Bank of Israel's independence Under BoI 2010 law

'Independence 20 years On' Conference

Bank of England

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Historical background:

- First Bank of Israel Law in 1954
- Key features:
  - **Single decision-maker model**, with respect to
    - Monetary policy decisions
    - Management of the central bank

  - Governor was given the task of **economic advisor to the government**

Changes within the old-law framework

Following 1984-5 very high inflation, a Stabilization program was adopted in July 1985, leading to

- The "**no-printing law**"
- Subjecting BoI wages to Ministry of Finance Oversight Unit

In the 1990's, a number of institutional reforms :

- Gradual shift from exchange rate peg to floating ER and to modern inflation targeting regime
- Allowing BoI to **issue short-term paper (for MP)**

BoI goals and functions under 2010 law:
from a de-facto to a de-jure Inflation targeting regime

New BoI law came into effect in 2010:

> **"The bank is independent in taking actions and using its mandate to achieve its goals and fulfilling its functions"** (The 2010 BoI law)

1. **Clearer definition of goals and objectives:**

Goal: price stability as primary objective; support of other gov's economic objectives, especially growth, employment and reducing social gaps; support financial stability

Main Functions:

- Conduct Monetary policy
- Manage FX reserves; ensure regular activity in FX market
- Bank supervision and regulation (prudential and conduct)
- Issuance of bank notes and coins;
- Regulation and Oversight of payment system
- Economic advisor to government

Key issues defined in the 2010 law:

2. Decision making \ oversight organs:

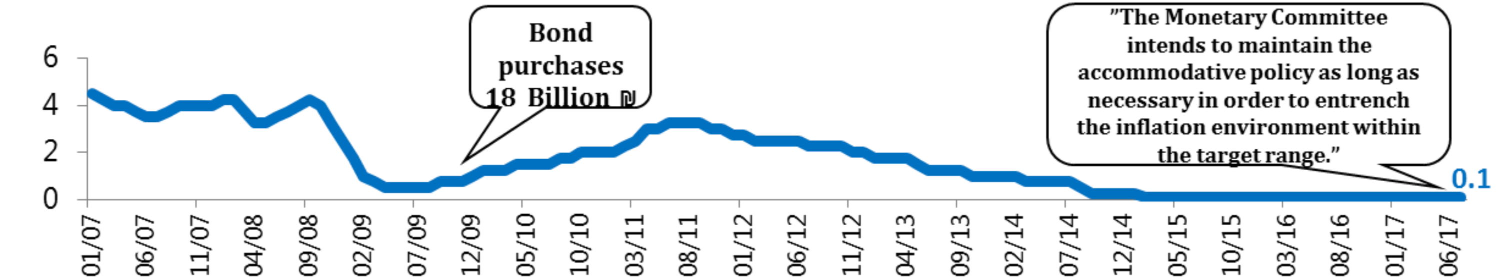
- **Gov’t appoints Governor and Deputy for a fixed 5 year term**
- **Monetary Committee :**
  - Conducting MP, managing FX reserves; 3 external members, 3 internal, governor has an additional vote in case of tied vote
- **Administrative council: Overlooking the BoI's management & budget** (5 external members,– including chairman + governor and deputy)
- **Formal definition of Exchange rate system**

Experience under current legal framework

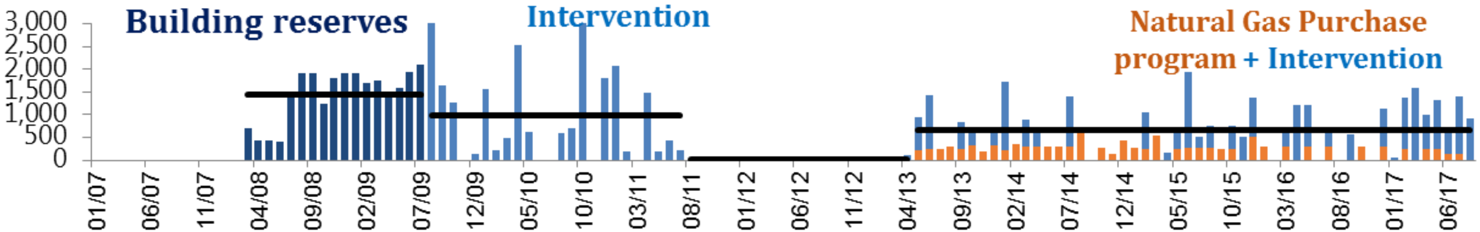
- Current framework **allowed the BoI to use multiple policy tools** (interest rate, FG; FX, MAP) aimed at its **multiple objectives** (price stability, activity and employment, and financial stability)
- This allowed us to "economize" on the use of each tool, and aim at the "optimal mix"
- Responsibility for banking supervision **allows using Macro – Prudential** tool as part of the set of policy tools, and **focus MP on its main objectives**

Bank of Israel Policy Tools 2007-2017

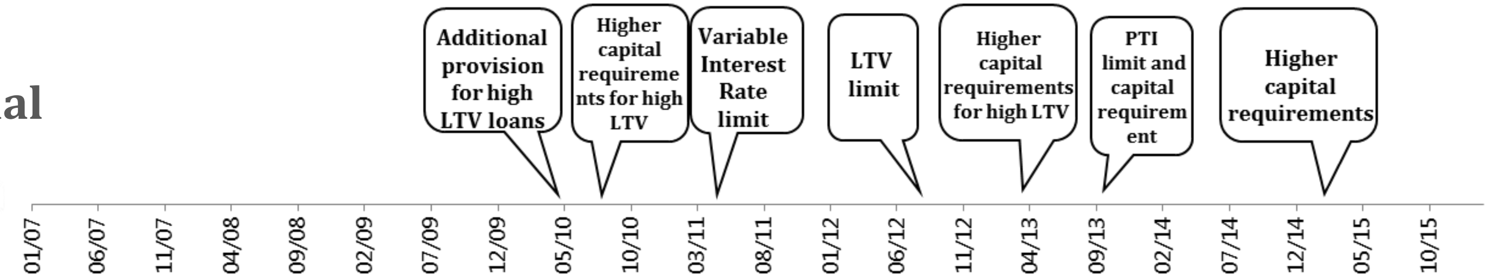
Interest Rate (%)



FX Intervention (US$)



Macroprudential Measures



Source : BoI

But, Some limits to Independence:

Need to Consult with or Seek Approval by Treasury over :

- **Foreign exchange market intervention** (when part of MP, **report** to MoF; if for other purposes, need MoF approval)
- **Size and management of reserves** (principles for adequate level set by MPC; changes require MoF approval)

Other limits to independence:

- **Wage agreements approved by administrative council, overseen by Treasury**
- **Provision of limited ST credit to the Government** (generally, No government financing; BoI can provide ST limited credit)
- **Transfer of profits to the Government** (Only if BoI capital exceeds 2.5% of total assets)

"Inherent Friction" with the Government and Parliament

Main areas of friction:

- BoI economic advice to the government (including on fiscal policy) characterized by professional long horizon view; leads to frequent friction with short term view of politicians
- Banking regulation gives the BoI a mandate to introduce often unpopular macro-prudential measures, that the political system may be reluctant to adopt. These lead to public discontent and political pressure
- Government / parliament promotes consumer related or competition enhancing initiatives which sometimes come at the expense of financial stability

→ Enhanced "political exposure" sometimes risking independence

→ Increasing the need to engage in public dialogue regarding BoI policies.

Thank you