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BANK OF ISRAEL

Office of the Spokesperson and Economic Information

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Press Release

**Remarks by Andrew Abir, Director of the Market Operations Department, at the Knesset Finance Committee discussion on the Bank of Israel’s policy in the foreign exchange market**

*Mr. Andrew Abir, Director of the Bank of Israel’s Market Operations Department, participated in a discussion today at the Knesset Finance Committee regarding the Bank of Israel’s policy in the foreign exchange market. The following are the main points of his remarks.*

We share the concern expressed by members of the Knesset regarding the state of exports, and most of the measures we have taken in recent years derived from this concern. The decision to intervene in the foreign exchange market in 2008 in order to increase the foreign currency reserves was made in view of the global crisis and the decline in global trade, which is the main variable affecting Israeli exports, obviously other than the exchange rate. Until 2008, global trade grew at around 5 percent per year, and since 2008, growth has declined to about 2.5 percent. This is the main problem faced by exports.

The exchange rate has been very volatile over time, and there were periods in the not-too-distant past when the trend of the exchange rate was very different than the current trend—for instance, the sharp depreciation against the background of the share price collapse on the Nasdaq and the second Intifadah, or the further depreciation against the background of the global economic crisis and the Bank of Israel’s intervention in the foreign exchange market.

**In the recent period, we have not seen activity by speculators in the market.** The volume of foreign exchange purchases and sales by foreign actors is similar, such that at the bottom line, activity by foreign entities was not a major factor in foreign exchange trading in 2013 or 2014. The two main factors that have been acting for appreciation of the shekel represent the relatively good state of the Israeli economy—the current account surplus and the large inflow of direct investment in the economy.

The Bank of Israel’s intervention in the foreign exchange market began in 2008, in view of the fact that the Bank of Israel saw fit to increase the foreign exchange reserves that constitute the Israeli economy’s emergency stores. In 2009, intervention based on the new policy began, where the Bank of Israel intervenes in the market in cases of outlier fluctuations in the exchange rate that are not consistent with the basic economic conditions, or when the foreign exchange market is not functioning properly. In May 2013, we announced an additional layer of intervention, in response to the sharp appreciation that had taken place since the end of 2012. The first part of the appreciation took place due to the decline in geopolitical tension at that time, and the second part was in response to the start of natural gas production from the Tamar reservoir, where our assessment is that the market will price in the effect of the flow from 20–30 years of natural gas production on the foreign exchange market in advance. We announced a foreign exchange purchasing program to prevent “Dutch Disease”, and according to the program, we are offsetting any effect of natural gas on the current account, and thereby on the exchange rate. The intention was to make sure that the discovery of natural gas would be a blessing for the Israeli economy, and not a curse. We created certainty in the market that we would purchase all of the foreign exchange that would flow into the market as a result of the production of natural gas until the establishment of the sovereign wealth fund in 2018—and I emphasize that this is a long-term commitment, not for a month or two, and unconnected to the level of the exchange rate.

As to the question of the effectiveness of foreign exchange purchases, the average exchange rate since the start of the purchases in 2013 is NIS 3.7, compared to a rate of NIS 3.2 to the dollar at the beginning of the intervention. Since the beginning of the year, despite the fact that there are a number of currencies that have greatly weakened against the dollar and a number that have strengthened, the shekel has remained almost unchanged against the dollar.

The Bank of Israel’s foreign exchange purchasing policy has an impact on the Bank’s balance sheet in two ways: First, there is the difference between the yield on foreign exchange balances and the cost of the Bank of Israel’s shekel commitments, and second, the fact that the Bank is holding foreign exchange balances for the State exposes it to changes in the exchange rate. The shekel’s appreciation has negatively impacted the Bank of Israel’s balance sheet in recent years, but we must remember that should we need to realize the foreign exchange balances, it is reasonable to assume that we will do so at a much higher rate, and the benefit to the economy of holding the balances, in our view, is much higher than the costs “on paper” in the Bank of Israel’s balance sheet.

An exchange rate floor policy has become popular in recent years, after such a policy was adopted in Switzerland and the Czech Republic. But we must understand that the situation there was very different than our situation. If we need to declare a floor rate, we will need to commit to purchase any amount necessary in order to defend that rate, and monetary policy will be subject to maintaining the exchange rate without being able to act to achieve its other objectives, such as preventing inflation. Therefore, we need to consider such a policy only in conditions of growth and inflation that are very different than what currently exists.

In summation:

* Conditions in the domestic foreign exchange market can change rapidly. As a result of the Bank of Israel’s intervention in the market, the level of foreign exchange balances is more closely in line with the needs and state of the economy.
* The Bank of Israel intervenes in the market when the exchange rate is not consistent with the basic economic conditions.
* The natural gas program is moderating pressure on the exchange rate that results from the production of natural gas in Israel.
* Volatility in the global foreign exchange market is a fact, and requires a response in the business plans of both large and small businesses.