



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

January 24, 2018

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

The discussions took place on January 9 and 10, 2017.

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. If the vote is tied, the Chairperson (the Governor) has an additional vote.

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 January 10, 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 for the economy. After the discussion, it was decided to keep the interest rate unchanged at 0.1 percent. The decision was unanimous.

The discussion focused on several main issues: (1) real economic activity; (2) inflation, (3) the global environment and the exchange rate; and (4) the housing market.

Main points of discussion

In their discussion on economic activity, the Committee members noted that according to initial Central Bureau of Statistics estimates of National Accounts data for 2017, the growth rate averaged 3 percent, similar to the economy's potential growth rate. The composition of growth during the period seems more balanced. It was not based solely on growth in private consumption (3 percent), but also on marked growth in exports (3.9 percent), thanks to growth in the export of services. The Committee members said that recent data hint at a decline in the growth of exports, and discussed the Research Department's forecast, which projects that the economy will continue to grow by about 3.5 percent in each of the next two years. The Committee members also noted that labor market data indicate a "tight labor market", which is reflected in a record high employment rate, a record low unemployment rate, a high level of job vacancies relative to the number of unemployed people, a decline in the rate of people who are employed in part time positions involuntarily, and a rapid increase in wages in the past two years.

The Committee discussed inflation and noted that for most of 2017, it ranged within positive bounds. The situation in the labor market, and particularly the rapid rate of wage increases, provide a basis for the assessment that inflation will continue to increase. Inflation in Israel and abroad was affected, inter alia, by the increase in oil prices. The Committee members stated that there are a few factors reducing the rate of inflation at this time, including the appreciation of the shekel, actions taken by the government to reduce the cost of living, enhancement of competition, and the low level of global inflation. Their assessment was that these factors do not reflect a weakness of demand.

The Committee members noted that the global environment is in a positive trend, reflected in the recovery of global growth and world trade and in price increases in the financial markets. This trend is expected to increase demand for Israeli exports. They pointed out that despite the positive trend, the major central banks are still not meeting the inflation targets. The ECB maintained its negative interest rate policy, and even though it reduced the extent of asset purchases, this policy is expected to continue until at least December. The US Federal Reserve increased its interest rate as expected.

The Committee members expressed concern over the marked trend of appreciation of the shekel in the past few weeks, mainly due to the weakness of the dollar worldwide. A continuation of this trend will delay the return of inflation to the target range. The Committee members agreed that the exchange rate is over-appreciated.

The Committee noted that housing market data continue to point to moderation of demand, particularly a decline in the number of transactions and a slowdown in the rate of housing price

increases. Building starts declined in recent months, but the Committee members mentioned that this figure is generally revised upward over time, that there is a marked increase in building permits, and that this will likely be reflected in future building starts. In addition, the Committee members discussed the connection between building starts and building completions. They stated that at least until May of 2017, building starts reached a historically very high level, and we can therefore expect a high level of building completions in the coming two years and an increase in supply, which may lead to a decline in the prices of housing services.

All the Committee members agreed to keep the interest rate at its current level in view of the low inflation environment, monetary policy in major economies, and developments in the exchange rate. In its notice, the Committee emphasized that the monetary accommodation will remain in place as long as necessary in order to entrench the inflation environment within the target range. One of the Committee members noted that the low inflation rate is impacted, inter alia, by the fact that price levels in Israel are high to begin with relative to the global levels, and the fact that the government is working to reduce the cost of living, and that it does not indicate a problem with demand. Therefore, it would not be correct for the Committee to condition a change in monetary policy only on developments in inflation, and it would be proper to decide on policy while noting additional considerations, including the manner in which the continued low interest rate affects asset prices and savings. Another Committee member noted that in view of the continued deviation of inflation from the target, it is appropriate that the Committee examine the possibility of monetary accommodation through the use of additional policy tools. He added that the countries with prevailing low inflation took drastic measures to extract themselves from it.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:

Dr. Karnit Flug, Governor of the Bank and Chairperson
Dr. Nadine Baudot-Trajtenberg, Deputy Governor
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. Daniel Hahiashvili, Chief of Staff to the Governor
Ms. Maya Haran Rosen, Economist in the Research Department
Mr. Ilan Socianu, Assistant to the Secretary of the Monetary Committee
Mr. Yoav Soffer, Bank of Israel Spokesperson
Prof. Michel Strawczynski, Director of the Research Department