

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

January 16, 2023

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

The discussions took place on January 1 and 2, 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 January 2, 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 3.75 percent. Five Monetary Committee members supported increasing the interest rate by 0.5 percentage points and one member supported an increase of 0.75 percentage points.

The discussion focused on the inflation environment in Israel and worldwide, the economic activity level and the labor market that are at a high environment, with a decline in the most recent data. 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 5.3 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. The Monetary Committee members noted that despite the increase in the inflation environment in recent months, some moderation can be seen in the most recent data, particularly in the tradable components. The Committee discussed inflation in Israel remaining low relative to most economies worldwide, though net of energy and food, the inflation rate is slightly closer to the OECD median. The inflation expectations and forecasts for the coming year from all the sources are within the target range, and expectations derived from the capital market for the second year and onward are also within the target range. The Committee assessed that these trends, the monetary tightening processes in Israel and worldwide, and the moderation of demand are acting to moderate the inflation rate. However, the Monetary Committee members noted that there is uncertainty regarding the extent of fiscal expansion and the development of wages, which in turn will impact on the pace of convergence to the inflation target.

The Committee discussed the data on economic activity, which indicate a continued robust rate of activity, with a slight decline in the most recent data. As such, 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 number of job vacancies and their rate declined in November but are still at historically high levels. The level of GDP continues to be above the trend line of before the COVID-19 crisis, and additional economic indicators, including goods exports (excluding ships and aircraft, and diamonds), services exports, and components of goods imports, continue to be at an environment higher than their level of before the

crisis. The Committee discussed the Research Department's updated macroeconomic forecast. The expected level of activity remains robust and is around the economy's potential growth. According to the forecast, GDP is expected to grow by 2.8 percent in 2023 and by 3.5 percent in 2024. The Bank of Israel interest rate is expected to be 4 percent, on average, in the fourth quarter of 2023. Committee members also studied the various risks to the realization of the forecast and their possible impact on economic activity and the monetary policy adopted.

The Committee discussed housing market developments. Home prices increased in the past 12 months by 20.3 percent, a markedly high rate compared to the pace of recent years. Alongside that, the Committee members noted that several other indicators could point to expected moderation in the market: the number of home purchase transactions continues to decline and new mortgage volume in November is approaching the pre-COVID-19-crisis average level.

The Monetary Committee discussed the domestic capital market, in which equity indices declined, and yields on long-term government bonds increased notably. Since the beginning of the monetary tightening, there has been some slowing in business credit, alongside an increase in interest rates on the credit. According to the Business Tendency Survey conducted by the Central Bureau of Statistics, there has been an increase in the difficulty of financing reported by small and medium companies, but the difficulty in attaining credit remains low.

The Committee members also discussed developments in the exchange rate, its impact on inflation, and the pace of inflation's return to the target. Since the previous policy decision, the shekel weakened by 1.6 percent against the dollar and by 5.8 percent against the euro, and by 3.4 percent in terms of the nominal effective exchange rate.

The Monetary Committee discussed global activity, which continues to moderate, and the continued trend of monetary tightening being adopted by central banks, including the Fed and the ECB. The continuing war in Ukraine, the energy crisis in Europe, the monetary tightening, and the slowdown in China, are expected to lead to moderation in the pace of economic activity worldwide. Accordingly, investment houses revised their 2023 and 2024 global growth forecasts downward. Purchasing managers indices for advanced and developing economies indicate a slowdown in the pace of economic activity. The inflation environment worldwide remains high. However, in some countries, particularly the US, moderation is seen. In contrast, core inflation remains stable. 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, five of the six Committee members supported an interest rate increase of 0.5 percentage points, to 3.75 percent. One Committee member supported an increase of 0.75 percentage points, in view of the increase in inflation and the prolonged depreciation in recent months. 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. Moshe Hazan

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

Dr. Oded Cohen, Chief of Staff to the Governor

Mr. Nadav Eshel, Consultant to the Governor

Mr. Arad May, Monetary Committee Secretariat

Mr. Ari Kutai, Research Department