

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

March 6, 2023

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

The discussions took place on February 19 and 20, 2023.

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 February 20, 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 4.25 percent. Four Monetary Committee members supported increasing the interest rate by 0.5 percentage points and one member supported an increase of 0.25 percentage points.

The discussion focused on the inflation environment in Israel and worldwide, alongside an examination of the economic activity level and the labor market that are at a high environment. 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 5.4 percent. An analysis of CPI components indicates that the price increases were recorded in a wide range of CPI components, and that a notable portion of them is driven by domestic demand factors. Along with that, the Committee members noted that inflation in the nontradable component has remained high for some time now. The Committee discussed inflation in Israel remaining low relative to most economies worldwide, though net of energy and food, the inflation rate was closer to the OECD median. The inflation expectations and forecasts for the coming year from all the sources increased, but are around the upper part of the target range. Expectations derived from the capital market for the second year and onward are also within the target range. The Committee assessed that the monetary tightening processes in Israel and worldwide are acting to moderate the inflation rate. The Monetary Committee noted that the extent of fiscal expansion, the development of wages in the economy, the exchange rate, and inflation worldwide will have an impact on the pace of convergence of inflation to its target.

The Committee discussed the data on economic activity, which indicate continued robust activity, with a slight decline in the most recent data. Within that, the Committee discussed the tight labor market, which weakened a bit in the most recent data, but remains in a high environment that reflects a full employment environment. Likewise, the job vacancy rate declined moderately in most of the previous months, but is still very high. In the fourth quarter of 2022, GDP grew relative to the third quarter of the same year by 5.8 percent in annual terms, higher than expected growth, which derived from an increase in private consumption, public consumption, and in investments and a decline in imports. In contrast, there was a notable decline in goods exports and services exports, which are still at levels higher than their pre-crisis levels.

The Committee discussed housing market developments, particularly the moderation in the scope of activity. Home prices increased in the past 12 months by 17.1 percent, a high rate compared to the pace of recent years, but in the most recent data there is moderation in the growth rate. In addition, the number of home purchase transactions continues to decline and new mortgage volume in January continued to decline as well and is approaching the pre- crisis average level.

Monetary Committee members discussed the domestic capital market, in which equity indices are at a level similar to their level at the beginning of the year, and reflected underperformance vis-à-vis equity markets around the world. Long-term government bond yields are at a level similar to the beginning of the period reviewed. According to the Business Tendency Survey conducted by the Central Bureau of Statistics, the difficulty of attaining credit reported by various companies continues to be at a relatively low level.

The Committee members also discussed developments in the exchange rate, its impact on inflation, and the pace of inflation's return to the target. Exchange rates were characterized by high volatility, and since the previous policy decision, the shekel weakened by 1 percent against the dollar, by 2 percent against the euro, and by 1.3 percent in terms of the nominal effective exchange rate.

The Monetary Committee discussed global activity. The IMF and investment houses revised the 2023 growth forecast upward for the various blocs as a result of a decline in concerns of an energy crisis in Europe, the reopening of China after lifting the COVID-19 limitations, and better than expected activity data in the US. However, the growth rate in major economies continues to be moderate. Purchasing managers indices for advanced and developing economies increased, with the index for developing economies in an environment indicating economic expansion, but in advanced economies the index still indicates slowing in the pace of activity. The inflation environment worldwide remains high, but there has been a trend of moderation in many countries. However, in core inflation indices the trend is mixed. In most countries, inflation indices are at a markedly higher level than central bank targets, and therefore the monetary tightening worldwide continues, but major central banks are slowing the pace of interest rate increases.

At the end of the discussion, four of the five Committee members supported an interest rate increase of 0.5 percentage points, to 4.25 percent, in view of the persistence of inflation and the prolonged depreciation in recent months. One Committee member supported an increase of 0.25 percentage points. 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

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

Ms. Shira Buzaglo-Baris, Research Department

Mr. Gilad Brand, Research Department

Dr. Oded Cohen, Chief of Staff to the Governor

Mr. Nadav Eshel, Consultant to the Governor

Mr. Arad May, Monetary Committee Secretariat

Mr. Daniel Shlomiuk, Bank spokesperson's office