

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

Press release

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**Box from the forthcoming Bank of Israel Annual Report for 2024:**

**Developments in Mortgage Pricing in Israel**

* In the past two years, mortgage spreads in Israel have declined in view of several developments: the increase in the Bank of Israel's interest rate, consumer reforms aimed at enhancing information transparency and competition in the mortgage market, and the Swords of Iron War.
* Approximately a quarter of the decline in spreads can be attributed to increased competition in the market, while the remainder is explained by the narrowing spreads following the interest rate hike and the decline in mortgage demand.

Mortgage spreads in Israel have declined sharply in recent years. The mortgage spread is the difference between the interest rate on the mortgage track and the anchor rate, which is calculated based on the zero-coupon yield curve of government bonds, according to the relevant indexation (nominal or real) and duration. This spread reflects the additional cost paid by the borrower beyond the alternative interest rate available to the bank when granting the loan.[[1]](#footnote-1) The size of the spread is influenced by several factors, including the borrower's risk, operational costs associated with providing the loan (such as underwriting and risk management), and potentially an additional premium related to the bank's market power. Generally, for borrowers with identical risk profiles and mortgage characteristics, a smaller spread indicates lower profitability for the bank from the mortgage.

The decline in mortgage spreads occurred against the backdrop of several significant developments in the Israeli mortgage market. First, starting in the second quarter of 2022, new mortgage borrowing declined sharply due to the rise in the Bank of Israel's interest rate. Generally, an increase in interest rates raises the marginal cost for banks to provide credit, effectively reducing the supply of mortgages. In such a situation, banks may choose to absorb part of the increase to prevent an even sharper decline in mortgage borrowing, leading to a reduction in market spreads.

Second, in September 2022, the Bank of Israel led a consumer reform aimed at increasing information transparency and competition in the mortgage market.[[2]](#footnote-2) This was achieved by enhancing borrowers' ability to compare offers from different banks and improving the process of obtaining preliminary mortgage approval. Before the reform began, the spread was on a slight downward trend, and in September 2022, it started to decline consistently. This trend continued even after the Bank of Israel's interest rate stabilized in June 2023 and with the recovery of the mortgage market starting in the second quarter of 2024.

A box from the forthcoming Bank of Israel Annual Report examines whether the reduction in spreads resulted from the credit supply side, influenced by the reform that increased competition for customers, or from a decrease in demand due to the rise in the Bank of Israel's interest rate.

1. The spread between mortgage interest rates and the zero-coupon yield curve based on government bonds does not necessarily represent the spread over the cost of raising funds for the banking system, but rather the alternative cost, which is the yield the bank would receive on another asset with the same duration and the same type of indexation, instead of the mortgage. [↑](#footnote-ref-1)
2. As part of the reform, banks were required to provide customers with a standardized preliminary approval format, which, in addition to the mortgage package they offer, includes three standardized packages determined by the Bank of Israel. For each package, the total expected interest rate, the total expected payments over the entire mortgage period, and the highest expected monthly payment according to forecasts are presented. Additionally, the time to receive preliminary approval was shortened to just a few days, and banks were required to allow the application and approval process to be conducted online. For details on the reform measures, see <https://mash-boi.org.il/>. [↑](#footnote-ref-2)