BANK OF ISRAEL
Office of the Spokesperson and Economic Information

Press release

April 21, 2024

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

The discussions took place on April 7, 2024 and April 8, 2024.

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 April 8, 2024, 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 4.5 percent. All members of the Monetary Committee supported the decision.

The discussion focused on economic developments: the level of economic activity, inflation, inflation forecasts and expectations for the various ranges, developments in the financial markets, particularly the foreign exchange market, the labor market, the housing market, the Research Department's updated forecast, fiscal developments, and global conditions.

Main points of discussion

The Committee discussed the state of the economy after approximately half a year since the eruption of the "Swords of Iron" War, and examined the developments since then. The discussion focused on the geopolitical uncertainty that remains high and even increased in magnitude in the recent period, and possible future effects on the economic variables were examined. Economic activity indicators point to a gradual improvement in activity, after a notable contraction in business activity after the war broke out. Despite the gradual improvement in activity, there is still a long way to go until a full economic recovery.

The level of overall economic activity is still lower than what persisted just before the war, but the activity is adjusting to the situation, and a consistent improvement can be seen in recent months. The Composite State of the Economy Index and the aggregate balance of the Business Tendency Survey remain on an upward trend, and credit card purchases in most industries have returned to their prewar level and even higher. However, the expansion of aggregate supply is slower than the development of demand, which is liable to lead to inflationary pressures.

The Committee discussed the construction industry, which has a large weight in economic activity. Based on data presented to the Committee members, it could be seen that the return of building sites to activity is progressing, but the activity is still lower than its prewar level and is impacted on by the shortage of workers. In particular, it can be seen that the absorption of foreign workers from abroad is a complex process carried out gradually, and it is expected to take a prolonged period of time. It is important to maintain a high supply of construction over time in order to ensure the stabilization of housing prices.

The Committee discussed the inflation environment and the war's impacts on it. Year over year inflation continued to moderate gradually, and was 2.5 percent in February, within the inflation target range. In addition, the nontradable components also moderated. Furthermore, the CPIs net of taxation, energy, and fruit and vegetables are around the midpoint of the target. In contrast, inflation expectations for the various ranges increased over the course of the period to around the upper bound of the target range, and they incorporate assessments for expected tax increases. Against the background of indicators for a gradual recovery in the labor market and in demand (with variance among the principal industries) and in contrast, the supply limitations in some industries—the Committee assessed that there are several main risks to a possible acceleration of inflation: the development of the war and its impact on economic activity, depreciation of the shekel, limitations on construction industry activity, fiscal developments, and global oil prices.

The Committee discussed the war's impacts on financial markets. Israel's risk premium, as measured by the CDS premium, was at a high level and increased in the days preceding the decision, in view of the geopolitical tension. In addition, the Committee discussed the decision by international credit rating agency Fitch to keep Israel's credit rating unchanged but to adjust the rating outlook from stable to negative. The increase in the extent of uncertainty also impacts on the extent of the adverse impact on the various financial indicators—in international comparison, Israel's equity markets continued to underperform, and its government bond yields increased over the period reviewed, at a rate above the global trend. In the credit market, the slowdown in activity continues. In addition, risk indices in all credit activity segments are increasing somewhat, but still indicate a level that is not high relative to the past decade. In order to provide relief to borrowers in this period, the framework for deferring payments formulated by the Banking Supervision Department and adopted by the banking system was extended for an additional 3 months.

Committee members discussed developments in the foreign exchange market. Since the monetary policy decision in February, there was considerable volatility in the foreign exchange market. For the period overall, the shekel weakened against the dollar by 2.7 percent, against the euro by 2.6 percent, and in terms of the nominal effective exchange rate, the shekel weakened by 2.3 percent.

The Committee discussed developments in the labor market, which continued to recover in view of the increase in demand for workers, alongside an easing in the labor supply limitation due to the decrease in the number of people serving in reserves duty. In February, the employment rate remained stable at a level lower than before the war, and the employment rate net of those temporarily absent for economic reasons continued its upward trend. Based on rapid indicators from the Central Bureau of Statistics, the average wage per employee post continued to increase in February, and over the past 3 months the annual growth rate of nominal wages was 8.3 percent (the past 3 months compared with the corresponding period in the previous year). This pace is still impacted by a change in the composition of employees due to furloughs in preceding months and by the one-off additions to wages that were paid in January 2023. However, the impact of the change of the composition of employees on wages contracted in January and February, and the level of nominal wages is consistent with the pace forecast based on the prewar rate of increase. The most recent data also indicate the convergence of the real wage to the 2015–19 trend, pre-COVID-19.

In the housing market, there was an increase in home prices in recent months, alongside continued moderation in rents. Despite the supply limitations in the construction industry and the sharp decline in residential construction investment, building starts in the fourth quarter of 2023 continued to be at a relatively high level in a long-term comparison (although there was a decline in the most recent data). In addition, building completions reached record levels. Home prices increased in the past two months, after declining in the 10 months preceding that. The scope of transactions increased in January compared with the corresponding period of the previous year, and in March mortgage volume was high compared to preceding months. In contrast, the housing component in the CPI declined by 0.3 percent and the year over year rate of change continued to moderate, reaching 2.6 percent. Alongside these, construction industry activity is recovering gradually, but the industry is still not operating at its full potential. Supply limitations in the construction industry and the need for housing solutions for those forced to leave their homes are liable to weigh on the continued moderation of housing prices and rents going forward.

The Committee discussed the Research Department's updated macroeconomic forecast and fiscal developments. The Department assessed that GDP is expected to grow by 2 percent in 2024 and by 5 percent in 2025, similar to the January forecast. The forecast assumes that the direct economic effect of the war will last until the end of 2024 at a decreasing intensity. For 2025, the assumption is that there will not be additional direct effects of the combat. Similar to previous forecasts, the Department assumes that the lion's share of the fighting will occur on one front. It is important to emphasize that the uncertainty regarding the various developments in the war could have a substantial effect on the forecast. The inflation rate assessed by the Department for 2024 increased slightly from previous forecasts. In view of the changes in the government's budget, the debt to GDP ratio, one of the most important fiscal indicators, is expected to rise to a level of 67 percent in 2024 and to remain at a similar level during 2025 as well. Responsible fiscal policy is important for strengthening markets' trust, and in addition is likely to help entrench inflation within its target.

The Committee discussed global conditions as well. The rate of economic activity worldwide surprised to the upside, against the background of stronger than expected activity in the US and some recovery in China. In contrast, the economic weakness continues in the eurozone. World trade increased for the first time in several months. The price of oil increased substantially during the period, and shipping costs, which soared against the background of the tension with the Houtis in the Red Sea, moderated. The inflation environment in numerous countries moderated, but in most of them it remains above central bank targets, in view of the inflation rate in services, which remained sticky and weighs on the convergence of inflation to the target range. In the US and the eurozone, the central banks kept the interest rate unchanged and signaled that the path of interest rate reductions will be slower and more gradual.

In view of the recent developments, indicating a material increase in the extent of geopolitical uncertainty, the Monetary Committee decided to keep the interest rate unchanged. This policy is consistent with the one adopted by the Committee since the eruption of the war, a policy that is focused on stabilization of the markets and reduction of uncertainty, alongside price stability and support for economic activity.

All 5 Monetary Committee members supported the decision to keep the interest rate unchanged at a level of 4.5 percent.

In view of the war, the Monetary Committee's policy is focusing on stabilizing the markets and reducing uncertainty, alongside price stability and supporting economic activity. The interest rate path will be determined in accordance with the continued convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.

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
Dr. Oded Cohen, Chief of Staff to the Governor
Mr. Nadav Eshel, Advisor to the Governor
Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department

Mr. Arie Knopf, Monetary Committee Secretariat
Ms. Dana Orfaig, Research Department
Ms. Nava Ostrov, Monetary Committee Secretariat
Mr. Daniel Shlomiuk, Bank Spokesperson’s office
Mr. Tzvi Sussmann, Monetary Committee Secretariat