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**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

October 9, 2024

**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.

Yesterday and today, the Monetary Committee held discussions in order to reach the policy decision. At the end of the meetings, the leave the interest rate unchanged at 4.5 percent.

Two days ago, Israel marked one year since the October Seventh massacre, and the beginning of the Swords of Iron War that erupted immediately after it. The State of Israel is in a continuing war, and recently the intensity of the fighting has increased on the northern front. The geopolitical uncertainty remains high. As we have emphasized, the war has significant economic ramifications, and the path back to routine full activity of the Israeli economy still lies ahead of us. We are facing notable economic challenges, and dealing with them requires conducting responsible economic policy, both fiscal and monetary, in order to ensure the continued financial robustness and economic growth in the future.

The Monetary Committee discussions focused on analyzing the various economic developments and the war’s effects on the economy and the increase in the inflation environment. In view of the increasing geopolitical uncertainty, the monetary policy is focusing on stabilizing and reducing the uncertainty in markets, alongside maintaining price stability and supporting economic activity. The monetary policy is expected to continue to be restrictive, and it will be adjusted as necessary in line with data and developments—in the inflation environment, the level of activity, fiscal policy, and the markets.

I will review now some of the considerations that we took into account when reaching the decision, and I will expand on the main economic developments in Israel and worldwide.

In contrast to the global trend, the inflation environment in Israel has been on an upward trend in recent months. The inflation rate is above the upper bound of the target range and the year over year inflation rate continued to increase in August. The increase in the inflation rate is across a wide range of components, both tradable and nontradable. Inflation expectations, which are an important component of our analysis in examining the monetary process, reflect a further increase in the inflation rate expected at the beginning of 2025, and moderation toward the target only in the second half of the year. The expectations for longer terms are within the target range. In the Committee’s assessment, among the factors liable to lead to an additional increase in the inflation environment are the continuation of the war and its impact on economic activity, including shekel depreciation, housing market activity and the constraints on it, fiscal developments, and global oil prices.

Analysis of real economic activity shows that the economy has not yet returned to the level of activity that prevailed just before the war. The economy’s second quarter growth was low, and revised slightly lower by the Central Bureau of Statistics. Accordingly, GDP is 3.3 percent below the long-term trend line. However, based on current indicators, there was a moderate recovery in economic activity in the beginning of the third quarter. The growth rate of private consumption, which moderated in the second quarter of 2024, is showing slight signs of recovery, as reflected in the increase in nominal credit card expenditure data. In addition, high tech services exports, fund raising by high tech companies, and the Purchasing Managers Index are also pointing to a trend of improvement in activity. The Business Tendency Survey for September reflects a mixed trend among businesses, mainly against the background of the deterioration in the security situation in the North.

The labor market remains tight, in view of supply limitations. The employment rate is stable. In contrast, the participation rate has continued to decline moderately in recent months, and the scope of military reserve call-ups has increased since the beginning of September. Notwithstanding the decline in the participation rate, the job vacancy rate in August was still higher than the prewar level. Supply restrictions in the labor market, mainly due to a shortage of non-Israeli workers and to those absent due to their serving in the reserves, continue to weigh on the economic activity and are delaying the economy’s return to the prewar trend.

In the housing market, there is a continued upward trend in home prices, which increased by 5.8 percent in the past year. New mortgage volume remains high, at NIS 8.4 billion in August. The construction industry is operating at a level lower than its prewar level, and a decline in building starts and completions can be seen. A year has already passed since the beginning of the war, and the process of hiring additional foreign workers in the construction industry is progressing slowly. This issue has macroeconomic importance even beyond the construction industry. Therefore, subject to security related limitations and guidelines, steps should be taken, to the extent possible, to enable Palestinian workers to return to the construction industry.

In the credit market, the framework for deferring payments that was formulated by the Banking Supervision Department and adopted by the banking system was extended, with the goal of providing relief for borrowers in this difficult period. Alongside that, the trend of moderate expansion in the balance of business credit and consumer credit continues.

Since the previous monetary policy decision, the shekel has weakened by 2.8 percent against the dollar and by 1.5 percent against the euro, with high volatility in view of the various geopolitical developments. Due to the deterioration in the North, Israel’s risk premium, as measured by CDS spreads, increased sharply and the spread between Israeli government dollar bonds and US government bonds widened slightly and is at a high level. In the equity market as well, despite increases in recent weeks, the underperformance vis-à-vis the world since the beginning of the war continues. It is important to note that a risk premium that is at a high level involves higher financing costs, in both the public and private sectors, and is liable to reduce investments and to impact negatively on economic growth.

I would like to refer to the further reduction of Israel’s credit rating and the continued negative rating outlook by Moody’s and S&P. It is important to pay attention and take the assessments of the rating agencies seriously, as they reflect the challenges and risks faced by the Israel economy as the world sees it. The credit rating agencies emphasize the impact of the geopolitical reality, but also the importance of fiscal policy conduct, with an emphasis on the importance of the future policy framework. The rating agencies explained that the decision to downgrade Israel was made for various reasons. These include first and foremost the geopolitical uncertainty, the increased intensity of the war in the northern front, and the decline in the probability of a ceasefire in Gaza. In addition, Moody’s also emphasized: the process of passing the budget, and the ability to carry out the required fiscal adjustments, the difficulty in recruiting the ultra-Orthodox, and the processes of changes in the judicial system. It is important to emphasize, as the agencies did as well, that the State of Israel has experienced geopolitical crises in the past, including in periods in which the debt to GDP ratios were much higher, and there has never been any delay in repaying Israel’s debt. The trust of the markets and of international economic institutions is essential for the stability of the Israeli economy. To ensure the continued trust of the markets in the Israeli economy, it is important that the government act to deal with the economic issues raised in the reports, which to a large extent are in line with the recommendations raised in the past by the Bank of Israel.

The updated macroeconomic forecast published today by the Research Department incorporates recent developments. The Department assumes that the war, which expanded on the northern front too, will continue at a high intensity in the beginning of 2025 as well.

In the baseline scenario, the Department's assessment is that GDP is expected to grow by 0.5 percent in 2024 and by 3.8 percent in 2025. This is a growth rate that is lower than the July forecast by 1 percentage point in 2024 and by 0.4 percentage points in 2025, and distances the economy from the growth trend of recent years. The forecast for the inflation rate was increased from the previous forecast and assumes that annual inflation is expected to be 3.8 percent at the end of 2024 and 2.8 percent in 2025. The government budget deficit is expected to be 7.2 percent of GDP in 2024, in view of the growth in the costs of the war and the flows of special US aid that were partly shifted to 2025 and onward. In 2025, the deficit is expected to reach 4.9 percent of GDP, under the assumption that fiscal adjustments of a permanent nature will be made, totaling NIS 30 billion. The public debt is expected to reach a level of approximately 68 percent of GDP in 2024 and approximately 69 percent of GDP in 2025. The forecast is characterized by a particularly high level of uncertainty. The Department also examined scenarios in which the fighting is more intense and prolonged. These scenarios, as expected, point to lower growth, higher inflation, and an increase in the deficit and in the debt to GDP ratio. Against this background, the Department’s assessment is that the balance of risks related to the growth forecast tends to the downside, while regarding the inflation forecast and the deficit, the balance of risks tends to the upside.

The State budget for 2025 is challenging, and the progress in formulating it is positive, certainly in view of the scope of required fiscal adjustments. Approval of a responsible budget for 2025 is an essential component in strengthening the international markets’ trust and maintaining the economy’s robustness. It is important that the government and Knesset approve significant fiscal adjustments of a permanent nature, in contrast to the consistent increase in defense expenditures. This is in order to allow the debt to GDP ratio to stabilize and go back to declining over the next 2 years. In this regard, the steps presented by the Minister of Finance are in the right direction. From the perspective of the composition of the budget, the adjustments should be spread out over as broad a population as possible, and it is important that the government prioritizes growth-supporting expenditures, reduces negative incentives for going out to work, and eliminates non-essential ministries.

I will move now to speak about global developments. The increase in geopolitical tension in the Middle East has so far impacted global financial markets moderately, though there have been increases in oil and natural gas prices. Economic growth data published in the reviewed period in the US surprised to the upside, while in the eurozone, second quarter growth was slightly lower than expectations. Inflation trends point to continued convergence to central bank targets. The monetary easing among advanced economy central banks continues, as the US Federal Reserve reduced the interest rate by 50 basis points and the ECB continued its path of interest rate reductions and reduced its rate by 25 basis points. This trend of continued interest rate reductions is expected to continue in the coming year.

To conclude, the Israeli economy is facing a complex period—a period in which we are seeing moderate recovery alongside continued challenges such as supply limitations in some industries, geopolitical uncertainty, and a high risk premium. Israel’s economy has a history of resilience in difficult times. This has been partly due to the implementation of responsible economic policy and the promotion of essential structural reforms. It is important to note that particularly in challenging periods, opportunities sometimes arise for making significant and necessary changes.

The Bank of Israel and the Monetary Committee express our support for the soldiers and other security forces who are risking their lives for us on the various fronts. We extend our deep condolences to the families of those killed. We also send from here wishes for a complete recovery for the injured, and hope for the speedy return of all the captives and the missing.

Our thoughts are with you.

I take this opportunity as well to wish you a Shana Tova—happy New Year.

Thank you.