

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

# September 4, 2023

Press Release:

**The Monetary Committee decides on September 4, 2023**

**to leave the interest rate unchanged at 4.75 percent**

* Inflation is moderating, but is still above the target range. One-year inflation expectations and forecasts are within the target range, near the upper bound. Expectations derived from the capital market for the second year onward are within the target range.
* National Accounts data show that the level of GDP reflects a level of activity that is above the pre-COVID-19 trend line. However, the pace of growth is below potential economic growth, total uses in the economy declined, and a number of indicators point to some moderation in growth.
* The labor market remains tight and in a full employment environment, but the downward trend in the job vacancy rate continues.
* The volume of activity in the housing market continues to moderate. Home prices have declined in recent months, and the annual pace of home price increases moderated to 5.2 percent. The moderating trend in the number of purchases and in the volume of new mortgages continues.
* Since the previous monetary policy decision, the shekel weakened by 2.3 percent against the US dollar, by 1.3 percent against the euro, and by 1.5 percent in terms of the nominal effective exchange rate. The shekel’s depreciation in recent months is contributing to the increase in the inflation rate and the path of the exchange ratge in the coming months will have an impact on the dynamics of inflation.
* Globally, the pace of economic activity is moderate, but the most recent growth figures surprised to the upside, mainly in the US. The inflation environment is moderating in many countries, but remains above central bank targets, while core inflation remains sticky. With that, monetary tightening around the world continues.

**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. With that, in recent months inflation appears to be slowing. Therefore, the Monetary Committee decided to leave the interest rate unchanged, but sees a real possibility of having to raise the interest rate in future decisions, if the inflation environment does not continue to moderate as expected. 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.**

**For the file of figures accompanying this notice, click here.**

Economic activity in Israel remains at a high level, although there is some continued moderation in a number of indicators. The labor market remains tight and in a full employment environment. Inflation is moderating, but remains above the target range. The continued tight monetary policy and moderation of activity abroad are expected to lead to a slowing in the pace of inflation alongside some slowdown of economic activity in Israel.

Since the previous policy decision, the CPI increased by 0.3 percent in July, after remaining unchanged in June. The index for those two months was lower than market forecasts. Inflation in the past 12 months declined, but remained above the upper bound of the target range, at 3.3 percent (**Figure 1**). The sharp decline in the annual inflation rate also reflects the effect of the removal of the July 2022 index, which was particularly high. In view of the negative August 2022 index, our assessment is that following the next publication of the CPI, the inflation rate in the coming months is expected to be higher (**Figure 5**). Inflation remains lower in Israel than in most of the advanced economies. Net of energy and fruits and vegetables, inflation in the past year is 3.6 percent, and with the further neutralization of the effects of taxation and regulation inflation is 3.8 percent (**Figure 2**). The pace of annual inflation of the nontradable components of the CPI, which mainly reflects the housing services component and the services industries, remained high, at 5 percent. The annual pace of inflation of the tradable components, which is partly affected by declines in commodity prices abroad, declined, to 0.6 percent (**Figure 3**). Over the past 6 months, and even more so over the past 3 months (in seasonally adjusted annual terms), the pace of inflation is moderating, and is lower than that of year-on-year inflation in the prices of both tradable goods and nontradables (**Figure 4**). One-year inflation expectations and forecasts are within the target range, around its upper bound. (**Figure 6**). Expectations derived from the capital market for the second year and onward are within the target range (**Figure 7**). The data to be published in the coming months will contribute significantly to clarifying the inflation picture. The Monetary Committee’s assessment is that the monetary tightening processes and the moderation of demand in Israel and abroad are working to moderate inflation. In contrast, the depreciation of the shekel in recent months is contributing to an increase in the pace of inflation, and the path of the exchange rate in the coming months will have an impact on inflation dynamics.

National Accounts data show that GDP grew by 3 percent in annual terms during the second quarter of 2023 (**Figure 18**). The level of GDP reflects a level of economic activity that has been above the pre-COVID-19 trend line for eight consecutive quarters. However, the pace of growth is below potential, and total uses in the economy declined. Second quarter growth was especially affected by an increase in fixed capital formation, driven by nonresidential construction, and declines in goods and services exports and imports (**Figure 19**). Private consumption increased moderately, by 1.9 percent, largely due to an increase in Israelis’ consumption abroad (import of tourism services). The output of startup companies declined by 9.5 percent, and returned to its mid-2021 level.

Alongside the National Accounts data for the first half of the year, some activity indicators for July point to some moderation in growth. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey declined in July, but continues to indicate businesses’ positive assessments of their state (**Figure 20).** Credit card expenditure data in real terms are below the trend and are not increasing (**Figure 21**). Tax revenues in July were about 5.5 percent lower in real terms than in the same period last year. Most of this decline was in real estate and income taxes. Goods and services exports stabilized in recent months (**Figure 22**). Goods imports have been in a downward trend in recent months (**Figure 23**).

The labor market remains tight and in a full employment environment, but the job vacancy rate continued to decline in July. The employment rate among those aged 15 and over (61.5 percent, seasonally adjusted) and the employment rate among the prime working ages (25–64, 79.3 percent, seasonally adjusted), are higher than before the COVID-19 crisis (**Figure 24**). The unemployment rate for those aged 15+ declined from the previous month, to 3.4 percent, seasonally adjusted, while the unemployment rate among the prime working ages declined to 3 percent (seasonally adjusted) (**Figure 25**). In the high-tech services industry, the job vacancy rate declined to a level slightly lower than the precrisis data, although the employment level is higher than it was prior to the crisis (**Figure 28**). According to the Central Bureau of Statistics Business Tendency Survey, high-tech companies’ expectations regarding the state of their activity became more pessimistic in the past year (**Figure 30**). The average wage per employee post in May, as well as the nowcast estimate for June, stabilized at a high level relative to the beginning of the year. In view of these figures, the real wage level increased slightly.

The volume of activity in the housing market continues to moderate. Home prices have declined in recent months, and the pace of home price increases in the past 12 months moderated to 5.2 percent (**Figure 13**). In May–June 2023, the Index of Home Prices declined by 0.2 percent, and the prices of new homes declined by 0.6 percent. The downward trends in the number of housing transactions and in new mortgage volume continued. In July, new mortgage borrowing totaled NIS 6.4 billion (**Figure 14**). According to Central Bureau of Statistics data, despite the decline in the number of building starts, the number of people employed in the construction industries and investment in residential buildings (second quarter data) remain high. The owner-occupied housing services component in the CPI increased by 6.2 percent in the past year. Monthly rents for tenants renewing their contracts increased by 3.8 percent in July, and monthly rents on new contracts increased by 9 percent.

Israeli equity indices increased during the reviewed period, more prominently than the global trend. However, the trend of underperformance of the Israeli market relative to global indices since the beginning of the year persists (**Figure 41**). Yields on long-term government bonds increased slightly, and corporate bond spreads remained relatively unchanged. There was a slowing trend in bank and nonbank credit to all activity segments and all industries. According to the Central Bureau of Statistics Business Tendency Survey for July, the difficulty in obtaining credit as reported by the various segments remains relatively low (**Figure 16**). However, there are indications of a slight increase in the indices of credit risk to medium, small and micro businesses. There was a significant decline in capital raised by the high-tech sector relative to recent years, which is part of the global trend (**Figure 29**).

Since the previous monetary policy decision, the shekel weakened by 2.3 percent against the US dollar, by 1.3 percent against the euro, and by 1.5 percent in terms of the nominal effective exchange rate (**Figure 8**). Since the beginning of the year, the shekel has remained one of the weakest currencies in the world (**Figure 9**), while the volatility of the shekel exchange rate has remained high.

The pace of global economic activity is moderate, but the most recent growth data in most blocs, mainly in the US, surprised to the upside. A number of factors continue to weigh down on economic activity, including the continuing war in Ukraine, high inflation, monetary tightening, and the slower-than-expected growth in China. Growth forecasts for 2024 by investments houses remained virtually unchanged, projecting continued moderate growth, while the 2023 forecast for the US was revised upward (**Figure 31**). The global purchasing managers’ indices for both advanced economies and emerging markets continued to decline in July, but continue to indicate expectations of economic expansion (**Figure 32**). In contrast, the indices for the manufacturing sector, which reflects forecast activity in manufacturing-oriented economies such as Germany, continue to indicate economic contraction. Data on the volume of world trade for June 2023 declined, and continue to indicate a slowdown. The export orders component of the Purchasing Managers Index, which is a leading indicator of world trade data, continues to point to a weak trade environment in the coming months as well. Oil prices increased sharply during the period, in view of an increase in demand and a cut in supply. The prices of other commodities excluding energy remained virtually unchanged, but trading was volatile.

The global inflation environment is moderating in many countries, but remains above their central bank targets (**Figure 39**), while core inflation remains sticky. With that, monetary tightening around the world continues, and the markets are pricing in some likelihood of an interest rate increase by the ECB, and to a more moderate extent by the Federal Reserve. In the US, economic activity data continue to indicate positive growth above the trend line, and investment houses accordingly revised their 2023 US growth forecasts upward. The American labor market remains tight, with some moderation. The Consumer Price Index for July resulted in an increase in annual inflation to a rate of 3.2 percent due to the base effect, but inflation is lower than previous expectations. The PCE index declined to 4.7 percent in July, supported by moderation in the increase of the housing component. The Federal Reserve increased the federal funds rate by 25 basis points, and emphasized that it is critical that monetary policy be sufficiently restrictive to return inflation to the target. In the eurozone, economic growth surprised to the upside, and the labor market remained very tight. Inflation for August was unchanged at 5.3 percent, remaining high. Core inflation in the eurozone declined to 5.3 percent, and is also high. The ECB increased its interest rate by 25 basis points, and its president emphasized that the Bank’s future policy directly depends on economic data that will be published in the upcoming period. In the UK, inflation declined sharply in July, to 6.8 percent. Core inflation remained unchanged, at an annual rate of 6.9 percent. The Bank of England increased its interest rate by another 25 basis points.

The minutes of the monetary discussions prior to this interest rate decision will be published on September 18. The next decision regarding the interest rate will be published at 16:00 on Monday, October 23, 2023, followed by a press briefing with the Governor.