

## **BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

October 22, 2024

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

**The discussions took place on October 8, 2024 and October 9, 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 October 9, 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 unchanged at 4.5 percent. All members of the Monetary Committee supported the decision.

The discussion focused on the impacts of the geopolitical environment on the economy and on economic developments: inflation and inflation expectations, the level of economic activity in view of the war, the labor market, the Research Department's forecast, the credit rating reductions, fiscal developments, developments in the financial markets and in the foreign exchange market, the housing market, and the global conditions.

### **Main points of discussion**

The Committee discussed the state of the economy after approximately a year from the beginning of the Swords of Iron War. The prolonged war has significant impacts on Israel's economy. The geopolitical uncertainty continues, in view of the increased intensity of the fighting in the northern front alongside the tension with Iran.

The Committee discussed the inflation environment. The Committee's assessment is that there has been an increase in the inflation environment, in contrast to the global trend. Inflation over the past 12 months was 3.6 percent in August. The year over year inflation rate net of energy and fruit and vegetables was more moderate, at 3.1 percent in August. The increase in the inflation rate is broad, and is reflected in both the tradable and nontradable components. Based on forecasters' assessments, the inflation rate will continue to increase in the beginning of 2025, in view as well of the expected increase in VAT, and then will moderate toward the upper bound of the target range in the second half of the year. One-year inflation expectations and forecasts are around the upper bound of the target range. Expectations for the second year and onward are within the target range, in its upper portion. In the Committee's assessment, that there are several risks for a possible acceleration of inflation: geopolitical developments and their impact on economic activity, including shekel depreciation, continued supply limitations, fiscal developments, and the increase in the oil prices worldwide.

Economic activity indicators show that there has been some increase in activity in the third quarter, though the level of activity is still far from the trend line. Based on National Accounts data, second quarter economic growth was low, and was even revised slightly downward by the Central Bureau of Statistics. Accordingly, GDP is 3.3 percent below the long-term trend line. The Business Tendency Survey for September

reflects a mixed trend among businesses, mainly against the background of the escalation in the North.

The labor market remains tight, in view of the labor supply constraint. This is from a shortage of non-Israeli workers, and from the absence of workers who have been called up for military reserve service (the scope of which increased in September). The tight labor market is reflected in a low unemployment rate, a high job vacancy rate, and a rapid rise in wages.

The Research Department updated its macroeconomic forecast. The Department assumed that the war will continue at a high intensity in the beginning of 2025 as well. In view of the below-forecast growth in the second quarter of 2024 and the recent intensification of the fighting, the growth forecast for 2024 was revised downward to 0.5 percent. In addition, against the background of the increase in defense expenditures and the shift of special US aid receipts to the coming years, the forecast for the deficit in the government budget for 2024 was revised upward to 7.2 percent. Alongside these, the inflation forecast for 2024 was revised upward to 3.8 percent. There is a particularly high level of uncertainty in the forecast, so that Committee members were presented with additional scenarios that include an extension of the war beyond the baseline scenario and/or a marked worsening in its intensity. The Department assesses the balance of risks with regard to the growth forecast to the downside, while with regard to inflation and the deficit the balance of risks tends to the upside.

In the reviewed period, rating agencies Moody's and S&P again reduced Israel's credit rating, and added a negative rating outlook going forward. The agencies' rating reductions emphasize the impact of the geopolitical reality, but also reflect the impact of fiscal policy management with an emphasis on the importance of the future policy framework. The rating agencies explained that their decision derived first and foremost from the geopolitical uncertainty, in view of the increase in the intensity of the war on the northern front, and the decreased chances for a ceasefire in Gaza. In addition, Moody's also emphasized the process of passing the budget and the ability to carry out required fiscal adjustments, the difficulty in drafting the ultra-Orthodox, and the processes of changes in the judicial system. The Committee members emphasized that the trust of the markets and the international economic institutions is essential to the stability of the Israeli economy, and in order to ensure this trust it is important that the government act to deal with the issues raised in the reports.

With regard to fiscal policy, the Committee members emphasized that the process of formulating the 2025 State budget is a positive, if challenging, step, against the background of the scope of required fiscal adjustments. In their assessment, the passage of a responsible budget for 2025 is a crucial component, particularly in such a period, which is required for strengthening the international markets' trust. They added and

emphasized that the forward looking planning of fiscal economic policy—one that will make it possible for the debt to GDP ratio to go back to declining in the next two years—is extremely important.

The Committee discussed the impacts of the war on financial markets and the foreign exchange market. Israel's risk premium continued to increase, and is at a historically high level. This is reflected in the CDS, which increased by about 30 points to a record of 165 points during the reviewed period, and in the spread that continues to widen between 10-year Israeli government (dollar) bonds and 10-year US Treasuries. It is important to note that a risk premium that is at a high level involves high financing costs—both in the public sector and the private sector—and is liable to reduce investments and to adversely impact economic growth. In the capital market as well, domestic equity indices remained essentially unchanged in the reviewed period, in contrast to an increase in most major equity indices worldwide. The cumulative underperformance of the domestic market vis-à-vis the world since the beginning of the war can still be seen. The balance of business credit and consumer credit continues to grow, though at a lower pace than before the war. Since the last interest rate decision, the shekel depreciated by 2.8 percent against the dollar and by 1.5 percent against the euro, and by 2.3 percent in nominal effective exchange rate terms. The exchange rate moved during the reviewed period with high volatility against the background of the geopolitical developments.

The Committee members discussed housing market developments. Home prices continued to increase at a rapid pace in recent months, alongside growth in mortgage volume. The rate of increase in rent prices remained relatively stable, while the increase in rental prices for new tenants is higher. The construction industry is operating below its prewar level, and a decline can be seen in building starts and completions. The Committee members emphasized that after a year it appears that the process of absorbing foreign workers into the industry is progressing slowly. This development is a challenge to economic activity because this industry has significant macroeconomic importance to the Israeli economy.

The Committee discussed global conditions. The increase in geopolitical tension in the Middle East has so far had a moderate impact on global financial markets. Alongside that, there has been an increase in the most recent data on oil and natural gas prices. Economic growth data published during the reviewed period in the US surprised to the upside and they point to a growth path that is slightly higher than the long term trend. In the eurozone, second quarter growth was slightly lower than expectations. In China, second quarter growth was lower than forecasts and it can be seen that activity continues to be weak in the third quarter as well. Inflation trends point to continued convergence toward central bank targets. In the US, the CPI moderated to an annual rate of 2.5 percent. The monetary easing among advanced economy central banks continues. The

Fed reduced the interest rate by 50 basis points and revised its interest rate forecasts downward. In addition, the ECB continued on its path of interest rate reductions and lowered the interest rate by 25 basis points. This trend of continued interest rate reductions worldwide is expected to continue in the coming year.

**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 continuing 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 convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.**

**The next monetary policy decision will be published on Monday, November 25, 2024.**

**The dates of interest rate decisions for 2024 and 2025 can be found at:**  
<https://www.boi.org.il/en/economic-roles/monetary-policy/interest-rate-announcement-dates-2024/>

**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  
Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department  
Ms. Liat Indig, Bank Spokesperson's office  
Dr. Ziv Naor, Bank Spokesperson  
Ms. Dana Orfaig, Research Department  
Mr. Tzvi Sussmann, Monetary Committee Secretariat