BANK OF ISRAEL
Office of the Spokesperson and Economic Information

July 20, 2020

Press Release

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

The discussions took place on July 5 and 6, 2020.

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 6, 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 0.1 percent. Five Committee members supported the proposal to keep the interest rate unchanged, and one Committee member supported the proposal to reduce it to 0 percent. In addition, the Monetary Committee unanimously accepted the decisions to launch an NIS 15 billion corporate-bond purchase program based on a broad benchmark of securities, to renew the special program to expand the supply of credit to small businesses, and to create an infrastructure for expanding the range of assets that banks will be able to accept as collateral against credit.

The discussion focused primarily on the effects of the coronavirus crisis on Israel's economy in the short and long terms, and on the policy required to reduce the scope of the adverse economic impact on businesses and households and to support an economic recovery that is as rapid as possible.

Main points of discussion

The significant negative impact on the economy as a result of the coronavirus crisis that began in March, the process of economic recovery that began with the removal of the limitations, and the risk of deterioration in economic activity in view of the increase in infection rates, were the focus of the Monetary Committee's discussions.

The Committee discussed the status of the real economy. According to the Research Department's assessment, the scope of the economy's shutdown, which was around 36 percent of activity at the height of the crisis, continued to decrease in light of the removal of the limitations, and is now around 12 percent. Goods exports continued to recover in May, after the steep decline in March, but they remain lower than the precrisis level. All components of goods imports declined in May, including imports of raw materials, which had been stable in March and April. Services exports decreased sharply in March and April in view of the sharp decline in exports of tourism and transportation services, while business services exports were not adversely impacted. The Companies Survey indicates a steep decline in business sector activity in the second quarter, and the Business Tendency Survey shows only a slight improvement in June compared with April and May. The scope of credit card purchases is about 10 percent lower than the pre-crisis average.

The Research Department updated its macroeconomic forecast. The forecast for growth in 2020 was revised downward and GDP is expected to contract by approximately 6 percent, in view of the worsening in morbidity data that increases the uncertainty and delays the return to routine economic activity, and in view of global developments. In light of the deterioration in the 2020 growth forecast, the 2021 forecast was revised upward, to 7.5 percent. In 2020, the budget deficit is expected to be about 12 percent of GDP, as a result of NIS 55 billion in lost revenues due to the slowdown in activity and an increase in expenditure of about NIS 60 billion that is needed for financing unemployment benefits and the assistance steps announced by the government.

An analysis of the labor market indicates that the negative impact on the labor market remains notable. This conclusion is seen in all the data, despite there being a difficulty in precisely assessing the labor market situation in light of the variance in data from the various sources. After a sharp decline in employment in March–April, there was an improvement in May, but the pace of the improvement declined in June. An analysis conducted by the Research Department, based on real time surveys by the Central Bureau of Statistics, indicates that between 500,000 and 570,000 employees are still either on unpaid leave or have been let go from their workplace due to the coronavirus crisis, in addition to 150,000 people who were unemployed prior to the crisis. In addition, approximately one-fifth of self-employed people (as of May) have either partially or fully lost their livelihood.

The Committee was presented with updates regarding the development of the coronavirus crisis around the world, and its economic ramifications. The Committee members discussed the assessments by international institutions and investment houses regarding the decline in global output and in the scope of world trade. The assessments were revised downward and indicate that in 2020 global growth is expected to contract by the sharpest rate since World War II, among other things due to the spread of the pandemic to emerging markets as well. The Committee analyzed the existing risks in the global economy and the various scenarios published by the international institutions.

The Committee referred to global capital markets remaining volatile and supported by unprecedented steps taken by central banks worldwide. Governments in many countries are operating extensive assistance plans in order to moderate the adverse impact of the crisis and to provide an incentive for economic activity. The growth forecasts for the US, Europe, and China were revised downward by the IMF and the downward trend in world trade continues.

The Committee referred to the continued downward trend in the inflation environment, which is markedly lower than the lower bound of the target range. The May CPI declined by 0.3 percent, and annual inflation was negative 1.6 percent, mainly in light of the notable negative contribution of the energy component. There is a methodological difficulty in calculating the CPI so long as the limitations on economic activity lead to certain products and services not being consumed and their price not being able to be measured, and there has been a change in the composition of the household's consumption basket. Inflation expectations for the coming 12 months, from all sources, were higher in June than in May, but the developments during the period were uneven: inflation expectations derived from the capital market declined, while professional forecaster's projections increased slightly after the CPI was published. In the coming months, the annual inflation rate is expected to remain negative.

The Committee discussed foreign exchange market developments. Since the previous interest rate decision, the shekel strengthened by about 1.2 percent in terms of the nominal effective exchange rate; the exchange rate is delaying the return of inflation to the target range and is weighing on the recovery of exports.

The Committee discussed developments in Israel's capital markets. The equity market remains volatile; major stock market indices on the Tel Aviv Stock Exchange declined, similar to indices around the world, when the crisis broke out, but their corrections were more moderate relative to indices around the world. Bank of Israel activity in the financial markets markedly reduced the yield on government and corporate bonds. However, corporate bonds spreads have recently returned to widening.

The Committee discussed credit market developments. Bank credit continued to increase, primarily in view of the growth in business credit (credit to medium-sized and large businesses) and housing credit. The taking of consumer credit by households increased in May, after a sharp decline in April. The Business Tendency Survey indicates some moderation in companies' financing constraints, but the limitation remains higher than it was before the crisis. The government increased the scope of he fund for extending government-guaranteed credit to small and medium sized businesses by an additional NIS 4 billion; the total scope of the fund is NIS 18 billion, with requests for credit from the fund at a scope of NIS 47 billion. Likewise, the operation of the fund to extend credit to companies at high risk with higher backing began, at a scope of an additional NIS 4 billion. The banking system deferred payments in about 530,000 loans, totaling NIS 6.8 billion, by the middle of June.

The data and assessments that were available to the Committee indicated, as noted, that the economy entered a severe crisis in view of the spread of the coronavirus, a crisis that was reflected in difficulties in the capital markets and in notable economic distress among businesses and households. Within the framework of the discussion, the Committee referred to the range of intervention tools available to it. The range of tools is intended to enhance the extent of monetary policy accommodation, to ensure the continued orderly functioning of financial markets, and to support the monetary passthrough mechanism to credit in the economy. The Committee members emphasized that the Bank of Israel took determined steps at the outbreak of the crisis to support the orderly activity in the capital market and in the functioning of the government bond, corporate bond, and foreign exchange markets, and that there is a need to continue following those markets and to adopt new activities or to expand the existing activities, as needed.

The Committee discussed several alternatives regarding monetary steps that can be put into operation at this time in view of the economic situation. There was a discussion on the issue of the possibility of launching a program to purchase corporate bonds on the secondary market. The discussion referred to various aspects that justify intervention, while distinguishing between a situation of a market failure and intervention intended to help reduce issuance costs. It was established that as of now, there is no market failure but there is room for a plan that will strengthen the passthrough from the monetary interest rate to overall interest rates in the market, will encourage the issuance of credit to the business sector, and will make funds available for credit to all segments in the economy. The Committee members noted that there is importance in the timing of the launch and execution of the program and they established that the program has to be of a significant scope. In addition, the Committee members referred to the importance of the orderly providing of credit and discussed the renewal of the special plan to expand the supply of bank credit to small and micro companies. In addition, the Committee members emphasized the importance of establishing an infrastructure that will enable banks to extend credit at lower cost and while maintaining high liquidity. The Committee discussed creating an operational and legal infrastructure that will enable banks to put up mortgage portfolios as collateral against the credit they receive from the Bank of Israel within the framework of the plan to expand the supply of credit to small and micro companies.

The Committee members unanimously accepted the decisions to launch a NIS 15 billion program to purchase corporate bonds on the basis of a broad benchmark of securities, to renew the special plan to expand the supply of credit to small businesses, and to create an infrastructure to expand the range of assets that the banks will be able to accept as collateral against credit.

Five Committee members were of the opinion that the interest rate should be kept at its current level of 0.1 percent. They were of the opinion that this low interest rate level supports the recovery of economic activity and the gradual return of the inflation rate to within the target range, and in particular in view of the fact that the government bond purchase program continues and that the Committee decided on the 3 new steps. One Committee member voted in favor of reducing the interest rate to 0 percent. He was of the opinion that an interest rate lower than 0.1 percent is more appropriate due to the magnitude of the crisis and the adverse impact, anomalous in its magnitude, on the employment level.

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. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski, Director of the Research Department

Other participants in the narrow-forum discussion:
Mr. Uri Barazani, Acting spokesperson of the Bank
Mr. Tal Biber, Head of the Markets Division, Markets Department
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Arad May, Secretariat of the Monetary Committee
Mr. Yoav Soffer, Advisor to the Governor
Mr. Michael Gurkov, Research Department
Ms. Esti Schwartz, Secretary of the Monetary Committee