rapid pace, as was seen in the past year, is a problem for Israel’s economy and society. However, in recent quarters there have been positive developments on the side of housing supply. Recent construction data indicate a continued increase in the number of building permits and starts, which reached high levels. Alongside these, we also see some moderation in mortgage data in recent months.

Let us look now at the state of the real economy in Israel. Alongside the good growth data reported by the Central Bureau of Statistics for the past few quarters, we see that the indicators of current economic activity continue to point to a robust level of economic activity. With that, some of them do indicate some moderation in third-quarter growth. The aggregate balance of the Business Tendency Survey conducted by the Central Bureau of Statistics continues to indicate positive assessments by businesses regarding their situation. Exports of goods and services are also at a high level; the labor market remains tight, demand for workers is high in most industries and the employment rate among the prime working ages is at a record. With that, looking ahead we can see that skies are growing darker worldwide, particularly in Europe. These are liable to have an impact as well on the Israeli economy, which is exposed to global activity.

All the developments I’ve discussed until now, and others, are incorporated into the updated macroeconomic forecast that is being published today by the Research Department. The Department assesses that there will be high growth in 2022, with GDP growth of 6 percent. However, the Department forecasts that in 2023, GDP will grow by a more moderate rate of 3 percent, a pace that is still close to the economy’s natural potential growth. Compared to the growth rate prior to the COVID-19 crisis, GDP, which has already crossed the forecast trend line and is above it, is expected to return close to the long-term trend environment in 2023. Accordingly, based on the forecast, the labor market will continue to be tight. The unemployment rate among the prime working ages is expected to be 3.5 percent at the end of 2023. Inflation, in the forecast, is expected to be above the target range at the end of 2022, but over the course of 2023, it is expected to total 2.5 percent, closer to the midpoint of the target range. With that, there are still several causes of uncertainty pointed out by the Research Department. The main risks to the forecast are: a worsening of the energy crisis in Europe that is liable to adversely impact global growth and thus negatively impact Israeli exports; aggressive monetary policy abroad due to high global inflation that is not stabilized in 2023 either, and the domestic environment also has risks, such as the uncertainty regarding policy steps that the next government will take in all areas of its activity, including wage agreements that will be signed and their impact on inflation.

As for the global economic situation, after a period characterized by high growth, the economic environment is changing, as reflected in the forecasts of a slowdown in economic activity and in declines in financial markets. The ongoing war in Ukraine, the energy crisis in Europe, and the slowdown in China, despite some easings in the supply chains and transport costs, impact on growth forecasts. These continue to be revised downward, and it appears that the risk of recession in Europe is growing markedly. Uncertainty worldwide and monetary contraction activities of central banks are being felt in financial markets, which continue to decline with relatively high volatility. We are also exposed to a continued decline in the value of technology companies. In view of the difficulties described, there was also high volatility and an increase in government bond yields worldwide, alongside widening corporate bond spreads.

In conclusion, Israel’s economy heads into the new year in a robust state. Alongside the challenges we are facing, we need to promote important reforms and investments on behalf of the coming generations in order to succeed in ensuring the continued growth of GDP in the future. Whatever government is formed will have to take care to act on behalf of these important goals. It will be important to pass the State budget and to continue to advance the reforms being discussed and other necessary reforms. As I have already said numerous times, uncertainty is not good for the economy, but this uncertainty has been increasing recently in many areas in Israel and abroad. At the same time, Israel’s economy is strong and has proven its ability to grow in the short term even in conditions of uncertainty and global difficulties as well. We at the Bank of Israel are closely following the various developments in Israel and abroad, and will continue to conduct monetary policy that is appropriate for dealing with inflation and in order to meet the various targets and challenges we are facing.

“Shana tova”—may you and your families have a good New Year.

Thank you.