



BANK OF ISRAEL
Office of the Spokesperson and Economic Information

September 11, 2024

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

The discussions took place on August 27, 2024 and August 28, 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 August 28, 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 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, fiscal developments, developments in the financial markets and in the foreign exchange market, the domestic equities and credit markets, the housing market, and the global conditions.

Main points of discussion

The Committee discussed the state of the economy after 10 months of war. The prolonged war has significant economic ramifications on Israel's economy. In recent months, the geopolitical uncertainty has intensified, which, alongside fiscal uncertainty, has been reflected in an increase in the economy's risk premium.

The Committee discussed the inflation environment. The Committee noted that there was an increase in the inflation environment in recent months. Inflation over the past 12 months was 3.2 percent in July. Net of energy and fruit and vegetables, the inflation rate is more moderate, at 2.8 percent in July. The Committee noted that the increase in the pace of inflation mainly reflects the increase in the rate of change of prices of the nontradable components, which was 3.4 percent in annual terms, and 5.4 percent in the past three months (in annual terms). According to forecasters' projections, inflation over the preceding 12 months is expected to increase and to remain above the upper bound of the target range at the beginning of 2025, partly due to the expected increase in taxes, and in mid-2025 to decline toward the upper bound of the target range. Inflation expectations and forecasts for the coming year are around the upper bound of the target range. Expectations for the second year and onward are within the target range, in its upper part. In the Committee's assessment, there are several main risks of a possible acceleration of inflation—geopolitical developments and their effect on economic activity, shekel depreciation, continued supply constraints on activity, and fiscal developments. The Committee noted that the uncertainty regarding the state budget for 2025 and the adjustments necessary to reduce the deficit on an on-going basis are contributing to the increase in the risk premium, and may make it difficult to return inflation to the target range.

In the labor market, there is a supply constraint, partly in view of the lack of non-Israeli workers and the absence of workers who are serving in the defense forces or who are usually employed in the northern border area. This is contributing to a tight labor market with a low unemployment rate, a high job vacancy rate, and wages that are increasing at a rapid pace.

The Committee discussed the National Accounts data for the second quarter of 2024. The data show that GDP expanded by a moderate rate of 0.3 percent in quarterly terms (1.2 percent in annual terms) in the second quarter. The moderate growth rate in the second quarter distanced GDP from its trend line. GDP is about 3 percent lower than the trend line, and business product is about 5 percent lower. At the same time, GDP figures for the two previous quarters were revised upward, which offset some of the deviation from the trend line in view of the second quarter data. The level of economic activity is below the trend, mainly due to the lack of workers, primarily in the construction industry, in view of the war. GDP grew moderately in the second quarter, and business product even declined, mainly due to a decline in exports, where there was a decline in investments alongside high public demand due to the war. According to current indicators, the level of economic activity is expected to be moderate in the third quarter as well. These trends, alongside the increase in inflation, are consistent with an economy that is characterized by supply restrictions on activity, particularly in view of the fiscal expansion due to the war.

The Committee discussed the impacts of the war on financial markets and on the foreign exchange market. During the reviewed period, the Fitch ratings agency announced a lowering of Israel's credit rating from A+ to A, with a "negative" outlook. As the agency explained, the decision reflected the security situation, but also an assessment of the management of Israel's fiscal policy, and emphasized the future policy path. In view of the increased geopolitical uncertainty, Israel's risk premium, as measured by the spread between dollar-denominated government bonds and US Treasury bonds remained high and even increased to record levels during the reviewed period. The 5-year CDS spread also increased, and remains at high levels. In addition, the shekel traded with high volatility and high sensitivity to geopolitical developments.

Domestic equity indices increased during the reviewed period, but the underperformance of the domestic stock market relative to various indices worldwide since the outbreak of the war remains significant. Government bond yields declined, but more moderately than the global trend. The growth rate of business credit in recent months has been lower than in the period prior to the war, and the most recent figures (June) show that credit to large companies increased, while credit to the rest of the business sector declined slightly. Credit risk indices in the business and consumer credit segments increased somewhat, but they indicate a level that is not high relative to the past decade.

The Committee members discussed developments in the housing market. Home prices continued to increase rapidly in recent months, rising 4.7 percent in the past year, alongside an increase in mortgage volume. The pace of increase in rental prices (owner-occupied housing services component in the CPI) also grew. Concurrently, activity in the construction industry is recovering gradually but the limitations on the industry's activity in view of the shortage of workers due to the war are still significant.

The Committee discussed the global environment. Economic activity worldwide continues to expand. Activity in the US remained strong, and concerns of a coming recession dissipated. In the eurozone, second quarter growth surprised to the upside, but economic weakness in Germany is expected to continue to affect activity in the third quarter. In China, second quarter growth was lower than forecast, and activity remained relatively weak at the beginning of the third quarter as well. Investment houses' global growth forecasts for 2024–2025 remained virtually unchanged. In their most recent decisions, both the Federal Reserve and the ECB left their monetary interest rates unchanged. The downward path of their interest rates is expected to remain more rapid, and in his speech at Jackson Hole, the FED Chairman signaled the start of a process of lowering the interest rate in the US.

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 Wednesday, October 9, 2024.

The dates of interest rate decisions for 2024 and 2025:

<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 Chairperson of the Monetary Committee
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, Assistant to the Governor
Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department
Ms. Liat Indig, Bank Spokesperson's office
Mr. Daniel Nathan, Research Department
Ms. Dana Orfaig, Research Department
Mr. Tzvi Sussmann, Monetary Committee Secretariat