BANK OF ISRAEL
Office of the Spokesperson and Economic Information

July 22, 2024

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

The discussions took place on July 7, 2024 and July 8, 2024.

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 July 8, 2024, 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 at 4.5 percent. All members of the Monetary Committee supported the decision.

The discussion focused on the impacts of the geopolitical environment on the economy and on economic developments: inflation and inflation expectations, the level of economic activity in view of the war, the labor market, developments in the financial markets and in the foreign exchange market, the housing market, the macroeconomic forecast, fiscal developments, and the global conditions.

Main points of discussion

The Committee discussed the state of the economy after 9 months of war. The prolonged war has significant economic ramifications on Israel’s economy. The geopolitical uncertainty intensified and the economy’s risk premium increased.

In the past quarter there was some increase in the inflation environment. The inflation rate over the past 12 months was 2.8 percent in May. Net of energy and fruit and vegetables, the inflation rate is more moderate, at 2.2 percent. According to forecasters’ projections, inflation over the preceding 12 months is expected to increase to above the upper bound of the target range at the beginning of 2025, partly due to the upward impact of taxes, and later in the year to decline to near the upper bound of the target range. Inflation expectations and forecasts for the coming year are around the upper bound of the target range. Expectations for the second year and onward are within the target range, in its upper part. The Committee analyzed the various developments and assessed that there are several main risks to a possible acceleration of inflation—geopolitical developments and their effect on economic activity, shekel depreciation, continued supply constraints on activity in the housing and air travel industries, fiscal developments, and global oil prices.

Based on current indicators, the growth rate of activity in the second quarter moderated after a sharp recovery in the first quarter. The level of activity in the economy is still lower than what prevailed just before the war, and supply constraints are weighing on the convergence of economic activity to the trend that characterized the economy before the war. The labor market is tight, and the most recent data point to stabilization after a rapid recovery in previous months. In the past year, (already before the war) there was an acceleration in the pace of increase in nominal wage per employee post. However, this increase was accompanied by a notable increase in the business sector productivity, so that the (nominal) cost of labor per unit of (real) GDP increased moderately. The level of real wages is around the trend line.

The Committee discussed the impacts of the war on financial markets and on the shekel exchange rate. The continued geopolitical uncertainty is reflected in the high level of Israel’s risk premium, as measured by, among other things, the CDS and the yield spread between government bonds denominated in dollars and US Treasury bonds. In addition, in view of the geopolitical developments, the shekel weakened by approximately 1.3 percent against the dollar and by 1 percent in terms of the nominal effective exchange rate, with high volatility since the previous interest rate decision.

Domestic equity indices increased, but the underperformance of the domestic stock market vis-à-vis various indices worldwide from the beginning of 2023 is still notable. Government bond yields were traded during most of the period with increases and with enhanced volatility but for the period overall they declined slightly. Corporate bond spreads remained without significant change and are below their prewar level. The balance of business credit is on a trend of expansion since the beginning of the year, mainly among large companies. Credit risk indices in the various activity segments increased somewhat, but they indicate a level that is not high relative to the past decade.

In the housing market, home prices continued to increase, for the 5th consecutive month, alongside an increase in mortgage volume. The owner-occupied housing services component in the CPI (monthly new and renewal leases) increased by 1.9 percent in the past year. Within that, construction industry activity is recovering gradually but the limitations on the industry’s activity vis-à-vis the shortage of workers due to the war is still notable.

The Committee discussed the Research Department’s macroeconomic forecast, which was updated this month. Relative to the previous forecast, in April, the Department assumes that the war will continue at a higher intensity until the end of 2024 and will wind down in the beginning of 2025. Therefore, the growth forecast was revised downward. GDP is expected to grow by 1.5 percent in 2024 and by 4.2 percent in 2025, growth rates that are lower than the previous forecast by a cumulative 1.3 percent. The annual inflation rate for 2024 is higher than the previous forecast, at 3 percent, and 2.8 percent in 2025. The forecast was constructed under the working assumption that the government will make adjustments of a permanent nature to reduce the deficit in 2025 that will total NIS 30 billion, and that every additional expenditure on which the government will decide, including a permanent increase in the defense budget, will be balanced by additional steps. These adjustments include, among other things, taxation measures that impact on the inflation forecast. Under these assumptions, the deficit in the government budget is expected to be 6.6 percent of GDP in 2024 and about 4 percent of GDP in 2025. The debt to GDP ratio is expected to be around 67.5 percent of GDP in 2024 and to increase to 68.5 percent of GDP in 2025. The uncertainty with regard to the forecast is particularly high, and various developments in the war could have a marked impact on the economic variables and the economy's performance.

The Committee discussed the global environment. Economic activity worldwide continues to expand but the most recent data present a mixed trend in the various blocs. Inflation rates are in a trend of convergence to central bank targets, but at a slow pace compared to assessments from the beginning of the year. The Fed kept the interest rate unchanged, with guidance that the process of reducing the interest rate will be slow relative to the previous forecast presented in March 2024. The ECB reduced its interest rate by 25 basis points and revised inflation forecasts upward for 2024 and 2025. In addition, the ECB noted that it is not committed to a predetermined path of the interest rate, and it will continue with a data dependent approach.

All 5 Monetary Committee members supported the decision to keep the interest rate unchanged at a level of 4.5 percent.

In view of the continuing war, the Monetary Committee's policy is focusing on stabilizing the markets and reducing uncertainty, alongside price stability and supporting economic activity. The interest rate path will be determined in accordance with the convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.

The next monetary policy decision will be published on Wednesday, August 28, 2024.

The dates of interest rate decisions for 2024 and 2025:
https://www.boi.org.il/en/economic-roles/monetary-policy/interest-rate-announcement-dates-2024/

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. Tal Biber, Markets Department
Dr. Oded Cohen, Chief of Staff to the Governor
Mr. Nadav Eshel, Assistant to the Governor
Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department
Ms. Liat Indig, Bank Spokesperson’s office
Mr. Arie Knopf, Monetary Committee Secretariat
Ms. Dana Orfaig, Research Department
Ms. Irit Rozenshtrom, Research Department
Mr. Tzvi Sussmann, Monetary Committee Secretariat