BANK OF ISRAEL
Office of the Spokesperson and Economic Information

October 18, 2022

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

The discussions took place on October 2 and 3, 2022.

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 October 3, 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 increase the interest rate by 0.75 percentage points, to 2.75 percent. Five members of the Monetary Committee supported the decision to increase the interest rate by 0.75 percentage points, and one Committee member supported increasing the interest rate by 0.5 percentage points.

The discussion focused on the inflation environment in Israel and worldwide, the high level of economic activity, the tight labor market, and the housing market. The Committee also discussed the expected continued moderation in global economic activity and the impact of this moderation on the economy.

Main points of discussion

The Committee discussed the inflation rate in Israel being above the upper bound of the target range. The inflation rate over the preceding 12 months declined somewhat, to 4.6 percent, but the inflation environment remains high. An analysis of CPI components at a high resolution indicates that the price increases trickled down to many CPI components, and there are more indications that the inflation also derives from domestic factors originating in elevated demand. However, the Monetary Committee members noted that despite the increase in the inflation environment in recent months, it remains low relative to most economies worldwide, and it is around the bottom decile of OECD countries. The inflation expectations and forecasts for the coming year from the various sources are around the upper bound of the target, and expectations derived from the capital market for the second year and onward are within the target range.

The Committee discussed the data on activity, which indicate continued robust economic activity. In this regard, the Committee members noted the tight labor market and the employment rate among the prime working ages currently being at a record. In addition, the number of job vacancies and their share out of total positions are at very high levels. According on the Business Tendency Survey conducted by the Central Bureau of Statistics, although there is some decline in businesses' expectations for expanding their number of employees, these continue to be high compared to their level just before the COVID-19 crisis. Additional indicators of economic activity, including goods exports (excluding ships and aircraft, and diamonds), services exports, building starts, and the various components of imports, also point to heightened activity, and the Research Department's forecast for growth in 2022 increased to a level of 6 percent. Looking to 2023, the growth forecast is 3 percent, a pace that is still close to the potential natural growth of the economy.

The Committee members also discussed developments in the area of the exchange rate, its impact on inflation, and the inflation rate's return to the target. Since the previous monetary policy decision, there has been considerable volatility in the foreign exchange market, and the shekel depreciated by 8 percent against the dollar, by 6.2 percent against the euro, and by 5.9 percent in terms of the nominal effective exchange rate, among other things as a result of the strengthening of the dollar worldwide. An analysis of the market in Israel indicates that it is impacted as well by investments by Israeli institutional investors abroad and by financial market performance, while in contrast there are offsetting impacts such the high tech sector and investments in it.

The Committee discussed housing market developments. Home prices increased in the past 12 months by 17.9 percent, a markedly high rate compared to the pace of recent years. Alongside that, the Committee members noted that the number of construction permits and building starts increased in recent quarters, and are at a very high level. At the same time, building completions have remained low until now, against the background of the lengthening of the extent of construction. The number of transactions continues to decline and new mortgage volume in August decreased to NIS 9.6 billion, but it is still high relative to previous years.

The Monetary Committee discussed global activity, which continues to moderate, and the strengthening of the trend of monetary tightening being adopted by central banks, including the Fed and the ECB. The combination of the energy crisis in Europe and the war in Ukraine, the monetary tightening, and the slowdown in China, is expected to lead to moderation in the rate of economic activity worldwide. In view of this, and against the background of the increase in the real interest rate being led by central banks, equity indices declined sharply in capital markets worldwide, and government bond yields increased sharply. Corporate bond spreads widened and point to an increase in the risks of default due to the changes in the economic environment. The OECD and investment houses revised the 2023 global growth forecast downward.

At then end of the discussion, five Committee members supported an interest rate increase of 0.75 percentage points, to 2.75 percent, and one Committee member supported increasing the interest rate by 0.5 percentage points. The Committee members noted that the Israeli economy is recording strong economic activity, accompanied by a tight labor market and a high inflation environment. The Committee has therefore decided to continue the process of accelerating and bringing forward the pace of increasing the interest rate (front loading). The Committee assesses that the monetary tightening process will return the inflation rate to the target range. The pace of raising the interest rate 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 Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Naomi Feldman
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski

Other participants in the narrow-forum discussion:
Mr. Nadav Eshel, Assistant to the Governor
Dr. Golan Benita, Director of the Markets Department
Mr. Uri Barazani, Spokesperson of the Bank
Dr. Oded Cohen, Chief of Staff to the Governor
Mr. Arad May, Monetary Committee Secretariat
Dr. Yoav Friedmann, Research Department
Mr. Ari Kutai, Research Department
Mr. Daniel Shlomiuk, Bank Spokesperson's Office