



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

July 22, 2019

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

The discussions took place on July 7 and 8, 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 July 8th, 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 members supported the proposal to keep the interest rate unchanged, and one member supported the proposal to increase it to 0.5 percent.

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

Main points of discussion

The Committee assessed that the economy continues to grow by around its potential rate. Based on the second estimate of first quarter National Accounts data, which were revised downward, the economy grew by 4.8 percent, but the growth was impacted markedly by volatility in vehicle imports. The figure reflects moderate growth in private consumption and solid growth in exports, mainly in services industries. Various estimates indicate that the economy continues to grow at its potential pace: the Business Tendency Survey points to growth continuing at a solid pace, and the labor market remains tight—the unemployment rate continues to decline, and wages continue to increase, primarily in the business sector. With regard to the housing market, the Committee members noted that an acceleration in activity is becoming apparent: home prices increased moderately in the past year, but the number of transactions increased markedly among all buyer types. In addition, the trend of expansion in mortgage volume continues, and mortgage interest rates continued to decline moderately.

Regarding the inflation environment, the Committee members noted that the inflation rate reached a level of 1.5 percent. Inflation in nontradable goods' prices (an approximation of the domestic component of inflation) remains above 2 percent, and inflation in tradable goods' prices continued to increase in May and is not negative. In their view, although a decline in inflation is expected in the coming months, based on estimates, the probability that it will remain above the lower bound of the target range is greater than it was in previous months. They noted that 1-year expectations and forecasts for the coming year from the various sources continue to hover slightly above the lower bound of the target range, while forward expectations for medium and long terms remained around the midpoint of the target. The Committee discussed the exchange rate of the shekel; in the past year the shekel strengthened by approximately 5 percent in terms of the nominal effective exchange rate. The Committee members noted that the appreciation is the main factor delaying the continued increase in the inflation rate toward the midpoint of the target, and thus could have an impact on Bank of Israel policy.

The Committee discussed the uncertainty and the risks to economic activity worldwide. The slowdown in world trade continues and forecasts for world trade and growth in most regions were revised downward. In addition, the “trade war” between the US and

China continues and there is political risk in Europe and the Persian Gulf. Monetary policy makers in major economies are signaling monetary accommodation: in the US, the Fed kept the interest rate unchanged but market expectations are that it is expected to implement accommodative policy due to the increased risks and the decline in inflation expectations. The ECB kept the interest rate unchanged but noted that an interest rate increase is not expected until at least the middle of 2020.

The Committee discussed the marked uncertainty in the fiscal situation as well. The government budget deficit in the past 12 months was 3.9 percent of GDP and is higher than expected based on the seasonal path. The Committee members were of the opinion that the fiscal uncertainty is expected to last for some time, in view of the political uncertainty and the steps the future government could take in order to deal with the expected deficit, and they discussed the possible ramifications of the deficit on economic activity and on the path of inflation.

As noted, four Committee members were of the opinion that the interest rate should be kept at its current level. They explained that even though the inflation environment has been stable for several months within the inflation target range, there is currently particularly high uncertainty regarding economic developments in Israel and abroad, and therefore the interest rate should remain unchanged at this time. They noted that even though a turnaround in the monetary policy of major central banks is becoming apparent, which will impact partly on the domestic economy, policy makers have to respond primarily to domestic developments. They assessed that in the coming months conditions could ripen for increasing the interest rate by 0.25 percentage points, they emphasized that the decision will be contingent on developments regarding the inflation environment and economic developments in Israel and abroad. The fifth Committee member was of the opinion that the interest rate should be increased to 0.5 percent, as in his view the current interest rate is not in line with the state of the economy, compared with economic conditions and the interest rates prevailing in several other economies.

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. Daniel Nathan, Economist in the Research Department
Ms. Esti Schwartz, Secretary of the Monetary Committee
Mr. Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department