BANK OF ISRAEL
Office of the Spokesperson and Economic Information

March 11, 2019

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

The discussions took place on February 24 and 25, 2019.

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 Market Operations), who prepare and present the material for discussion.

In the narrow forum—which consists of the Monetary Committee and the Director of the Research Department—the Research and the Market Operations 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 February 25th, 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 unchanged at 0.25 percent. The decision was unanimous.

The discussion focused primarily on real economic activity, the global environment, recent developments in financial markets, the inflation environment, and the expected path of monetary policy.

Main points of discussion

The Committee assessed that the slowing down in economic activity on the annual level derives mainly from the supply constraint, and that the economy is apparently converging to its potential growth rate. Labor market data support the assessment that the economy is at a full employment environment—the unemployment rate is low, the job vacancy rate (demand for workers) is high, and wages continue to rise. Although in recent months the unemployment rate increased slightly, and the job vacancy rate declined somewhat, the Committee members assessed that the labor market remains tight.

The Committee noted that the growth rate increased in the fourth quarter of 2018, after it had slowed down in the second and third quarters, and that the increase was driven by growth in private consumption. The Committee members were of the opinion that the increase in imports also supports the assessment that the slowing growth reflects the supply constraint—the increase in domestic demand was met by imports, and less by domestic production. Data on foreign trade and from the Business Tendency Survey indicate some weakness in exports, particularly goods exports.

The Committee discussed the price increases in financial markets from the beginning of the year, after the sharp declines at the end of 2018. The Committee noted several possible reasons for the price increases, including a correction to the declines in 2018, the expectation that for now the global process of monetary tightening will halt, and optimism in markets regarding the signing of US-China trade agreements, which could create a positive impact on the global economy.

The Committee members agreed that the global economy continues to lose momentum. The IMF again revised downward its growth forecast for most regions, particularly for Europe. Recently, there have been assessments that the global slowdown will lead to a deferral in interest rate increases in the US and in a contraction of the quantitative easing in the eurozone.

With regard to the housing market, the Committee members noted that the decline in home prices moderated and industry activity continues to show weakness: in particular, investment in residential construction is low. It was observed that if the slowdown in residential construction continues, it is liable to moderate the rate of growth in the coming period.

Regarding the inflation environment, the Committee members noted that there was no major change in it since the previous interest rate decision. After the annual inflation rate declined in December to below the target range, it returned in January to above the lower bound, and the Committee members assessed that in the coming months inflation will hover near it. The Committee pointed to the gaps observed between tradable inflation and nontradable inflation (an estimate for the domestic component of inflation)—while the former is approximately 2 percent, the latter turned negative. Since the previous interest rate decision, 1-year expectations and forecasts from the various sources continue to range around the lower bound of the target range, while medium-term and long-term expectations increased slightly toward its midpoint. It was noted that wage increases have not yet been reflected in sharp price increases, and that could be due to enhanced competition. However, in view of the labor supply constraint and wage pressures, it is plausible that in the future there will be stronger pass-through from wage increases to prices. In addition, the Committee noted that since the previous interest rate decision, the shekel had strengthened by approximately 2 percent in nominal effective exchange rate terms; if the shekel appreciation continues, it is liable to weigh on the return of inflation to the midpoint of the target range.

In the discussion on the path of monetary policy, the Committee members noted that the challenge for policy is in the need to return inflation to around the midpoint of the target, and that the gradual reduction in the extent of monetary accommodation will be carried out accordingly. The Committee assessed that the economy growing at a rate in line with its potential pace will support the continued increase of inflation, but as the global economy is showing signs of slowdown, inflation is expected to return to around the midpoint of the target range gradually.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Chairperson
Dr. Nadine Baudot-Trajtenberg, Deputy Governor
Mr. Andrew Abir, Director of the Market Operations Department
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz

Other participants in the narrow-forum discussion:
Eddy Azoulay, Chief of Staff to the Governor
Uri Barazani, Deputy Spokesperson of the Bank
Ms. Dana Orfaig, Economist in the Research Department
Esti Schwartz, Secretary of the Monetary Committee
Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department
Dr. Darin Vaisman, Economist in the Research Department