BANK OF ISRAEL
Office of the Spokesperson and Economic Information

December 9, 2019

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

The discussions took place on November 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 November 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. Four Committee members supported the proposal to keep the interest rate unchanged, and one Committee member supported the proposal to reduce it to 0.1 percent.

The discussion focused primarily on the picture of real economic activity and the development of exports, the risks reflected from the global economy, developments in the inflation environment, the fiscal uncertainty, and the expected path of monetary policy.

Main points of discussion

The Committee discussed developments that occurred in the inflation environment in recent months. The Committee members noted that the year over year inflation rate remained low, below the lower bound of the target range, but that 1-year expectations remained stable near the lower bound of the target range. In addition, it was noted that medium-term expectations and long-term forward expectations declined moderately. The Committee noted that the inflation environment also declined when looking at the CPI excluding energy, fruit and vegetables, and they noted the negative impacts of the strengthening of the shekel and the moderation of the increase in housing prices. The Committee members discussed the significant appreciation that has taken place since the beginning of the year, and noted that the shekel is notable in its strengthening relative to most currencies. They assessed that continuation of the appreciation will weigh on the return of inflation toward the midpoint of the target range. The Committee members noted that although the inflation rate is expected to return to the lower bound of the target in a range of about a year, the uncertainty regarding that is high.

With regard to economic activity, the Committee assessed that the economy continues to grow at around its potential rate. According to initial estimates for the third quarter, the economy grew by 4.1 percent, and the Research Department assesses that net of the volatility deriving from vehicle imports, the growth rate in the quarter was slightly below 3 percent. The Committee members noted that according to company reports in the Business Tendency Survey, in the manufacturing industries there was no worsening in the exporter-profitability constraint while in the services industries there was a slight increase in this percentage. However, it was noted that the exchange rate impacts exports with a lag, and therefore it is possible that the cumulative appreciation of the shekel will have a negative effect on exports going forward. In addition, the Committee members noted that the labor market remains tight: the most recent data indicate a decline in unemployment, even if with a decline in the participation and employment rates. The increase in wages continues to be driven by the business sector, but at a slightly slower rate than what prevailed in the beginning of the year. The job vacancy rate has declined moderately for several months now, but it is still high and at this stage, it is not clear that it is an indication of a slowdown in activity.

The Committee discussed the impacts of the uncertainty regarding the fiscal situation, against the background of the continued political uncertainty and the handling that will be required in view of the expected deficit and the impacts on real activity and the path of inflation. The Committee members assessed that until now, there have not been signs of a negative impact from the political situation in Israel on the economy, but they noted that to the extent that the government will be required to act based on an interim budget for an extended period of time, it will have a restraining impact on activity. In addition, one Committee member noted that although the business sector does know how to deal with uncertainty in the short term, there is a concern of a negative impact on economic activity and productivity in the long term.

The Committee members also discussed the uncertainty and the risks to economic activity worldwide. They noted that most signs point to a slowdown in the pace of global economic activity and that, according to the most recent OECD forecast, global growth is expected to remain low. However, there has recently been some decrease in the risks of a marked slowdown deriving from a deterioration in the “trade war” between the US and China and from a “hard Brexit”. In parallel, a discussion was held on the assessments that the accommodative monetary measures around the world are nearing exhaustion. In particular, the messages conveyed by the Fed indicate that the federal funds rate will remain at its current level unless there is a material change in the economic situation, and the markets are estimating that the ECB is not expected to change the interest rate in the next two years.

After a discussion, four Committee members were of the opinion that the interest rate should be kept at its current level. Three of those members claimed that in view of the economy continuing to grow at close to its potential rate, the labor market remaining tight, inflation being expected to begin converging to within the target range beginning in a year, and the Fed and ECB apparently having exhausted their interest rate reductions at the current stage, the interest rate can be kept at its current level for now, and to use additional monetary tools. However, they added that the risks to activity and to inflation are significant, so there may be a need to increase the extent of monetary policy accommodation going forward. The fourth member claimed that at the current level of the real interest rate, monetary policy is very accommodative, and given the growth and employment conditions, there is no need for additional accommodation.

In contrast, one Committee member voted in favor of reducing the interest rate to 0.1 percent. He claimed that the cumulative appreciation is liable to adversely impact economic activity and to act toward a continued decline in inflation, which in any case is at a low level. In addition, according to that same Committee member, the moderation of economic activity worldwide is a significant risk, and requires an enhancement of the level of monetary accommodation.

The Committee members were of the opinion that in view of the inflation environment in Israel, the monetary policies of major central banks worldwide, the moderation in the global economy, and the continued appreciation of the shekel, it will be necessary to leave the interest rate at its current level for a prolonged period or to reduce it in order to support a process at the end of which inflation will stabilize around the midpoint of the target range, and so that the economy will continue to grow at an adequate pace. Moreover, the Committee members noted that the Committee takes additional steps as necessary to make monetary policy even more accommodative.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Chairperson
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:
Mr. Eddy Azoulay, Chief of Staff to the Governor
Mr. Uri Barazani, Deputy Spokesperson of the Bank
Mr. Arad May, Secretary of the Monetary Committee
Dr. Nimrod Segev, Economist in the Research Department
Mr. Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department