BANK OF ISRAEL
Office of the Spokesperson and Economic Information

July 19, 2021

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

The discussions took place on July 4 and 5, 2021.

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 Markets), who prepare and present the material for discussion.

In the narrow forum—which consists of the Monetary Committee and a representative of the Markets Department—the Research and the Markets 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 July 5, 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 0.1 percent. In addition, the Committee decided to end the program providing long-term loans to the banking system against credit extended to small and micro businesses on October 1, 2021, or when NIS 40 billion have been utilized in the program. Both decisions were reached unanimously.

The discussion focused on the possible factors in the increase of the inflation environment in Israel and the extent to which they are expected to persist over time, the global economy and monetary policy in various countries, the improvement in economic activity and the slow labor-market recovery, which is not uniform across the various sectors; the exchange rate; and the risks remaining despite the recovery of economic activity.

Main points of discussion

The Committee discussed the increase in the inflation environment reflected in the year over year inflation rate entering the target range for the first time since the middle of 2019, as well as in higher inflation expectations. An analysis of the sharp increase in US inflation indicates that a considerable portion of the rising prices is focused on a small number of CPI components. While most assessments are than the high inflation in the US is not expected to persist, the Committee was of the view that it remains difficult to determine how transitory the increase in Israel's inflation is, but emphasized that inflation in Israel is much lower than in the US, and there is no concern of an outbreak of inflation. In a small number of economies (mostly developing markets) notable inflationary pressures were seen, which led to interest rate increases. However, the monetary policy in major economies remained very accommodative—major central banks kept interest rates unchanged and did not change purchase programs. The global economy can be seen to be continuing on an improving trend, with an increase in the share of vaccinated people—a development that helps to continue driving the Israeli economy forward, as it is a small open economy that is impacted by global developments.

Available indicators of economic activity point to a continuation of the recovery that began with the exit from the third lockdown, although the level of activity, and primarily employment, remains lower than the pre-crisis levels. The broad unemployment rate declined, and the employment rate (excluding COVID-19 absentees) increased slightly. However, an analysis of labor market data indicates that the recovery is not uniform across the various sectors. In addition, the job vacancy rate is still at a high level. The main industries in which there is a shortage of workers are the restaurant and tourism industries, which were markedly adversely impacted by the crisis, as well as the construction industry. The Committee assessed that the recovery in the labor market is expected to continue, even if at a relatively moderate pace, and apparently a return to the unemployment rates of just before the crisis is expected to take a long time. A similar picture is conveyed at other countries, such as the US—a slow decline in unemployment, while the level of job vacancies remains high.

The Committee discussed the risk of a renewed spread of the current coronavirus variant, and its possible impact on activity should the government be required to impose additional limitations. The Committee also discussed recent financial market developments and noted that corporate bond spreads are still at low levels, and since the beginning of the year there have been marked increases in equity indices in Israel and abroad. However, since the previous interest rate decision, equity prices and corporate bond spreads have remained without significant changes, corporate bond spreads are at a level similar to that of before the crisis, and government bond yields also remained stable. In addition, there was an acceleration in the increase in home prices—which increased in the past year at a relatively rapid pace of 5.6 percent. In contrast, the fiscal uncertainty declined, and will decline even further after the State budget is passed.

Since the previous interest rate decision, the shekel weakened by 1.1 percent against the dollar, and strengthened by 0.6 percent in terms of the nominal effective exchange rate and by 2.2 percent against the euro. In the Committee’s discussions, it was noted that the plan to purchase $30 billion in 2021 was a special program for a very special situation, which supported the economy’s dealing with the economic ramifications of the COVID-19 crisis. Since the publication of the program, morbidity around the world, and in Israel in particular, improved, the economy recovered at a solid pace, the employment situation was improved, and the inflation rate returned to the target range. It was noted that the intervention this year is not limited to $30 billion, and at the end of the program, the Bank will intervene in the foreign exchange market at its discretion, given the state of the economy.

The Committee members assessed that the current extent of monetary accommodation, via a range of policy tools, is appropriate for now. The Committee will formulate its policy so that it will continue to provide macroeconomic support in the process of exiting the economic crisis, and will ensure that the credit market continues to function. However, with the removal of the limitations, and the recovery of the economy, the Committee members assessed that the need for a program to provide long-term loans to the banking system against credit extended to small and micro businesses declined, and the Committee decided unanimously that the operation of that program would be halted: the pillar of the program in which loans were extended to banks at an interest rate of -0.1 percent ended as planned in June, and regarding the pillar of loans extended at an interest rate of 0.1 percent, the Committee decided that it will end on October 1 or when the NIS 40 billion of the plan are utilized. The Committee members noted that the Committee will continue to examine market conditions constantly and will continue operating the other tools used in the crisis, as needed.

All six members of the Monetary Committee were of the opinion that the interest rate should be kept unchanged at 0.1 percent. They were of the view that that the low level of the interest rate supports the continued recovery of economic activity.

The Committee noted that the process of returning to routine in Israel supports rapid growth in the coming year. However, there are still challenges to activity, in view of the health risks in Israel and abroad and the adverse impact on the economy, particularly the labor market. The Committee will therefore continue to conduct very accommodative monetary policy for a prolonged time, using a range of tools as necessary, including the interest rate tool. This is in order to continue supporting he attainment of the policy targets, the economy's recovery from the crisis, and ensuring the continued orderly functioning of the financial markets.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski

Other participants in the narrow-forum discussion:
Ms. Dana Orfaig, Research Department
Mr. Tal Biber, Head of the Markets Division, Markets Department
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Uri Barazani, Spokesperson of the Bank
Mr. Arad May, Secretariat of the Monetary Committee
Ms. Shulamit Nir, Research Department
Mr. Yoav Soffer, Advisor to the Governor
Mr. Daniel Shlomiuk, Spokesperson's Office