

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

Press Release:

# May 27, 2024

**The Monetary Committee decides on May 27, 2024**

**to leave the interest rate unchanged at 4.5 percent**

* Economic activity and the labor market continue to recover gradually. Alongside this, continued geopolitical uncertainty is reflected in the economy’s high risk premium.
* There has been some increase in the inflation environment. Inflation in the past 12 months is 2.8 percent. Inflation expectations and forecasts from the various sources for the coming year increased, and are around the upper bound of the target range. Expectations for the second year and forward are within the target range, in its upper portion.
* Since the previous monetary policy decision, the shekel strengthened by about 1.1 percent against the dollar and the euro, and by about 1.2 percent in terms of the nominal effective exchange rate.
* GDP expanded by 3.35 percent in the first quarter of 2024, compared with the previous quarter, and reflects growth in private consumption and in fixed capital formation. Despite this expansion, GDP remains 2.8 percent lower than its prewar level.
* In the housing market, home prices continue to increase and the constraints and difficulties in the industry’s activity in view of the war remain significant. The housing component of the CPI increased by 0.6 percent, and the pace of annual increase is 2.7 percent.
* The global economy continued to expand in the first quarter. Inflation remains above central bank targets, and there was an increase in the interest rate path expected by markets.

**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.**

The State of Israel has been at war for approximately 8 months. Beyond the security effects, the war has economic consequences, both on real activity and on the financial markets. National Accounts data indicate improvement in activity in the first quarter, following a notable contraction in business activity with the outbreak of the war. However, the activity level has not returned to its prewar level and is impacted mainly by supply constraints. The level of prolonged geopolitical uncertainty is reflected in the economy’s high risk premium.

There has been some increase in the inflation environment. The CPI for March increased by 0.6 percent and the index for April 2024 increased by 0.8 percent. Inflation in the past 12 months increased to 2.8 percent, close to the upper bound of the target range. (**Figure 1**). Net of energy and fruits and vegetables, the inflation rate is at an annual pace of 2.4 percent (**Figure 2**). The inflation dynamic has increased and inflation in the past three months, seasonally adjusted in annual terms, has been higher than year-over-year inflation. The annual pace of inflation of the tradable components continued to increase, to 2.8 percent, while the pace of annual inflation of the nontradable components of the CPI continued to moderate, to 2.8 percent as well (**Figure 4**). The travel abroad component, which accounts for less than 2 percent of the CPI, contributed 0.4 percentage points to the change in the April CPI, which is also having an impact on the various core indices, although it is not yet clear whether this increase is temporary. Inflation expectations for the coming year from various sources increased, and are around the upper bound of the target range (**Figure 6**). Expectations for the second year and forward are within the target range, in its upper portion (**Figure 7**). The Committee’s assessment is that there are several risks of a potential acceleration in inflation: geopolitical developments and their effects on economic activity, a depreciation of the shekel, continued supply constraints on activity in the construction and air travel industries, fiscal developments, and global oil prices.

Since the previous interest rate decision, the shekel strengthened by about 1.1 percent against the US dollar and against the euro, and by 1.2 percent in terms of the nominal effective exchange rate. The exchange rate has been highly volatile, mainly influenced by the security developments.

National Accounts and employment data point to recovery of the economy in the first quarter, after the sharp decline that occurred with the outbreak of the war. However, the economy is below the trend of recent years, and has not yet returned to the activity level that characterized it before the war. There is still considerable variance among major industries, with adverse effects on the construction and hospitality industries in particular. Tax revenues in April 2024 were 4.1 percent higher (in real terms, net of legislative changes) than in the corresponding month of the previous year, and are in line with the multiyear trend line. The cumulative deficit over the past 12 months continued to increase due to the growth in government expenditures. Net of the specific deferral of VAT payment collection, it totaled 6.7 percent of GDP, as of April. The cumulative annual deficit is expected to continue to climb in the coming months, and to converge back to an environment similar to the current one toward the end of 2024, provided that there are no notable deviations in security expenditures.

National Accounts data from the Central Bureau of Statistics indicates that GDP expanded by 3.35 percent in the first quarter of 2024, relative to the fourth quarter of 2023, and in annual terms, the growth rate is 14.1 percent (**Table 1**). The quarterly growth of GDP reflects an increase in private consumption and in fixed capital formation. However, despite this expansion, GDP remains 2.8 percent lower than its level in the third quarter of 2023, prior to the war. The activity level measured on the basis of rapid indicators for April reflects moderate improvement. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for April remains stable relative to the previous month, following a sharp recovery in the first quarter of the year.

The supply constraint in the construction industry is expected to continue being affected mainly by the shortage of workers and the uncertainty about them, and the adverse impact on supply chains. According to the Central Bureau of Statistics Business Tendency Survey, the supply constraint of the shortage of equipment and raw materials is still higher than before the war. In April there was still a high level of 18 percent of manufacturing companies and 16 percent of companies in the construction industry that reported constraints on the growth of activity due to a shortage in equipment and raw materials (**Figure 16**).

Credit card expenditure volume remained high and is on the long term trend path. Goods and services exports declined by 2.9 percent in the first quarter, led, by a decline in goods exports, alongside an increase in services exports. Services exports, excluding tourism, have essentially recovered completely and there has also been an increase in the pace of high tech funding (**Figure 25**). In contrast, goods exports and tourism service exports are still significantly lower than the prewar level.

The labor market continues to recover in view of the continued increase in demand for workers, and alongside an easing of the labor supply constraint due to the reduction in the number of those serving in military reserve service. In March, there was an increase in the employment rate, and in April it remained stable, at a level that is slightly lower than before the war. The employment rate net of those temporarily absent for economic reasons continued its upward trend, although the increase was minor in April. The broad unemployment rate continued to moderate, to 3.8 percent in April, compared to 4.1 percent in March. The rate of employees absent from their jobs for noneconomic reasons continued to moderate as well, and now reflects almost solely those performing reserve duty (0.9 percent). However, there was also a decline in the labor force participation rate, such that the employment rate (excluding those absent for economic reasons) remained similar to the previous month (60.5 percent compared to 60.4 percent). Labor input (the total number of actual work hours) continued its upward trend, but remained lower in March than the 2023 (prewar) average. The job vacancy rate increased in April to 4.4 percent and is reflected mainly in industries in which employment declined significantly due to the war, such as construction and food and hospitality services (**Figure 23**). In the past year, the increase in wages accelerated, although this was accompanied by a significant increase in labor productivity in the business sector.

In the housing market, home prices continue to increase, while the pace of increase in rents is moderate. In February–March 2024, the Index of Home Prices increased by 0.9 percent and new home prices increased by 0.5 percent. In the past 12 months, home prices increased by a cumulative 1.1 percent (**Figure 17**). The volume of transactions has been relatively stable over the past 3 months, after recovering from its low level following the outbreak of the war. In April, new mortgage volume was NIS 5.9 billion (**Figure 18**). The housing component in the CPI increase by 0.6 percent and the year over year rate of increase reached 2.7 percent. Alongside these, construction industry activity is recovering gradually but the industry is sill not functioning at its full potential. As of April, the number of employees reported in the industry is about 20 percent lower than the overall employment in the industry before the war. The constraints in the construction industry, due to the shortage in workers and in raw material and equipment, alongside the need for housing solutions for those evacuated from their homes because of the war, are liable to make it difficult for further moderation of housing and rental prices.

In the capital market, local equity indices declined during the reviewed period. The cumulative underperformance of the domestic equities market relative to the global market since the start of 2023 remains significant (**Figure 34**). Government bond yields increased more than the global trend during the reviewed period, and corporate bond spreads, which widened at the start of the war, declined to below their prewar levels (**Figure 10**).

Israel’s risk premium as measured by the spread between dollar-denominated Israel government bonds and US Treasuries increased in the reviewed period. In addition, the CDS spread remains at high levels. In the reviewed period as well, the trend of credit to the business sector continued to slow. Based on the Central Bureau of Statistics Business Tendency Survey for April 2024, the difficulty in obtaining credit among large and medium-sized companies remained low, and the difficulty for small businesses declined slightly (**Figure 11**).

Worldwide, first quarter growth data indicated continued expansion of the global economy. US growth, including some of the most recent data in the reviewed period, moderated, but data related to consumption continue to indicate strong activity. In the eurozone, growth surprised broadly to the upside. The picture in China was similar, with a positive surprise in first quarter GDP data. The global growth forecast of investment houses was revised slightly upward (**Figure 27**). The Purchasing Managers Index (PMI) for advanced economies increased slightly, and the PMI for emerging markets declined slightly, though both are at levels indicating continued expansion of economic activity (**Figure 28**). World trade volume returned to a decline in March, after recovering slightly in February, and for the quarter as a whole, world trade expanded relative to the previous quarter. The data on orders for global exports also indicate a continuation of this trend as well. Oil prices declined during the period, and maritime shipping prices continued to increase. In the US, the general CPI declined in April to an annual rate of 3.4 percent, while the core PCE index moderated slightly to 3.6 percent. The Federal Reserve kept the interest rate unchanged for the sixth consecutive time, while continuing the guidance that the interest rate will remain high and the process of reducing the interest rate will be slow. As a result, the market is currently pricing in an interest rate reduction in the US only in the fourth quarter of the year. In the eurozone, inflation continues to moderate and the overall index was 2.4 percent in April. Core inflation is moderate as well, at 2.7 percent. The ECB kept the interest rate unchanged but the market is pricing in a high probability for a decline already in the next meeting in June.

The minutes of the monetary discussions prior to this interest rate decision will be published on June 10, 2024. The next decision regarding the interest rate will be published at 16:00 on Monday, July 8, 2024.