



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

September 11, 2019

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

The discussions took place on August 27 and 28, 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 August 28th, 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. The decision was unanimous.

The discussion focused primarily on the inflation environment and the contribution of the shekel's appreciation to the decline in the inflation rate; real economic activity and the development of exports in view of the risks to the global economy in particular; the fiscal uncertainty; and the expected path of monetary policy.

Main points of discussion

The Committee held a broad discussion of the change that has taken place in the inflation environment. The Committee members noted that annual inflation is below the lower bound of the target range, and that according to various assessments, it will remain within this environment in the coming months, before returning to around the lower bound of the target range. In this context they noted the negative contributions of the strengthening of the shekel and the decline in energy prices. The Committee noted the decline in one-year expectations and forecasts from various sources to around the lower bound of the target range, and the decline in medium-term forward expectations. In contrast, they noted the fact that long-term forward expectations remained anchored around the midpoint of the target. Most of the Committee members held the assessment that the appreciation of the shekel remains the main factor delaying the continued increase of inflation toward the midpoint of the target. In contrast, one of the Committee members emphasized that, net of the components characterized by high volatility, including the fresh fruits and vegetables item, inflation remains relatively stable around the lower bound of the target. The Committee members noted that there is great uncertainty regarding the future path of inflation.

In their discussion of economic activity, the Committee members noted that second quarter data indicate that the economy is continuing to grow at around its potential rate, led by private consumption excluding durables and public consumption. They noted that initial third quarter data support the assessment that growth is continuing at around the potential rate. The Committee members agreed that the Israeli economy, and services exports in particular, seem to have not been affected, for the time being, by the trade war. They noted the continued trend of expansion in exports, led by services exports, and the fact that companies' reports for the Business Tendency Survey do not indicate a decline in orders from abroad or in profitability.

The Committee believed that the labor market remains tight, and noted in particular the continued increase in nominal wages, led by the business sector, as an important factor in supporting the return of inflation to the target range. The Committee also discussed the marked uncertainty in the fiscal situation. The Committee believed that the fiscal uncertainty is expected to continue for some time, in view of the political uncertainty and the measures the government may take to deal with the expected deficit. The Committee discussed the potential effects of the deficit on economic activity and on the

path of inflation. In their discussion of the housing market, the Committee members noted that home prices have continue to increase moderately in the past year, and the number of transactions increase, mainly led by first-home buyers. In addition, there was an easing of the terms of finance. Mortgage interest rates continued to decline moderately, due to the decline in government bond yields, while the upward trend in mortgage volume continued. It was noted that the decline in medium- and long-term bond yields, without a significant increase in corporate bond spreads, makes the terms of financing for the business sector easier as well.

The Committee discussed the uncertainty in and risks to global economic activity. It noted that most of the signs point to a continuation of the slowdown in world trade, with forecasts of world trade and growth in most blocs revised downward. In addition, it was noted that the "trade war" between the US and China is continuing, and that the risks derived from the realization of Brexit have increased. In parallel, the assessments that monetary policy makers in the major economies are signaling further monetary accommodation were discussed. In particular, the Federal Reserve lowered the federal funds rate by 25 basis points, and market expectations are that the interest rate will continue to decline this year. The ECB left its interest rate unchanged, but signaled additional accommodative measures.

Following the discussion, the Committee members were of the opinion that the interest rate should be left at its current level, and expressed the assessment that it will not rise for a prolonged period. Most of the Committee members believed that the recent decline in the inflation environment to below the target range, together with a combined trend of appreciation and negative global economic developments increase the risk to achieving the goals of monetary policy. However, all of the Committee members agreed that it is best to wait and examine the trend of inflation and developments in the economy before taking additional accommodative measures.

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. Itamar Caspi, Head of the Monetary Analysis Unit
Ms. Esti Schwartz, Secretary of the Monetary Committee
Mr. Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department