

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

# October 9, 2024

**Press Release:**

**The Monetary Committee decides on October 9, 2024**

**to leave the interest rate unchanged at 4.5 percent**

* **We have seen an increase in the inflation environment in view of the supply limitations in the economy. The increase in the pace of inflation is broad, and is reflected in both the nontradable and tradable components.**
* **In the baseline scenario of the Research Department’s macroeconomic staff forecast, GDP is expected to grow by 0.5 percent in 2024 and by 3.8 percent in 2025. These growth rates are 1 and 0.4 percentage points, respectively, lower than the previous forecast.**
* **The latest indicators of economic activity point to some increase in activity in the third quarter, although the level of activity remains distant from the trend line. The labor market remains tight, mainly in view of the supply limitations.**
* **In the housing market, the rapid increase in home prices continues, and constraints on activity in the construction industry remain significant.**
* **The continuing geopolitical uncertainty was reflected in a downgrading of Israel’s credit rating and an increase in the economy’s risk premium. The increase in tension in the Middle East has so far had a moderate effect on the global financial markets, while oil and natural gas prices have increased.**

**In view of the continuing war, the Monetary Committee’s policy is focusing on stabilizing the markets and reducing uncertainty, alongside price stability and supporting economic activity. The interest rate path will be determined in accordance with the convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.**

**For the file of figures accompanying this notice, click here.**

The State of Israel is in the midst of a prolonged war, which has recently intensified along the northern front, alongside increasing tension with regard to Iran. The continuing geopolitical uncertainty has been reflected in a downgrading of Israel’s credit rating and in the continuing increase in the economy’s risk premium. According to current indicators for the third quarter, the moderate recovery is continuing, such that the level of economic activity remains lower than the trend line.

In view of supply limitations in the economy, we have seen an increase in the inflation environment. The Consumer Price Index for August increased by 0.9 percent, and inflation in the past 12 months stands at 3.6 percent, which is above the upper bound of the target range (**Figure 1).**  Net of energy and fruit and vegetables, inflation is at a year over year pace of 3.1 percent **(Figure 2)**. The increase in the pace of inflation is broad, and is reflected in both the nontradable and tradable components **(Figures 4)**. According to forecasters’ projections, inflation will continue to increase at the beginning of 2025, partly in view of the expected increase in VAT, and will then moderate toward the upper bound of the target in the second half of the year **(Figure 5)**. According to various sources, inflation expectations for the coming year are around the upper bound of the target range (**Figure 6**). Expectations for the second year onward are in the upper portion of the target range (**Figure 7**). In the Committee’s assessment, there are several risks for a possible acceleration of inflation: geopolitical developments and their impact on economic activity, shekel depreciation, prolonged supply limitations, fiscal developments, and higher global oil prices.

Since the previous interest rate decision, the shekel has depreciated by 2.8 percent against the US dollar, by 1.5 percent against the euro, and by 2.3 percent in terms of the nominal effective exchange rate. The exchange rate has fluctuated with high volatility in view of various developments in the war and in the geopolitical environment.

The Research Department revised its macroeconomic forecast. The forecast assumes that the war, which has expanded along the northern front, will continue with high intensity into early 2025. In view of the growth estimate that is lower than the previous forecasts and the increased intensity of the war in recent weeks, the growth forecast was revised downward. GDP is expected to grow by 0.5 percent in 2024 and by 3.8 percent in 2025 (**Figure 9**), which are 1 and 0.4 percentage points lower than the previous forecast, respectively. The forecast for the broad unemployment rate among the prime working ages (25–64) was revised downward, and is expected to average 3.5 percent in 2024 and 3.2 percent in 2025. The annual inflation rate is expected to be 3.8 percent on average in the fourth quarter of 2024, which is higher than the July forecast, and 2.8 percent on average in the fourth quarter of 2025. The forecast for the government budget deficit in 2024 was revised upward to 7.2 percent of GDP, in view of the increase in war expenditures and the deferral of special assistance receipts from the US to the coming years. The deficit forecast for 2025 was compiled under the working assumption that the government will make adjustments of a permanent nature to reduce the deficit, which will total at least NIS 30 billion. Under this assumption, the deficit in the government budget is expected to be 4.9 percent of GDP in 2025. The debt to GDP ratio is expected to be 68 percent at the end of 2024, and to increase to 69 percent in 2025. The forecast is characterized by a particularly high level of uncertainty. An increase in the intensity or an extension of the war, and not making the necessary fiscal adjustments, may lead to a change in economic conditions, and thereby to adjustments to the forecast. Therefore, we also analyzed alternative scenarios. For example, we examined a scenario involving a significant temporary escalation in the war, which would require a reserve mobilization similar in scale to the beginning of the war. This would lead to an expansion of the limitations on economic activity and the shutdown of the education system for several weeks, particularly in the northern region but also in the central part of the country. According to this scenario, the worsening security situation would negatively impact annual growth, causing a significant decline in output in the fourth quarter of 2024. In such a scenario, with the reduction in the number of reservists and the lifting of severe activity restrictions in 2025, growth that year would be higher than in the baseline scenario. However, the level of output in 2025 would still be lower than in the baseline scenario. If the war extends further into 2025, supply constraints will continue to hinder the recovery of economic activity, resulting in more moderate growth and a widening gap from the baseline scenario. In such a scenario, the continuation and intensification of the war would lead to a further increase in the deficit and debt due to higher defense expenditures and the impact on activity and tax revenues, necessitating additional budgetary adjustments. These could delay the convergence of inflation to its target.

The most recent indicators of economic activity show that there was some increase in economic activity, although the level of activity remains distant from the trend line. The Composite State of the Economy Index for August increased by 0.23 percent, which is higher than all of the index readings since February, but still lower than the average growth rate of the index in earlier months. Supply limitations are making it difficult for economic activity to converge to the prewar trend. Since the last monetary policy decision, there was a nominal increase in the volume of credit card purchases, but they declined in real terms in August (**Figure 11**). The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for September remains lower than before the war (**Figure 10**), although it reflected expectations of improvement in the coming months. The rate of companies in the services and manufacturing industries that reported a moderate or severe constraint in activity due to a shortage of equipment and raw materials increased, and remained higher than before the war (**Figures 23–24**). Foreign trade data indicate an increase in goods and services exports (**Figure 19**). Goods imports have recovered gradually in the first three quarters of the year, and the volume of consumption goods imports is about 7 percent higher than it was before the war. In contrast, the import of raw materials and the import of investment products are lower than their prewar levels.

The cumulative deficit in the government budget between January and August totaled 8.3 percent of GDP.

The labor market remains tight, mainly in view of supply limitations. The participation rate continues to decline, while the employment rate is stable. The employment rate among those aged 15 and older was stable, at 60.9 percent in August, and the broad unemployment rate remained low in August, at 3.2 percent (seasonally adjusted, **Figure 12**). The job vacancy rate declined in August, but remains above its prewar level (**Figure 14**). In addition, according to the Central Bureau of Statistics Business Tendency Survey, the constraint on expanding activity due to difficulty in hiring workers (moderate or severe) declined in September in most industries, but remained higher than before the war (**Figure 25**). Nominal wages continue to increase, although at a slightly more moderate pace, and real wages remain consistent with the long-term trend **(Figure 13)**.

Activity in the construction industry is recovering gradually, but limitations on activity in the industry in view of the war remain significant (**Figure 15**). Home prices continued their rapid upward trend, and the rate of increase in the past year is 5.8 percent **(Figure 16)**. According to the Central Bureau of Statistics, building starts declined by 6 percent in the second quarter, relative to the first quarter, while building completions declined by 17 percent. In addition, the number of building permits issued in the second quarter declined by 4 percent compared to the previous quarter. In August, new mortgage borrowing totaled NIS 8.4 billion (**Figure 17**). The pace of increase in rental prices remained relatively stable at 2.6 percent. However, for rentals in which the tenant changed, there was an increase of 5.3 percent in rents.

In the capital market, domestic equity indices remained virtually unchanged during the reviewed period, compared with increases in most of the main global equity indices (**Figure 32**). The cumulative underperformance of the domestic equities market relative to the global market since the start of the war remains significant. Government bond yields increased. Corporate bond spreads remained virtually unchanged (**Figure 29**). During the reviewed period, the Moody’s ratings agency downgraded Israel’s credit rating by two notches, and the S&P ratings agency downgraded Israel’s credit rating by one notch. Both agencies maintained a negative outlook for Israel’s rating. Israel’s risk premium, as measured by the 5-year CDS spread, increased to a record high of 165 points during the reviewed period, and the spread between dollar-denominated Israeli government bonds and US Treasury bills widened slightly and remains high (**Figure 28**). Outstanding business and consumer credit continues to grow, although at a lower pace than before the war.

The increase in geopolitical tension in the Middle East has so far had a moderate effect on the global financial markets, while the prices of oil and natural gas recently increased. The global purchasing managers indices for September indicated expansion in the services sector and continued contraction in the manufacturing sector. World trade was relatively stable. Economic growth data published during the reviewed period in the US were surprisingly good, and indicated a growth path that was slightly higher than the long-term trend. In the eurozone, second quarter growth was slightly lower than expected, with the German economy particularly negative. In China, second quarter growth was lower than forecast, and activity remained noticeably weak in the third quarter as well. Inflation trends indicate continued convergence toward the central bank targets. In the US, the August CPI increased by 0.2 percent moderating the annual inflation rate to 2.5 percent. The Core CPI increased by 0.3 percent in August, with the annual pace of increase remaining unchanged at 3.2 percent. Inflation in the eurozone declined to 1.8 percent in September, with the main decline coming from the energy component. The monetary easing among central banks in the advanced economies continued, with the Federal Reserve lowering its interest rate by 50 basis points and revising its interest rate forecasts from June downward for both 2024 and 2025. The ECB continued its path of lowering the interest rate, with a 25 basis point reduction (**Figure 39**). This trend of continued interest rate reductions is expected to continue in the coming year.

The minutes of the monetary discussions prior to this interest rate decision will be published on October 22, 2024. The next decision regarding the interest rate will be published on Monday November 25.

Interest rate decision dates for 2024 and 2025 are available at:

https://www.boi.org.il/en/economic-roles/monetary-policy/interest-rate-announcement-dates-2024/