



BANK OF ISRAEL
Secretariat of the Monetary Committee

April 20, 2020

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

The discussions took place on April 5 and 6, 2020.

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 April 6, and in the [data file](#) that accompanied that 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 lower the interest rate to 0.1 percent. Five Committee members supported the proposal to lower the interest rate to 0.1 percent, and one Committee member supported the proposal to reduce it to 0 percent. In addition, the Committee decided unanimously on two additional steps:

- To put a new monetary policy instrument into operation: the provision of monetary loans to the banks for a term of three years, with a fixed interest rate of 0.1 percent. The loans are contingent upon extending credit to small and micro businesses.
- The expansion of the program through which repo transactions are made vis-a-vis financial entities, so that the agreements can include corporate bonds as collateral.

The discussion focused primarily on the short- and long-term ramifications of the corona pandemic on the Israeli economy, and on the policy required in order to minimize the economic damage to businesses and households and support the recovery of the economy as quickly as possible.

Main points of discussion

While the Monetary Committee's discussions prior to deciding on the interest rate were the first such scheduled discussions following the worsening of the corona crisis, they took place following a series of discussions that the Committee held regarding the necessary monetary policy, during which a number of policy decisions were made that were implemented and [announced](#) during March.

The Monetary Committee's discussions focused on the significant worsening of the corona crisis during March. As part of this crisis, the government is making on-going decisions on the appropriate actions with the aim of mitigating public infection from the spread of the disease. These decisions have broad implications for Israel's economy. Many other countries are going through a similar process, which differs based on each country's characteristics, and the contraction of their activity has implications for the Israeli economy. With the exception of current data from the financial markets and some forecasts, the data available to the Committee were up to date as of January and February 2020, and therefore did not reflect the broad economic ramifications of the outbreak of the corona pandemic. The Committee discussed the real economic situation as shown in the qualitative information from the business surveys conducted by the Central Bureau of Statistics and the Bank of Israel, and in the quantitative assessment of the effects of health restrictions on reducing activity in various areas.

As of the date of the discussion, the corona virus had infected about one million people around the world, including close to 10,000 Israelis. The Committee discussed the sharp decline in the level of economic activity in Israel in March due to the crisis, and the expectation of continued contraction of activity, at least in the second quarter of the year. The Committee discussed the anomalous uncertainty regarding the health and economic scenarios expected in Israel and around the world, and the uncertainty regarding expected fiscal policy if the crisis is prolonged. The Committee members discussed the Research Department's assessment that private consumption is 27 percent lower than its pre-crisis level due to the public health instructions that are in place as of the date of the discussion. The Committee was presented with an analysis of the effect of the crisis by industry, which showed that the total negative impact to GDP, given Ministry of Health guidelines, is about 37 percent. These estimations show that in the first quarter, the economy contracted by about 5 percent relative to the

previous quarter (in quarterly terms). The Committee discussed the findings of the Bank of Israel's Companies Survey, which indicate a sharp decline in the net balance of the business sector, and the industry net balances from the Central Bureau of Statistics Business Tendency Survey, which also show a significant decline in all industries.

The Committee members discussed the assessments of international organizations and investment houses, which expect a contraction of global GDP in 2020 and a sharp decline in world trade. The Committee discussed the sentiment indices, which indicate contraction in economic activity in the advanced economies, and the data in China, which show a gradual return of economic activity thanks to the slowdown in the spread of the virus, which has allowed the authorities to reduce the restrictions on the populace. The Committee discussed the fact that the spread of the crisis has led to a sharp policy reaction by central banks and governments. Most of the central banks have lowered interest rates sharply and taken a variety of accommodative steps to supply liquidity to the markets. Governments have declared wide-scale programs to expand public expenditure, compensate victims of the crisis, and extend credit to the business sector. The slowdown in economic activity has led to a sharp decline in commodity prices, and the price of oil dropped by dozens of percent, also against the background of the lack of agreement between the major oil-producing countries regarding a cut in output.

The Committee members discussed the Research Department's staff forecast, which holds that, assuming that there is no further worsening of the restrictions in Israel, and that most of the restrictions blocking economic activity will be gradually removed until the end of June, the economy is expected to contract by 5.3 percent. The unemployment rate in the second half of the year (following the removal of the restrictions) among the primary working ages will be about 8 percent under this scenario. The Committee members emphasized that notwithstanding the assessment in this scenario that rapid growth is expected in 2021, the unemployment rate is expected to return to the low levels that were prevalent prior to the crisis only toward the end of 2021. A more pessimistic scenario might take place, according to which a delay in the removal of the restrictions would lead to a sharper contraction of GDP in 2020—8.8 percent—and an unemployment rate that is 2 percentage points higher on average.

The Committee discussed the shake-up of the capital markets in Israel and abroad during March. The stock indices in the major markets dropped by around 30 percent, and most of them offset part of that decline thereafter. Yields in the government and corporate bond markets were very volatile, and there was a sharp increase in the risk indices. In Israel, the Tel Aviv 35 index declined by about 25 percent, and the sharp increase in government bond yields and in corporate bond spreads was halted after the announcement of the Bank of Israel's measures in the bond market and the halt in the trend of withdrawals from the mutual funds, which had reached NIS 8 billion per day at its peak.

The Committee members also discussed the anomalous volatility in the exchange rate during March, against the background of the liquidity distress in the foreign exchange market in view of the sharp declines in global equity markets. From the previous interest rate decision through March 17, the shekel weakened by 11 percent in terms of the effective exchange rate, but after the Bank of Israel instituted dollar/shekel swap transactions, the volatility declined and the weakening of the shekel moderated to 3.4 percent since the previous interest rate decision. The Committee members were of the opinion that the depreciation is expected to help exports, particularly manufacturing exports, and to offset the downward forces on inflation.

The inflation environment has declined in recent months. This decline began even before the outbreak of the corona crisis, and when the crisis began, there was a further sharp decline in one-year inflation expectations. The expectations derived from the capital market, and expectations from the other

sources decline, partly as a result of the sharp decline in global oil prices. However, longer-term expectations did not change significantly. The Committee members discussed the expectation that the negative impact to the production chain of many products may lead to an increase in prices from the supply side, and that the effect of the decline in demand is apparently more significant and will lead to a decline in inflation in the coming months. However, in the short term, there is expected to be some difficulty in measuring inflation, which is reflected in particular in the 27 percent of CPI components where activity was near zero in March.

The data and assessments available to the Committee showed, as stated, that the economy entered a serious crisis in view of the spread of the corona virus, with the crisis reflected in difficulties in the capital market and significant economic distress among businesses and households. The Committee members were of the opinion that monetary policy must focus on supporting the proper activity of the capital market, particularly the functioning of the government and corporate bond markets, and the need to ease the economic distress of businesses and households. In view of the uncertainty in decision-making due to the dependence on actual infection data from the virus, a discussion was held regarding the appropriate policy under various assumptions about the duration of the crisis. In this context, it was noted that the two scenarios included in the Research Department's staff forecast were compiled on the basis of the information available at the time the discussion was held, and that other scenarios may develop later on as a function of the exit strategy and of actual developments. Therefore, the Committee was of the opinion that its decisions must also take into account the possibility that a more pessimistic scenario than the Research Department's basic scenario may play out, and the support for demand in the economy that will be necessary when the health restrictions are removed.

The Committee members emphasized that in view of the serious crisis, it is important that monetary policy lead to an easing of credit terms in the form of lowering the interest rate along the entire curve. While the Bank of Israel's measures in the bond market are lowering the medium- and long-term interest rates, many households and businesses are also exposed to the short-term interest rate, particularly those who borrow at variable rates. Therefore, five of the Committee's members were of the opinion that the interest rate should be lowered to 0.1 percent. One Committee member voted for lowering the interest rate to 0 percent. He was of the opinion that the intensity of the crisis and the exceptionally intense negative impact to employment require an interest rate lower than 0.1 percent, the level that was prevalent for a long period when employment in the economy was full.

The Committee members agreed that action must be taken to increase the pass-through from the low interest rate set by the Committee to the interest rates that the banks charge on loans to a variety of borrowers in the economy. Therefore, the Committee decided unanimously to put a new instrument into action, through which the Bank of Israel will extend monetary loans to the banks, totaling NIS 5 billion, for a term of three years, with a fixed interest rate of 0.1 percent. The loans are contingent upon extending credit to small and micro businesses. This tool is intended to ensure that the low level of the interest rate will also be reflected in the price of loans extended to these businesses. The Committee also decided unanimously to expand the program under which repo transactions are conducted vis-à-vis financial entities, such that the transactions will also be able to include corporate bonds as collateral (in addition to transactions with government bonds as collateral pursuant to the program announced on March 16). The Committee members were of the opinion that this step will strengthen the program's support of liquidity and of the orderly functioning of the Israeli bond markets.

The Committee members emphasized that they will expand the use of existing tools, including the interest rate tool, and will be able to operate additional tools, to the extent that the crisis lengthens

and it is necessary in order to achieve the monetary policy goals and to moderate the negative economic impact resulting from the crisis.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:

Prof. Amir Yaron, Governor of the Bank of Israel and Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski, Director of the Research Department

Other participants in the narrow-forum discussion:

Mr. Uri Barazani, Acting Spokesperson of the Bank
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Tal Biber, Head of the Markets Division, Markets Department
Mr. Arad May, Secretariat of the Monetary Committee
Ms. Esti Schwartz, Secretary of the Monetary Committee
Ms. Tida Shamir, Bank of Israel Legal Counsel
Ms. Michal Sinai-Liviatan, Bank of Israel Legal Division
Mr. Yoav Soffer, Advisor to the Governor
Mr. Shay Tsur, Senior Researcher in the Research Department