



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

June 3, 2019

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

The discussions took place on May 19 and 20, 2019.

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 Market Operations), who prepare and present the material for discussion.

In the narrow forum—which consists of the Monetary Committee and the Director of the Research Department—the Research and the Market Operations 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 May 20th, 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 unchanged at 0.25 percent. Four members supported the proposal to keep the interest rate unchanged, and one member supported the proposal to increase it to 0.5 percent.

The discussion focused primarily on real economic activity, expected developments in inflation and particularly in view of the appreciation in the shekel, risks to the global economy, the fiscal uncertainty and the expected path of monetary policy.

Main points of discussion

The Committee assessed that the economy continues to grow by around its potential rate, and that data for the first quarter of 2019, net of increased vehicle imports, indicates growth slightly lower than 3 percent (based on the Research Department's assessment). The data reflect moderate growth in private consumption, contraction in most investment components (excluding vehicles), and solid growth in exports, primarily of services. However, data on exports going forward remain mixed: there is a positive decline in the percentage of companies reporting a severe constraint of a shortage of export orders (based on the Business Tendency Survey), while at the same a slowing in goods exports is seen in April (based on foreign trade data). The labor market remains tight—the employment and participation rates increased slightly from their record levels, and accordingly, wages continued to increase, primarily in the business sector. With regard to the housing market, the Committee members noted that the number of transactions continued to grow, alongside a moderate rise in home prices, in parallel with the prolonged decline in investment in residential construction.

Regarding the inflation environment, the Committee members noted that for a considerable period there has not been a major change in it and that downward and upward surprises in recent CPI figures should not be ascribed too much importance. The annual inflation rate is above the lower bound of the target, and the Committee members assessed that in the coming year inflation will continue to hover near it. Nontradable inflation (an estimate for the domestic component of inflation) is over 2 percent, and tradable inflation increased and is not negative. They noted that 1-year expectations and forecasts from the various sources continue to range slightly above the lower bound of the target range, while expectations for two years and longer are slightly below the midpoint of the target range. The Committee discussed the continued strengthening of the shekel since the previous interest rate decision; since the beginning of the year it appreciated by approximately 6 percent in terms of the nominal effective exchange rate. The Committee members noted that the appreciation is the main factor delaying the continued increase in the inflation rate toward the middle of the target, and thus could have an impact on Bank of Israel policy.

The Committee discussed the uncertainty and the risks to economic activity worldwide. First-quarter growth data of major economies were encouraging. In contrast, however, the “trade war” between the US and China increased in severity, and there were mounting assessments that there will be a delay in reaching an agreement and that it will apparently be more partial than expected—developments that are expected to have an impact on financial markets. In addition, forecasts of world trade and growth were again revised downward for most regions, particularly Europe.

The Committee discussed the marked uncertainty in the fiscal situation as well, in view of the possible ramifications of the negotiations to form a coalition and the steps the government may take in order to deal with the expected deficit, and the possible effects these will have on economic activity and the path of inflation. The Committee was of the opinion that in any case, the fiscal uncertainty is expected to last for some time.

As noted, four Committee members were of the opinion that the interest rate should be kept at its current level. The fifth Committee member was of the opinion that it should be increased to 0.5 percent, as in his view the current interest rate is not in line with the state of the economy, compared with economic conditions and the interest rates prevailing in several other economies. The other Committee members noted that the real interest rate in Israel is not particularly low in international comparison. They were of the opinion that the current interest rate is in line with state of the economy, particularly in view of the appreciation of the shekel and the marked uncertainty in the global economy and in fiscal policy. They assessed that the reduction in the extent of monetary policy accommodation will take place through a gradual and cautious process in order to support the continued increase of inflation toward the midpoint of the target range.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:

Prof. Amir Yaron, Governor of the Bank and Chairperson
Mr. Andrew Abir, Director of the Market Operations Department
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz

Other participants in the narrow-forum discussion:

Mr. Eddy Azoulay, Chief of Staff to the Governor
Mr. Uri Barazani, Deputy Spokesperson of the Bank
Ms. Dana Orfaig, Economist in the Research Department
Ms. Esti Schwartz, Secretary of the Monetary Committee

Mr. Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department