

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

Press release:

**Monetary Policy Report First Half of 2024**

**Abstract**

**This report surveys monetary policy during the first half of 2024.**

**General background:** During the first half of 2024, the Swords of Iron War continued. The Gaza Strip was the main site of fighting in the beginning of the half year, while in parallel the fighting at the Northern border continued and intensified during the half year. This was alongside a deterioration in the Iranian arena that was reflected in a massive missile attack in April, which was thwarted.

**Monetary policy:** During the half year, the monetary policy focused on reducing the uncertainty, and in stabilizing the financial markets, particularly the foreign exchange market, alongside the maintaining of price stability and support for economic activity. At the time of the January 2024 interest rate decision it appeared that despite the environment of high uncertainty, the geopolitical and economic conditions were on a trend of improvement, as opposed to the decisions in October and November 2023; in addition, a prolonged decline in the inflation environment and marked recovery of economic activity were seen. In addition, it appeared that the war would not expand to additional fronts, the concern of a notable depreciation moderated, and from a fiscal perspective it appeared that the government would make required budget adjustments. Accordingly, the Monetary Committee decided to reduce the interest rate by 0.25 percentage points, to 4.5 percent. Over the continuation of the half year—in the decisions of February, April, May, and July 2024—the geopolitical uncertainty increased, as did the inflation environment. Therefore, it was decided to keep the interest rate unchanged and to focus on stabilizing the markets and reducing the uncertainty, alongside price stability and supporting economic activity.

**Domestic real activity and the labor market:** In the first quarter of 2024, a recovery was seen in GDP, which grew sharply by 3.4 percent (in quarterly terms). However, GDP remained 2.7 percent lower than its level in the third quarter of 2023, which preceded the war. In the second quarter of 2024, indicators of economic activity showed a moderation in the pace of recovery. The construction industry was markedly adversely impacted mainly due to a severe shortage of workers, and due to the continued limitations on supply of raw materials. Another industry that was notably negatively impacted was the air travel and tourism industry, due to supply constraints in addition to a sharp decline in demand. In the labor market, the broad unemployment rate increased sharply in October, with the eruption of the war, after which it declined at a relatively rapid pace, and stabilized in the second quarter. At the end of the half year (May) it remained high compared to its prewar level. The employment rate declined with the outbreak of the war, after which recovery was seen, with volatility, while at the end of the half year (May) it was lower than it was before the war. Over the past year, wage increases accelerated, but this was accompanied by an increase in productivity per worker in the business sector.

**The inflation environment:** During the reviewed half year, the inflation rate declined, and throughout the entire period, the year-over-year inflation rate was within the price stability target (1–3 percent), and at the end the year-over-year rate was 2.8 percent. One-year inflation expectations from the various sources increased over the course of the half year reviewed, and were around the upper bound of the target.

**Exchange rate:** After a marked depreciation with the eruption of the war, and against the background of Bank of Israel intervention, a sharp appreciation was seen at the end of 2023. Afterward, during the course of the half year reviewed, the NIS/$ exchange rate hovered around a level slightly lower than just before the war, with high volatility, which was impacted on mainly by geopolitical developments.

**Fiscal policy:** Against the background of the war, the cumulative government budget deficit over the preceding 12 months increased over the course of the half year, and in June it was 7.6 percent of GDP, with a sharp increase in expenditures alongside an above-expectation increase in tax revenues. According to the Research Department forecast, the cumulative year over year budget deficit is expected to continue increasing in the coming months, however, it is seen to be converging back to 6.6 percent of GDP at the end of 2024, so long as there won’t be an anomalous deviation in defense expenditures.

**Financial stability:** Since the war erupted, the economy’s risk premium increased notably, some international rating agencies downgraded Israel’s rating, government bond yields increased, and the equity market in Israel continued to underperform compared internationally. Alongside that, the financial system in Israel continued to display robustness and resilience. The balance of business credit has been on a trend of expansion since the beginning of 2024. In bank and nonbank credit to the business sector, an increase in risk indices can be seen, but the risk levels are still not high compared to the past decade.

**The housing market:** Home prices increased in January through March 2024 by a cumulative 2.9 percent, and the year over year growth rate increased to 2.1 percent compared to -2.2 percent in October 2023. The increase in home prices was accompanied by sharp growth in the number of transactions. However, the number of transactions is still markedly lower than record levels of 2021. The annual pace of increase in the owner-occupied housing services index, measured through rents in new and renewing leases, moderated in the half year reviewed, ending it at 1.9 percent.

**The global economy:** First quarter growth data indicated continued expansion of the global economy. World trade volume recovered slightly during the period reviewed, the price of oil increased, and maritime shipping costs increased. Inflation trends during the reviewed period indicated convergence to central banks’ targets, but at a slow pace compared to forecasts from the beginning of the year. Against this background, major central banks continued to signal to the market that they will not hesitate to keep the interest rate at a restrictive level for a lengthy period of time. The US Federal Reserve did not change the interest rate during the half year reviewed, in contrast to expectations at the beginning of the period, and the ECB reduced the interest rate in June 2024 for the first time in 5 years.

**The Research Department staff forecast:** According to the forecast published in July, GDP is expected to increase by 1.5 percent in 2024 and by 4.2 percent in 2025—growth rates that are a cumulative 1.3 percent lower than forecasts in January and April. The annual inflation rate in 2024 is expected to be 3.0 percent, and during 2025 to be 2.8 percent—higher rates than those forecast in January 2024. Assuming that the government makes fiscal adjustments of a permanent nature of about NIS 30 billion, the deficit in 2025 is expected, according to the July 2024 forecast, to decline to around 4.0 percent of GDP.