BANK OF ISRAEL
Office of the Spokesperson and Economic Information

December 5, 2022

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

The discussions took place on November 20 and 21, 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 November 21, 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 0.5 percentage points, to 3.25 percent. The decision was unanimous.

The discussion focused on the inflation environment in Israel and worldwide, the economic activity level and the labor market that are at a high environment, with a decline in the most recent data. 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 increased to 5.1 percent. An analysis of CPI components at a high resolution indicates that the price increases trickled down to many CPI components, and that a notable portion of them derives from domestic demand factors. 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 derived from the capital market are within the target range and from other 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 assessed that the monetary tightening processes in Israel and worldwide and the moderation in the level of demand alongside easings in supply chains and a decline in commodity prices are acting to moderate the inflation rate.

The Committee discussed the data on economic activity, which indicate a continued robust growth rate of activity, with a slight decline in the most recent data. The level of GDP continues to be higher than the trend line from before the COVID-19 crisis for the fourth consecutive quarter. Committee members noted the third-quarter growth that was positive, but lower than the level of the previous quarter, mainly because of a decline in private consumption of durable goods. In addition, the Committee discussed the labor market, which weakened slightly in the most recent data, but remains at a high environment reflecting a full employment environment. According on the Business Tendency Survey conducted by the Central Bureau of Statistics, there is some decline in businesses' expectations for expanding their number of employees, with a marked decline in the high-tech manufacturing and hotels industries. In parallel, the magnitude of the constraint of recruiting new workers in recent months declined in most industries. Additional indicators of economic activity, including goods exports (excluding ships and aircraft, and diamonds), services exports, and the various components of imports, continued to be at an environment higher than their precrisis level.

The Committee members also discussed developments in the exchange rate, its impact on inflation, and the inflation rate's return to the target. Since the previous monetary policy decision, the shekel strengthened by 3 percent against the dollar and by 0.7 percent in terms of the nominal effective exchange rate. In contrast, the shekel weakened against the euro by 2.8 percent.

The Committee discussed housing market developments. Home prices increased in the past 12 months by 19.8 percent, a markedly high rate compared to the pace of recent years. Alongside that, the Committee members noted that other indicators of housing prices point to moderation of the market: the number of home purchase transactions continues to decline and new mortgage volume in October decreased considerably and was NIS 6.1 billion (NIS 8.2 billion seasonally adjusted).

The Monetary Committee discussed the domestic capital market, in which equity indices rose, and the yield on long-term government bonds and corporate bond spreads remained essentially unchanged, with a decline in the balance of tradable debt. In the balance of business credit from banks there was a slight decline with continued increase in interest rates.

The Monetary Committee discussed global activity, which continues to moderate, and the continued 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. Accordingly, investment houses revised their 2023 global growth forecasts downward. Purchasing managers indices for advanced and developing economies indicate a slowdown in the pace of economic activity. The inflation environment worldwide remains high. However, in some countries, particularly the US, moderation is seen. In most countries, inflation indices are at a level markedly higher than central bank targets, and therefore the monetary contraction worldwide continues. However, some central banks are slowing, or signaling a more moderate pace ahead. In line with that, major equity indices worldwide increased, and government bond yields remained essentially unchanged after trading with high volatility throughout the recent period.

At then end of the discussion, all six Committee members supported an interest rate increase of 0.5 percentage points, to 3.25 percent. The Committee members noted that the Israeli economy is recording strong economic activity, accompanied by a tight labor market and an increase in the inflation environment. The Committee has therefore decided to continue the process of increasing the interest

rate. 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 Monetary Committee 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