**BANK OF ISRAEL**
Office of the Spokesperson and Economic Information

December 14, 2020

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

### The discussions took place on November 29 and 30, 2020.

## 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 November 30, 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 keep the interest rate unchanged at 0.1 percent. Five Committee members supported the proposal to keep the interest rate unchanged, and one Committee member supported the proposal to reduce it to 0 percent.

The discussion focused on the path of recovery of economic activity in the exit process from the second lockdown, on economic developments worldwide, the development of the exchange rate and the inflation environment, as well as on the state of financial markets and the efficient functioning of the credit market.

## Main points of discussion

The Monetary Committee discussed the economic ramifications of the economy's exit process from the second lockdown. The data and indicators available regarding activity in October and November (data on credit card expenditures, mobility, electricity usage, the Business Tendency Survey) show an improvement in activity just before the second lockdown, and that the adverse impact on economic activity during the lockdown was moderate compared to the adverse impact of the first lockdown. However, it appears that the return of economic activity in the exit from the second lockdown is slower, due to the gradual easing of limitations. In particular, it was noted that there is considerable uncertainty regarding the continued exit from the lockdown and regarding the possibility of renewed limitations, in view of the increase in morbidity and the infection coefficient, R, being greater than 1. Real-time surveys by the Central Bureau of Statistics indicate that some industries adjusted their activity to the new environment and thus succeeded in moderating its negative impact—for example, businesses that increased their supply of products online and via deliveries, mainly in the retail trade and food industries. However, there is variance in the negative impact on the various industries, with businesses and employees in industries such as tourism, restaurants, education and leisure adversely impacted significantly and for a longer time.

The Committee had an extensive discussion on the labor market situation. The second lockdown led to a sharp increase in the broadly defined unemployment rate, which reached approximately 23 percent of the labor force in the first half of October, compared to approximately 11 percent in the first half of September. The increase derived mainly from an increase in the number of workers temporarily absent from their workplace. In the second half of October, with the beginning of the easing of the lockdown, the rate moderated to approximately 18 percent. The cumulative extent of the crisis is beginning to be felt in the labor market and is reflected in an increase in the number of people laid off due to businesses being closed. A real-time survey conducted by the Central Bureau of Statistics in October indicates that there is an increase in the unemployment rate compared with the survey conducted in August. Committee members expressed concern that the coronavirus crisis will have adverse ramifications on inequality in the economy, and noted that the handling of that is primarily from the fiscal policy side.

The Committee was updated regarding developments in the global economy. The global economy recovered in the third quarter and higher than expected growth was recorded in most economies, though the renewed spread of infection and the expansion of lockdowns and limitations in advanced economies are expected to lead to a moderation in global growth in the fourth quarter. However, the increase in the probability of a vaccine in the beginning of 2021 already, is expected to contribute to an improvement in the economic recovery next year, and contributed to a positive trend in the markets and to an increase in the price of oil. World trade is recovering after having declined sharply in the beginning of the crisis. In October, the inflation rate declined in all the regions and it is expected to remain low in 2021 as well.
The monetary policy around the world continues to be very accommodative. Central banks of major economies emphasized their commitment to maintaining the accommodative policy for a considerable time, and governments continue to adopt steps for assistance and fiscal expansion.

The Committee discussed the development of the real and nominal exchange rate of the shekel in recent years. In recent months, the effective exchange rate hovered in a relatively narrow range, but since the previous interest rate decision, the shekel strengthened by approximately 1 percent in terms of the effective exchange rate and by 1.7 percent against the dollar, against the background of the marked weakness of the dollar worldwide. In addition, the assessment was raised that continued appreciation is liable to adversely impact exports, and is expected to act toward an additional slowing of inflation.

The Committee discussed the inflation environment and the decline in it in view of the coronavirus crisis. The inflation rate in the past 12 months is -0.8 percent (-0.4 percent net of energy and fruit and vegetables). Inflation expectations for the coming year from all sources remained below the lower bound of the target range, but expectations derived from the capital market increased. Forward inflation expectations for the second year returned to within the target range, and expectations for longer terms remained anchored within the target. An analysis presented by the Research Department indicated that the crisis has had a moderating influence on most inflation components.

The Committee discussed the effects of the steps by the Bank of Israel and the Ministry of Finance on the easing of the terms of credit in the economy and the availability of credit. Interest rates on credit have been stable since the beginning of the crisis, and interest rates on credit to small and micro companies are even a bit lower than before the crisis. The Business Tendency Survey indicates that there has been a decline in the difficulty for large and medium sized businesses to raise credit, while among small companies the difficulty in raising bank credit remains in place. The effect of the extension of the framework for deferring households' loans was discussed.

The Committee discussed the Research Department's updated forecast, which describes 2 possible scenarios. According to the Department's assessments, in 2020 a contraction of 4.5 percent in GDP is expected if there is no significant backtracking in removing the limitations by the end of the year (the "control scenario"), and a contraction of 5 percent if there is such backtracking due to an increase in morbidity. Some of the Committee members assessed that the contraction in GDP will be even lower if the control scenario materializes. The Research Department assesses that in 2021, there is still a high level of uncertainty regarding the forecast, in view of the increase in R, the infection coefficient, recently, and the probability of entering into additional lockdowns, in contrast to the probability of a vaccine during the course of 2021. The forecast published in October, which contains a "control scenario" and a "low control scenario" still covers the range of possibilities expected by the Department for 2021.

The Committee noted that the positive results in trials for a coronavirus vaccine increase the optimism regarding a rapid return of the economy to growth in the coming year. However, the adverse impact on the economy, and particularly on the labor market, is expected to be prolonged, and the Committee will therefore continue to utilize a range of tools in order to increase the extent of the monetary policy accommodation and to ensure the continued orderly functioning of the financial markets. The Committee will expand the use of the existing tools, including the interest rate tool, and will operate additional ones, to the extent that it assesses that it is necessary in order to achieve the monetary policy goals and to moderate the adverse economic impact resulting from the crisis.

Five Committee members were of the opinion that the interest rate should be kept at its current level of 0.1 percent. They were of the opinion that this low interest rate level supports the recovery of economic activity and the gradual return of the inflation rate to within the target range, and particularly in view of the Bank of Israel operating additional tools in the credit market and the foreign exchange market. One Committee member voted in favor of reducing the interest rate to 0 percent. He was of the opinion that an interest rate lower than 0.1 percent is more appropriate due to the magnitude of the crisis and the adverse impact, anomalous in its magnitude, on the employment level.

**Participants in the narrow-forum discussion:**

**Members of the Monetary Committee:**
Prof. Amir Yaron, Governor of the Bank and Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski, Director of the Research Department

**Other participants in the narrow-forum discussion:**
Mr. Tal Biber, Head of the Markets Division, Markets Department
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Uri Barazani, Spokesperson of the Bank
Mr. Arad May, Secretariat of the Monetary Committee
Mr. Yoav Soffer, Advisor to the Governor
Mr. Nimrod Cohen, Research Department