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**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

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**Press release:**

**Remarks by the Governor of the Bank of Israel at the press briefing on monetary policy held today at the Bank of Israel**

Good afternoon.

On Saturday morning, October 7, in the midst of the Simchat Torah holiday, the Hamas organization launched a murderous campaign of terror in many locations in Israel, violating every basic rule of morality and humanity. As of now, the number of people killed is over 1,400, there are thousands of injured, and a large number of people taken hostage. There is almost no one in Israel who does not know a family in which one of their members was killed, injured, or taken hostage. Those who lost their lives include family members of Bank of Israel employees. I extend my condolences to all the families of those killed, wish a rapid recovery to all the injured, pray for the safety and welfare of the captives, and look forward to their safe return. This is the reality to which we awoke on the holiday morning. This is why Israel has gone to war now against the terrorists. It is a war that will continue to affect us, certainly in the coming period.

The war has various economic ramifications, both on real activity and on the financial markets. Already at the beginning of my remarks, I want to emphasize that Israel’s economy is robust and stable. In certain areas, such as innovation and technology, we are global leaders. The Israeli economy knew how to recover from previous difficult periods and return rapidly to prosperity, and I have no doubt that it will do so this time as well.

Since the beginning of the war, the Bank of Israel has been holding ongoing assessments of the effect of the security situation on various economic and financial aspects, and have taken policy steps accordingly. I will expand on that a bit later on. Naturally, a notable portion of the Monetary Committee’s discussions held in the past two days focused on the economic effects of the war. The Monetary Committee analyzed the various processes and their effect on economic activity and inflation, and at the end of the discussions decided to keep the interest rate unchanged at 4.75 percent.

At this point, I would like to lay out for you the various policy steps that the Bank of Israel has taken since the beginning of the war, in the financial markets and in banking. With the outbreak of fighting, significant depreciation pressures were seen, which were reflected in early trading in foreign markets. We responded rapidly. On October 9, before trading opened, we implemented a plan to sell up to $30 billion of foreign exchange and to put into operation Swap transactions totaling up to $15 billion. Within the framework of the program, the Bank is acting in the market to moderate the fluctuations in the value of the shekel and to supply the liquidity required to continue the orderly activity of the markets. We do not have a target exchange rate, but we do want to verify that there aren’t abnormal fluctuations and to ensure full and proper functioning of the markets in general, and the foreign exchange market in particular. The high level of the Bank of Israel’s foreign exchange reserves, at about $200 billion, gives us space to act to achieve this target. An additional plan that we put into operation is the Repo transaction program, the goal of which is to supply shekel liquidity to institutional entities and to mutual funds against government and corporate bonds. Our interventions in the financial markets, together with the other monetary policy tools, work to stabilize the markets and maintain their continued orderly operation by reducing uncertainty for the economy and the public at this time.

In parallel, from the beginning of the fighting I outlined several principles for banking system activity. I particularly emphasized the need to show extra sensitivity toward customers bearing the burden of the battle, those in the communities around Gaza, and the families of the injured and missing. Pursuant to this principle, the Bank of Israel’s Banking Supervision Department rapidly formulated a uniform and agreed-upon framework that was adopted by the banks and this morning was expanded to credit card companies as well. The framework is focused on those serving in the army reserves, the population bordering Gaza and in the South, and the families of the victims and missing. These populations will be able to defer for three months payments on mortgages, consumer credit, and small business credit. In contrast to frameworks from the COVID-19 period, in the current framework the deferrals will not carry any cost—neither interest nor fees. The framework also provides a response to the other parts of the population that are enduring difficulties. It markedly and rapidly eased cash flows of these populations, increased the financial certainty for them, and will help them get through this complex period. Some banks are even providing credit payment deferrals beyond the framework and I welcome that.

Every war, including the current one, has a notable fiscal dimension. This dimension is the responsibility of the government and led by the Ministry of Finance. I have been in contact with the Minister of Finance from the beginning of the war and this also goes for the relevant professionals at the Bank and the Ministry of Finance as well.

I am of the view that in this regard there are three main objectives that we need to keep in mind:

First, we have to continue providing fiscal cover that will enable the security forces and the fighting system to conduct the war in accordance with the goals defined for it. Second, we should ensure that there is assistance for residents of the border areas and the families of the victims and missing; and to support the people called up to military reserves and those that are staffing the emergency and rescue systems. The assistance plan launched by the government last week, which includes direct grants to households that were evacuated from the surrounding area and the measures to find housing for those displaced from the battles zones, is the beginning of a response in the right direction, and action should be taken to increase the efficiency of the aid systems consistently. The framework that we promoted with the banking system and the credit card companies and the various steps being taken by the banks on a voluntary basis in order to ease things for these population groups are a complementary step to the government’s policy and also serve the said objective.

In addition to the two goals I mentioned, a third goal is to moderate the war’s macroeconomic effect on the economy. This, among other things, is via business continuity grants and assistance with cash flows and loans guaranteed by the government that will support the ability of businesses, primarily small and medium sized businesses whose scope of activity has been adversely impacted, to meet their fixed expenses and salary expenses and to get through the current period. The government is currently working to create an assistance plan based on covering fixed expenses of businesses and financing part of the wage expenses. It is important that the framework that will be formulated will provide a response that is appropriate and as rapid as possible to the needs of the businesses negatively impacted alongside maintaining a responsible fiscal framework.

The budget conduct is important. In the first stage, an effort should be made to create the required budget sources by changing the order of priorities under the existing budgetary framework. This includes the priorities reflected in the coalition agreements. The budget framework has to be increased only after exhausting the possibilities of acting within the existing framework and in a measured and thought-out manner. I would like to emphasize that a government effort to continue to maintain fiscal responsibility in the current time as well, is an important message to financial markets, which will support keeping the costs low for raising the financing necessary at this sensitive time. It is important to remember that at this time there is of course a lot of uncertainty regarding the development of the war and its length. This is also one of the reasons why we need to maintain degrees of freedom to adjust our economic policy.

The housing market has considerable weight in economic activity. In recent months, we have seen moderation in this market. The Home Price Index continued to decline in September, following the trend of moderation noted in recent months. The security situation has led to an adverse impact on activity in the construction market, because of a lack of workers arriving from across the green line alongside the departure of foreign workers from other countries. In addition, the closing of construction sites by some local authorities limits the activity of the contracting companies. At this time, it is important that the government act to remove barriers in the process of bringing foreign workers into Israel. In addition, the government and local authorities should take care to minimize the various limitations in construction sites in order to maintain the activity in the industry. In addition to maintaining activity in the immediate term, a high supply of construction should be maintained over time. This is the key, as I have noted in the past, to continued moderation in housing prices.

On the eve of the war, we saw economic activity data in the Israeli economy that indicated a solid level of activity. We were at a high level of GDP, which reflected high demand and a positive output gap for a prolonged period. The labor market was tight with a record high employment rates and very low unemployment. This was alongside signs of a slowdown in the growth rate and moderation in the rate of price increases due to the interest rate policy. It is reasonable that the events of the war, the extensive scope of calling up the army reserves, and the adverse impact on businesses’ activity will affect these data. Experience has shown that the notable channels of real negative impact during a time of war are reflected on the supply side as well as the demand side. These include, among other things, absence of employees and irregularity in the education system, an adverse impact on consumption of leisure services, a negative impact on the construction, agriculture, and tourism industries, together with increased budgets for security issues. The government deficit and the debt to GDP ratio are expected to increase as well. The magnitude of the war’s impact will be affected by its scope. The longer and the wider the economy that is shut down, the greater the economic impact of the war. We already see, for example, that there is a significant decline in consumption as reflected in credit card expenditure, except in the food industry. In the domestic capital market, equity indices in Israel declined sharply and long-term government bond yields increased. In the credit market, corporate bond spreads in Israel widened.

These things and others are taken into account in the updated macroeconomic forecast published today by the Research Department. The forecast begins from the starting point in which the level of actual economic activity was higher than the assessment of the Department in its previous forecast in July. From this point, it incorporates the war’s impacts and estimated costs. It is important to emphasize clearly: This forecast was compiled in the midst of the war, in a period of great uncertainty related to the developments of the war and its various ramifications. The Research Department’s forecast is based on a scenario of a war that is concentrated in the South during the fourth quarter of the year. This is based on the existing data on previous security incidents and relevant adjustments to the current war. Clearly, a longer or shorter timespan and developments in the war to other arenas will change the estimates substantially. In accordance with these assumptions, the Department assesses that GDP will grow in 2023 by 2.3 percent and in 2024 by 2.8 percent. According to the forecast, the unemployment rate is expected to be 3.6 percent at the end of 2024. The year over year inflation rate is expected to decline to 2.9 percent in the third quarter of 2024 and to 2.5 percent at the end of 2024. The Department assesses that the costs of the war will lead to an increase in the government deficit to about 2.3 percent of GDP in 2023 and about 3.5 percent of GDP in 2024. These will lead to the debt to GDP ratio being about 65 percent at the end of 2024. This is the place to note again that responsible fiscal policy brought the economy to a desired debt to GDP ratio of about 60 percent at the beginning of the war. This ratio supports us at this time when the economy is expected to face significant expenditures as a result of the war. It is important to continue conducting responsible fiscal policy, and to convey this to the markets, which today more than ever are following the activity in Israel. In particular, it is important that the government shows its commitment to fiscal responsibility through a concerted effort to reduce expenditures that have become less crucial at this time, and adoption of an effective and targeted civilian expenditure plan. Recall that in contrast to dealing with the COVID-19 period, the Israeli economy’s dealing with the current war is a local event and therefore the markets’ response to the budget conduct is likely to be less tolerant.

In terms of financial risks, the steps being taken by the Bank of Israel and the government are expected to ease the financial situation of households and businesses. In addition, war scenarios, a pursuant increase in the risk premium, and a deterioration in the rating of banks in Israel, have been examined several times in the framework of the uniform macroeconomic stress test of the banking system. The results of the stress scenarios indicate that in situations such as these, as well, the banking system in Israel remains stable and resilient.

I would like to refer now to inflation. As I noted, monetary policy is working to stabilize the markets. The policy tools that we implemented so far are also consistent with our commitment to return inflation to the target.

We entered the war with inflation in Israel that was still above the target and that encompassed a wide range of CPI components. However, the inflation rate moderated gradually in recent months and is low relative to most countries. This trend of moderation can be seen in headline inflation as well as in the inflation rate among nontradable and tradable items, even though these are volatile due to commodity prices and the exchange rate.

Looking to the future, in the immediate term the war is expected to have a substantial impact on the development of prices, both in view of the shekel's depreciation and from the demand and supply shocks. As of now, the expectations and forecasts point to inflation returning to its target in the coming year. Expectations derived from the market for longer terms are within the target range. These provide us with important information on how market participants see the economic situation and their approach regarding the effect of the monetary policy on inflation. It is important to remember that the expectations are part of the equilibrium. They are determined, among other things, in view of our interest rate policy and the confidence the markets have in the Bank of Israel’s monetary policy. I will emphasize what I said several days ago in a speech to the G30: the main risk to inflation in Israel in the past 9 months, and even more so now, has been the depreciation of the shekel.

In terms of the rest of the world, the security incidents in Israel caused an increase in the geopolitical tension in the Middle East and led to fluctuations in trading and in the financial conditions in global markets as well. With the outbreak of the war, the prices of oil and natural gas increased.

Even before the war, economic activity in most areas, except the US, had weakened, and the forecasts of the economic entities expect moderate growth in the major blocs in 2023 and 2024. The monetary tightening worldwide continues, and therefore the trend of moderation in inflation continues, even in core indices, despite the renewed increase in energy prices. In financial conditions worldwide, there has been tightening and central banks are conveying the message of “higher for longer”, and financial markets declined, with considerable volatility.

In conclusion, I will repeat—the Israeli economy is robust and stable. We have known how to recover from difficult periods in the past and to return rapidly to prosperity. I have no doubt that it will do so this time as well. The Bank of Israel will continue to fulfill our function in conducting monetary policy, stabilizing the financial markets, supervising the banking system, and the continuity of the payment systems. The interest rate path and the implementation of additional policy tools will be determined in accordance with the development of the war, and activity data and the development of inflation, in order to continue supporting the stability of the markets and achieving the policy goals and the economy’s needs.

Since the war broke out, I have received messages of broad support and solidarity from governors of many central banks and senior economic officials worldwide. I continue to be in contact with many international organizations from the economic world, and I thank all of them for their expressions of support.

I would also like to convey that the thoughts of the Bank of Israel and the Monetary Committee are with the soldiers on the front. We extend our condolences to the families of those killed, we wish for a full recovery to the injured, and we pray for the speedy return of the captives and the missing. Our thoughts and prayers are with you.

I would like to conclude by noting the birthday of Ohad Munder Zichri from Kfar-Sava, who was to celebrate his 9th birthday today together with his friends and family. Instead, Ohad is a hostage in Gaza, after having been taken captive on that terrible day. At his family’s request, we will mark it with a balloon in honor of his birthday. We pray that Ohad and the rest of the hostages return to us and will celebrate their birthday at home.

Together we will overcome!