BANK OF ISRAEL
Office of the Spokesperson and Economic Information

July 24, 2023

Report on the Bank of Israel's discussions prior to deciding on the interest rate

The discussions took place on July 9 and 10, 2023.

General

The Monetary Committee sets the interest rate in a process that includes two discussions—the first in a broad forum, and the second in a narrower one.

In the broad-forum discussion, the relevant background economic conditions are presented, including the real and financial-monetary developments in Israel's economy and developments in the global economy. Participants in this discussion include the members of the Monetary Committee, senior representatives from the various departments of the Bank, and economists from the economic departments (Research and Markets), who prepare and present the material for discussion.

In the narrow forum—which consists of the Monetary Committee and a representative of the Markets Department—the Research and the Markets Departments present their views of the main considerations that should guide the setting of the monetary policy. An open discussion on monetary policy follows, which ends with a vote on the level of the interest rate. According to Section 18(c) of the Bank of Israel Law, 5770–2010, the decision on the interest rate is reached by majority vote of the members of the Monetary Committee who participate in the voting.

A summary view of the economic situation available at the time of the Committee's discussion is presented in the notice regarding the interest rate decision, which was published on July 10, and in the data file that accompanied the notice.

THE NARROW-FORUM DISCUSSION

The members of the Monetary Committee participating in the discussion decide on the appropriate rate of interest. After the discussion, it was decided to keep the interest rate at 4.75 percent. Four members of the Monetary Committee members supported the decision, while one Committee member voted for an increase of 0.25 percentage points, to 5 percent.

The discussion focused on the inflation environment in Israel and its development—the dynamics in recent months and the expectations for the coming year. The Committee discussed GDP growth data and economic activity, an analysis of labor market data, credit data, and the housing market. In addition, the Committee focused on developments in the global environment, as well as the effect of legislative changes on the depreciation of the shekel and on inflation.

Main points of discussion

The Committee discussed the inflation rate in Israel (4.6 percent), which is above the upper bound of the target range, and various signs of its moderation. It was noted that the CPI for the month of May was below forecasts. In addition, the half-yearly pace of inflation is lower than the year over year inflation rate, and a continued trend of the moderation can be seen when comparing the quarterly pace of inflation and the half-yearly pace (data in annual terms, seasonally adjusted). An analysis of CPI components indicates that price increases continue to characterize a wide range of components. The inflation environment in Israel remains low compared to most advanced economies worldwide, but these gaps have narrowed due to the decline in inflation in many countries. The 1-year inflation expectations and forecasts, as well those for the second year and onward, are within the target, around its upper bound.

The Committee assessed that the monetary tightening processes in Israel and abroad, and the moderation of demand, are working to moderate inflation. In addition, the Committee assessed that the interest rate in the economy is at a restrictive level, appropriate for the moderation of inflation over the coming year so long as there aren’t significant changes in activity or in inflation. The Committee noted that the depreciation of the shekel continues to be a significant factor delaying the convergence of the inflation rate back to the target. The Committee’s assessment is that the trend of depreciation in the shekel partly reflects some increase in the economy’s risk premium, and to the extent that the trend of depreciation continues, it is liable to weigh on the convergence of inflation to its target. The Committee noted the environment of high uncertainty and was of the opinion that should there be additional developments, beyond those currently expected, in the path of inflation and its convergence, the Committee will have to enhance the monetary tightening.

The Committee members discussed data on economic activity and the labor market. Growth data for the first quarter were revised upward, to an annual pace of 3.1 percent. The economy is at full employment, and unemployment is low—the employment rate and participation rates are at high levels—and real wages increased in recent months in the environment of the pre-COVID-19 crisis trend. However, there are signs of moderation in the labor market, including a downward trend in the job vacancy rate, particularly in the high-tech sector.

The Committee discussed developments in the housing market, particularly the moderation in the scope of activity and in mortgage volume. The pace of increase in home prices over the past 12 months continued to decline, and from the beginning of the year prices are unchanged. In contrast, the owner occupied housing services component of the CPI continued to increase, reaching 7.6 percent in the past year.

The Monetary Committee also discussed the state of global activity. It was noted that there was a slight slowing in the pace of economic activity, particularly in manufacturing areas and in the scope of world trade. The inflation environment worldwide remained high, and above central bank targets, but in many countries the trend of moderation continued. However, most core indices remained sticky. In the US, economic activity remained at a high level, with slight moderation in the most recent data. In Europe, there was minimally negative growth, while growth in China was slower than expected. Committee members noted that the risk of a recession in the US and in Europe remains elevated. However, the monetary environment continues to be tight.

The Committee discussed the Research Department's macroeconomic forecast. In a scenario in which the disagreement surrounding the legislative changes is settled in a manner that does not impact on economic activity going forward, the Department estimates that GDP will grow by 3 percent in each of 2023 and 2024. In this scenario, the unemployment rate is expected to increase to around 4 percent, and the year over year inflation rate is expected to decline to an average of 3 percent in the second quarter of 2024 and to 2.4 percent at the end of 2024. The Bank of Israel interest rate is expected to be 4.75 percent or 5 percent in the second quarter of 2024. The main risk to the forecast is the materialization of the scenario in which legislative and institutional changes will be accompanied by an increase in the State's risk premium and continued depreciation of the shekel, with an adverse impact on exports, and a decline in domestic investments and demand for private consumption. In the previous forecast, in April, the Research Department published a quantitative estimate of the economic ramifications of such a scenario.

At the end of the discussion, four Committee members supported keeping the interest rate at 4.75 percent, while one Committee member supported increasing the interest rate by 0.25 percentage points, to a level of 5 percent. Economic activity in Israel is at a high level, and is accompanied by a tight labor market, although there is some moderation in a number of indicators. Inflation is broad and remains high. With that, in recent months, inflation appears to be slowing. Therefore, the Monetary Committee decided to leave the interest rate unchanged, but sees a real possibility of having to raise the interest rate in future decisions, if the inflation environment does not continue to moderate as expected. The interest

rate path will be determined in accordance with activity data and the development of inflation, in order to continue supporting the attainment of the policy goals.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Monetary Committee Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Dr. Adi Brender
Prof. Naomi Feldman
Prof. Zvi Hercowitz

Other participants in the narrow-forum discussion:
Mr. Uri Barazani, Spokesperson of the Bank
Dr. Golan Benita, Director of the Markets Department
Mr. Gilad Brand, Research Department
Dr. Oded Cohen, Chief of Staff to the Governor
Mr. Nadav Eshel, Consultant to the Governor
Mr. Arad May, Monetary Committee Secretariat
Ms. Dana Orfaig, Research Department
Mr. Daniel Shlomiuk, Bank spokesperson’s office