

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

# July 8, 2024

**Press Release**

**The Monetary Committee decides on July 8, 2024**

**to leave the interest rate unchanged at 4.5 percent**

* The recovery of economic activity moderated in the second quarter of 2024. Supply constraints are making it difficult for activity to converge to the trend that characterized the economy prior to the war, and the extent of continued geopolitical uncertainty is reflected in the economy’s high risk premium.
* Inflation and one-year inflation expectations are around the upper bound of the target range, and expectations for the second year and forward are within the target range, in its upper portion. The moderation of inflation of the nontradable components of the CPI was halted.
* Since the previous monetary policy decision, the shekel weakened by about 1.3 percent against the dollar and the euro, and by about 1 percent in terms of the nominal effective exchange rate, with high volatility in the market.
* The Research Department’s assessment is that GDP will grow by 1.5 percent in 2024, and by 4.2 percent in 2025. These rates are 1.3 percentage lower, cumulatively, than the April forecast. There is considerable uncertainty regarding developments in the war, which may have a material impact on the forecast.
* In the housing market, home prices and new mortgage borrowing continue to increase. Activity in the construction industry is recovering gradually, but constraints on such activity in view of the war remain significant.
* The trends of global inflation indicate continued convergence toward the target ranges, but at a slower pace than in previous forecasts since the beginning of the year. In view of this, the major central banks continue to signal to the market that they will not hesitate to leave interest rates at restrictive levels over time.

**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 State of Israel has been at war for approximately 9 months. Beyond the security effects, the war is having significant economic consequences. According to current indicators, the growth of economic activity moderated in the second quarter, following a sharp recovery in the first quarter. Supply constraints are making it difficult for economic activity to converge to the trend that characterized the economy prior to the war, and the extent of continued geopolitical uncertainty is reflected in the economy’s high risk premium. Inflation and one-year inflation expectations are around the upper bound of the target range. The Consumer Price Index for May increased by 0.2 percent, and inflation in the past 12 months is 2.8 percent (**Figure 1**). Net of energy and fruits and vegetables, the year-over-year inflation rate stands at 2.2 percent (**Figure 2**). Inflation in the past three months, seasonally adjusted in annual terms, is higher than the year-over-year inflation rate (**Figure 3**). The moderation of inflation of the nontradable components of the CPI was halted, and the annual pace of inflation of the tradable components remained virtually unchanged (**Figure 4**). According to forecasters’ assessments, inflation will reach about 3.5 percent at the beginning of 2025, partly in view of the expected increase in VAT in 2025, and will then moderate toward the upper bound of the target range (**Figure** 5). Inflation expectations for the coming year from various sources are around the upper bound of the target range (**Figure 6**). Expectations for the second year and forward are within the target range, in its upper portion (**Figure 7**). The Committee’s assessment is that there are several risks of a potential acceleration in inflation: geopolitical developments and their effects on economic activity, a depreciation of the shekel, continued supply constraints on activity in the housing market and the air travel industry, fiscal developments, and global oil prices.

Since the previous interest rate decision, the shekel depreciated by about 1.3 percent against the US dollar and against the euro, and by 1 percent in terms of the nominal effective exchange rate, with high volatility influenced by developments in the war and in the geopolitical environment.

The Research Department revised its macroeconomic forecast. Relative to the previous forecast from April, the Research Department assumes that the war will last at a higher intensity until the end of 2024, and will subside at the beginning of 2025. The growth forecast was therefore revised downward. GDP is expected to grow by 1.5 percent in 2024 and by 4.2 percent in 2025 (**Figure 12**), which is cumulatively 1.3 percentage points lower than in the previous forecast. The forecast for the broad unemployment rate among the prime working ages (25–64) was revised downward, and is expected to average 4 percent in 2024 and 3.8 percent in 2025. The annual inflation rate is expected to be higher than the previous forecast, at 3 percent in 2024 and 2.8 percent in 2025. The forecast was compiled under the working assumption that the government will make adjustments of a permanent nature to reduce the deficit in 2025, which will total NIS 30 billion, and that any additional expenditure that the government may decide upon, including a permanent increase in the defense budget, will be balanced by additional measures. Among other things, these adjustments include taxation measures that will affect the inflation forecast. Under this assumption, the deficit in the government budget is expected to be 6.6 percent of GDP in 2024 and about 4 percent in 2025. The debt to GDP ratio is expected to be 67.5 percent at the end of 2024, and to increase to 68.5 percent in 2025. Not making such fiscal adjustments may lead to a change in economic conditions, and thereby to adjustments to the forecast.

Indicators of economic activity show that the growth of activity moderated in the second quarter, following a sharp recovery in the first quarter. Supply constraints are making it difficult for economic activity to converge to the prewar trend. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for June indicate moderate improvement in the financial state of companies (**Figure 15**). The rate of companies in the services and manufacturing industries that reported a moderate or serious constraint in activity due to a shortage of equipment and raw materials declined, but the level remains higher than before the war. The equipment constraint in the construction industry remains high (**Figure 16**). According to the Survey, the constraint on expanding activity due to difficulty in hiring workers (moderate or serious) remained higher than before the war in most industries.

Credit card expenditure volume remained relatively stable in recent months, following the sharp decline at the beginning of the war and the recovery that followed (**Figure 14**). Foreign trade data show a decline in goods exports in May, alongside increases in services exports and in goods imports (**Figures 22 and 23**). The most significant increase in imports between March and May relative to the preceding three-month period was in the import of consumption goods (13 percent). There was also growth in the import of raw materials (8 percent) and in the import of investment products (2 percent). The cumulative budget deficit in the past 12 months continued to increase in June, to 7.6 percent of GDP. The trend of growth in the deficit is expected to continue in the coming months, following which the deficit is expected to decline back to 6.6 percent in the fourth quarter of the year, as long as defense expenditures do not significantly exceed the current path due to the war.

The labor market was stable in recent months, following a rapid recovery in the previous months.

The employment rate among those aged 15 and up was 60.7 percent in May, compared with 60.9 percent in April (seasonally adjusted). Following a decline in the broad unemployment rate in the previous months, the rate moderated to 4.1 percent in May from 4.2 percent in April (seasonally adjusted) (**Figure 20**). In April, the trend of improvement in local workers’ total labor input (actual work hours) from previous months was halted, and it declined slightly. In the most recent data, it is 4 percent lower than the third quarter average from 2023. The job vacancy rate remained 4.4 percent in May, and is mainly reflected in industries where employment declined significantly due to the war, such as construction and hospitality and food services (**Figure 24**). In the past year (even before the war), the pace of increase in the nominal wage per employee post accelerated. However, this increase was accompanied by significant growth in productivity in the business sector, such that the nominal labor cost per real unit of output increased moderately. The real wage level is close to its trend line (**Figure 25**).

In the housing market, home prices continued to increase for the fifth consecutive month (**Figure 17**). According to Central Bureau of Statistics data, building starts are in an upward trend and increased by 2.7 percent in the first quarter of 2024 (relative to the first quarter of 2023), while building completions in the first quarter declined by 5.9 percent. In addition, there was a decline of 6.1 percent in the number of permits issued in the first quarter, relative to the first quarter of 2023. In May, there was an increase in new mortgage borrowing, to NIS 7.8 billion (**Figure 18**). Monthly rents continued to increase in May, by 2.5 percent in annual terms for tenants who renewed their contracts, and by 3.7 percent in annual terms for new tenants. The owner-occupied housing services component of the Consumer Price Index increased by 1.9 percent in the past year, and the annual pace of increase of the housing component reached 2.6 percent. Alongside this, activity in the construction industry is recovering gradually, but constraints on activity in the industry in view of the war remain significant.

In the capital market, local equity indices increased during the reviewed period. However, the underperformance of the domestic equities market relative to the global market since the start of 2023 remains significant (**Figure 35**). Government bond yields increased during most of the period, with increased volatility, but over the period as a whole, they declined slightly. Corporate bond spreads remained virtually unchanged, and are below their prewar levels (**Figure 10**). Since the beginning of the year, outstanding business credit has expanded, led by credit to large businesses. There are indications of some increase in the risk level of bank and nonbank credit to the business sector, particularly to the construction industry, and to households. However, the risk levels are not high relative to the past. In view of the assistance programs, the difficulty in obtaining credit among large and medium businesses remains low, and there has been some decline in the difficulty among small businesses.

Israel’s risk premium as measured by the spread between dollar-denominated Israel government bonds and US Treasuries remained high, and even increased during the reviewed period. The CDS spread also increased, and remains at high levels.

Global economic activity continued to expand, but most recent data indicate a mixed trend in the various blocs. The investment houses’ global growth forecasts for 2024–2025 remained unchanged (**Figure 28**). The Purchasing Managers Indices (PMI) for May indicate stronger positive sentiment in the manufacturing component in the US and China, but continued slight weakness in the eurozone countries. World trade volume increased by about 0.9 percent in annual terms in April, following a decline in March. In contrast, the index of export orders within the global Purchasing Managers Index in the manufacturing sector for May, which serves as a leading indicator of world trade, returned to indicating contraction in activity. Oil prices increased slightly during the reviewed period. In the US, inflation continues to moderate (**Figure 32**), with declines in May in both the core PCE index and the general CPI index (with the latter declining from 3.4 percent to 3.3 percent). Inflation in the eurozone, also continued to moderate, and the overall index declined from 2.6 percent to 2.5 percent in June. Core inflation remained unchanged, at 2.9 percent. The Federal Reserve left the interest rate unchanged, with continued guidance that the process of lowering the interest rate would be slower than the previous forecast presented in March 2024. The ECB lowered its interest rate by 25 basis points, and revised its inflation forecasts for 2024 and 2025 upward. The ECB also noted that it is not committed to a predetermined path of interest rate reductions, and that it will continue with its data-based approach.

The minutes of the monetary discussions prior to this interest rate decision will be published on July 22, 2024. The next decision regarding the interest rate will be published at 16:00 on Wednesday, August 28, 2024.