

## **BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

June 5, 2023

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

**The discussions took place on May 21 and 22, 2023.**

#### **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 May 22, 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 increase the interest rate by 0.25 percentage points, to 4.75 percent. All the Monetary Committee members supported the decision.

The discussion focused on the inflation environment in Israel and its development, with an emphasis on the increase in food prices and rents, as well as the impact of the depreciation on inflation. The Committee discussed GDP growth data and economic activity, an analysis of labor market data, and the housing market. In addition, the Committee focused on the global environment—a decline in the pace of interest rate increases, against the background of moderation in inflation worldwide.

### **Main points of discussion**

The Committee discussed the inflation rate in Israel, which is above the upper bound of the target range. The CPI increased in March by 0.4 percent and in April by 0.8 percent. The figure for April was markedly higher than had been forecast in the market, and was impacted particularly by the “Guest houses and holidays domestic and abroad” component, which accounted for half the total increase (0.4 percent out of 0.8 percent). In addition, inflation was impacted by the increase in the housing component, which represents rents. The inflation rate over the preceding 12 months, at 5 percent, is above the upper bound of the target range. An analysis of CPI components indicates that price increases continue in a wide range of components. There was an examination of Israel’s inflation environment, which despite the April CPI data remains low compared to most advanced economies worldwide. Looking over the past 6 months, and even more so over the past 3 months, (in annual terms, seasonally adjusted), it can be seen that the inflation rate is lower than the annual inflation rate. One-year inflation expectations and forecasts are around the upper bound of the target range. Inflation expectations derived from the capital market for the second year and onward remained stable and are within the target range. The Committee discussed the price increases in retail areas. It was brought up in the discussion that global commodity prices and transport costs that had declined, as well as the relatively moderate increase in nominal wage, are not factors that can fully explain the increases in those areas.

The Committee assessed that the monetary tightening processes in Israel and abroad, and the moderation in demand—as reflected to some extent in the development of private consumption—are working to moderate inflation. However, in contrast, the trend of depreciation in the shekel, which in the Committee’s assessment also reflects some increase in the economy’s risk premium, contributed to an increase in the inflation rate. The Committee also assessed that the interest rate is in a restrictive environment, in line with the moderation in inflation over the upcoming year, even including the

upcoming CPI, which according to the assessments is expected to be relatively high. Should there be additional developments, beyond those currently expected, in inflation's path and its convergence, or if there will be an additional increase in the risk premium to an extent that will impact on markets in general, and on the foreign exchange market in particular, the Committee will be required to enhance the monetary tightening.

The Committee members discussed data on economic activity and the labor market. The economy is at full employment. The unemployment rate is low, and the employment rate and participation rate are at record levels. National Accounts data for the first quarter indicated growth at a relatively high pace, after netting out the transitory effects of the changes in vehicle taxation. However, there was moderate expansion in private consumption excluding durable goods, the most recent data on the net balance in the Business Tendency Survey for April continued to moderate but still indicated positive assessments by businesses of their situation, and it was also seen that tax revenues and real credit card expenditures are moderating.

The Committee discussed developments in the housing market, particularly the moderation in the scope of activity. The pace of increase in home prices over the past 12 months moderated to 11 percent, with prices remaining unchanged in April after a slight decline in March. The decline in number of transactions and in mortgage volume continued, and in parallel the stock of unsold homes held by contractors increased notably in the past year. Mortgage volume in April was \$4.6 billion, the lowest total volume since the end of 2019.

The Monetary Committee discussed the state of global activity. It noted that economic activity worldwide continued to be moderate, but higher than expectations in the beginning of the year. The global inflation environment remained high, though the trend of moderation in many countries continued. Against the background of these trends, the monetary tightening continued worldwide, but many central banks slowed the pace of interest rate increases. The US Federal Reserve raised the interest rate by 25 basis points, and in parallel, within the framework of the decision, signaled the possibility of halting the current cycle of interest rate increases, and markets are expecting that the interest rate will decline already during 2023. In the eurozone, inflation moderated as well, but it is still relatively high, at an annual pace of 7 percent. In contrast, core inflation in the eurozone declined to 5.6 percent, though this is still a high level. The ECB increased the interest rate by 25 basis points, and continues to signal that additional interest rate increases are expected.

**At the end of the discussion, all the Committee members supported an interest rate increase of 0.25 percentage points, to 4.75 percent. The Committee members noted that 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. Therefore, the Monetary Committee decided to increase the interest rate. 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.**

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

**Members of the Monetary Committee:**

Prof. Amir Yaron, Governor of the Bank and Monetary Committee Chairperson

Mr. Andrew Abir, Deputy Governor of the Bank of Israel

Dr. Adi Brender

Prof. Naomi Feldman

Prof. Zvi Hercowitz

**Other participants in the narrow-forum discussion:**

Mr. Uri Barazani, Spokesperson of the Bank

Dr. Golan Benita, Director of the Markets Department

Mr. Gilad Brand, Research Department

Dr. Oded Cohen, Chief of Staff to the Governor

Mr. Nadav Eshel, Consultant to the Governor

Mr. Arad May, Monetary Committee Secretariat

Ms. Dana Orfaig, Research Department

Mr. Daniel Shlomiuk, Bank spokesperson's office