

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

April 17, 2023

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

The discussions took place on April 2 and 3, 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 April 3, 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 0.25 percentage points, to 4.5 percent. All the Monetary Committee members supported increasing the interest rate by 0.25 percentage point.

The discussion focused on the inflation environment in Israel and worldwide, alongside an examination of the domestic economic activity level and the labor market. The Committee also discussed global economic activity, which continues to be moderate, and its impact on the domestic economy, the housing market, and the decline in the volume of transactions, and the domestic capital market.

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 declined slightly in February but by less than previously assessed, and it remains at a high level (5.2 percent). An analysis of CPI components indicates that the price increases were recorded in a wide range of components, and that a notable portion of them derives from domestic demand factors, and in which “sticky inflation” is apparent. The Committee members noted that inflation in the nontradable component is made up mainly of the housing component and the services industries. Alongside that, the Committee noted that there has been a decline in inflation of tradable prices. The Committee members pointed out that the inflation rate in Israel remains low compared to most advanced economies worldwide, but that net of the volatile food and energy components, it is closer to the median of advanced economies. One-year inflation expectations and forecasts increased from all sources, and are in the upper part of the target range or even slightly above it. Expectations derived from the capital market for longer terms, for the second year and onward, are within the target range. The Committee assessed that the monetary tightening processes in Israel and abroad, and the moderation of demand, are working to moderate inflation. The Committee members noted that the proposed budget that was recently approved by the government is in line with the contractionary monetary policy in this period. The public sector wage agreements that were recently signed reduced the uncertainty in this area and are also consistent with reining in the inflation rate and returning it to within the target range. The Committee assessed that the wage developments in the economy, the exchange rate, and inflation worldwide will impact on the pace of inflation converging to its target.

The Committee discussed the data on economic activity and on the labor market. It was noted that the economic activity is around the long term trend. However, the pace of its

expansion slowed in the most recent data. The Committee members noted that the employment rate continues to be at a level that indicates a full employment environment and the unemployment rate among the prime working ages remained essentially unchanged. Within that, the job vacancy rate, which reflects excess demand for employees, continued to decline moderately but it remains at a very high level. The Committee members noted that the job vacancy rate in the high tech sector continues to decline in parallel with the sharp decline in capital raised. The average wage per employee post increased in real terms in January, after prolonged erosion during 2022. Despite this, the real wage remains slightly lower than the trend line. Goods and services exports slowed relative to data for the previous year but their level remains high. In addition, in accordance with the Business Tendency Survey conducted by the Central Bureau of Statistics, in recent months there has been some increase in the severity of the constraint of export orders for manufacturing companies, but compared to before the COVID-19 crisis there is not a major difference.

The Committee discussed housing market developments, particularly the moderation in the scope of activity. Home prices increased in the past 12 months by 14.6 percent, and in the most recent data there is moderation in the growth rate, almost to a halt; only 0.1 percent in February. In addition, the number of home purchase transactions continues to decline, in parallel with the decline in new mortgage volume. In February new mortgage volume was about half of the amount in February of 2022. Based on Central Bureau of Statistics data, in the final quarter of 2022 there was a slowing in building starts in Israel but the annual level remains high. In addition, 2022 ended with a very high level of construction permits compared to the past. At the same time, there was a moderate increase in building completions. The annual pace of increase of rents continued to rise in February.

Monetary Committee members discussed the domestic capital market and the price declines in equity indices. From the beginning of the year, equity returns reflected underperformance compared with equity indices worldwide. Long-term government bond yields increased slightly in the reviewed period, in contrast to the global trend of yield declines. According to the Business Tendency Survey conducted by the Central Bureau of Statistics, the difficulty of attaining credit reported by companies of various sizes continues to be at a relatively low level.

In terms of the foreign exchange market, the Committee members discussed exchange rate developments and their impact on the pace of inflation's return to the target. Since the previous interest rate decision, exchange rates displayed high volatility, and the strong connection between the exchange rate and the S&P 500 index was detached to some extent. In the reviewed period, the shekel weakened by 1.5 percent against the dollar, by 3.3 percent against the euro, and by 2 percent in terms of the effective exchange rate.

The Monetary Committee discussed global activity. It noted that global economic activity continued to be moderate, against the background of the increase in the risk of the global banking system, reflected in the collapse of SVB, which specialized in credit to the high tech industry. In contrast, the concern of a severe recession in Europe decreased and economic activity in China increased, though at a lower pace than previously expected. Investment houses worldwide revised the 2023 growth forecast slightly upward for most of the major blocs. However, world trade growth remained moderate. The export orders component in purchasing managers indices for various economies, a leading indicator for world trade data, also indicated some moderation. The inflation environment worldwide remains high, but the trend of moderation continued in many countries. In contrast, core inflation indices, in most advanced economies, continued to increase. Against the background of these trends, the monetary tightening worldwide continued, but many central banks slowed the pace of interest rate increases.

The Committee members also discussed the Research Department's macroeconomic forecast, which was updated this month. In view of the considerable uncertainty deriving from the legislative processes related to the judicial system and their economic ramifications, the Research Department included two possible scenarios within the framework of the forecast. In the first scenario, the disagreement around the legislative changes related to the judicial system will be resolved in such manner that there won't be effects on activity going forward. The additional scenario presented an analysis of the possible economic ramifications if the legislative and institutional changes are accompanied by an increase in the State's risk premium, an adverse impact on exports, and a decline in demand for domestic investments and in demand for private consumption.

At the end of the discussion, all the Committee members supported an interest rate increase of 0.25 percentage points, to 4.5 percent. The Committee members noted that economic activity in Israel is at a high level, and is accompanied by a tight labor market, although there is some moderation in a number of indicators. Inflation is broad and remains high. Therefore, the Monetary Committee decided to increase the interest rate. The interest rate path 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

Mr. Gilad Brand, Research Department

Dr. Oded Cohen, Chief of Staff to the Governor

Mr. Nadav Eshel, Consultant to the Governor

Mr. Ari Kutai, Research Department

Mr. Arad May, Monetary Committee Secretariat

Mr. Daniel Shlomiuk, Bank spokesperson's office