



## **BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

March 12, 2018

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

**The discussions took place on February 25 and 26, 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 February 26, 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. Five Committee members supported the proposal to keep the interest rate unchanged, and one Committee member supported increasing the interest rate to 0.25 percent.

The discussion focused on several main issues: (1) real economic activity; (2) inflation, (3) the global environment and the exchange rate, (4) the housing market, and (5) the forward guidance policy.

### **Main points of discussion**

In their discussion on economic activity, the Committee members discussed National Accounts data for the fourth quarter of 2017. They noted that the economy is growing at a pace similar to its potential growth rate, and that the composition of growth in the past year seems more balanced: It was not based solely on private consumption growth, but also on an increase in exports, against the background of solid growth in world trade. The Committee referred as well to labor market data that indicate a tight labor market, reflected in a record high employment rate, a record low unemployment rate, a high ratio of job vacancies to the number of unemployed people, a decline in the share of people who are employed in part time positions involuntarily, and a rapid increase in wages in the past three years. It was noted that the increase in wage per employee post moderated in recent months, but data on the growth in health tax receipts (updated through January 2018) indicate continued increase at a high rate.

The Committee noted that the inflation environment is lower than the target. They added that there was some increase in inflation expectations from the various sources, against the background of the depreciation that occurred since the last interest rate decision. They said that the inflation rate is expected to decline in the coming period, in accordance with the seasonal path and due to government-initiated price reductions; however, to the extent that the shekel depreciation will persist, it—and with it, the increase in wages—is expected to support a rise in inflation. The Committee members said that some factors continue to reduce the inflation rate at this time, including measures the government is taking to reduce the cost of living, the enhanced competition reflected in, among other things, a marked increase in online purchases of consumer products over the past decade, and the relatively low level of global inflation. They assessed that these factors do not reflect weakness in demand.

The Committee members noted that the global environment is in a positive trend, reflected in upward revisions of international institutions' growth forecasts for major economies and for world trade. The improvement in the global economy is expected to increase demand for Israeli exports. They noted that the US Federal Reserve is expected to increase the federal funds rate at its next meeting, and twice more in 2018. Despite other central banks continuing to adopt accommodative monetary policy, a

less accommodative future path of monetary policy is beginning to be priced in to financial markets. The ECB maintained its negative interest rate policy and signaled that it is expected to continue.

The Committee members discussed the depreciation in the shekel against the background of Bank of Israel intervention in the foreign exchange market, and occurrences in financial markets. The majority of Committee members claimed that the shekel is over-appreciated.

The Committee noted that housing market data continue to point to moderation of demand, which is reflected in the continued decline in the number of transactions and a decrease in home prices in the last three months for which data was published. The Committee members noted that investment in residential construction declined in the past three quarters, and it is possible that this decline indicates a moderation in supply of homes as well.

The Committee members reiterated that the monetary accommodation will be maintained as long as necessary in order to entrench the inflation environment within the target range. One of the Committee members noted that there will be room for further accommodation in the future if the inflation environment remains below target, and particularly if there is continued moderation in the increase in wages, which is the main factor that would support an increase in inflation. Another member said that as the low inflation rate does not indicate a problem in demand, it would not be right for the Committee to condition a change in monetary policy only on developments in inflation, and it would be correct to decide on policy taking into account other considerations, including the manner in which the continued low interest rate impacts on asset prices and on savings.

As noted, five Committee members reasoned that the interest rate should be kept unchanged. In their reasoning for the decision, the Committee members noted that the inflation environment remains low and that there is a need to keep the interest rate at its low level in order to support its return to within the target range. They added that increasing the interest rate before the entrenchment of inflation within the target range is liable to ultimately delay the return of the interest rate to higher levels, due to its possible impact on the exchange rate and on inflation expectations. The Committee members also noted that although the low interest rate creates financial risks, they are not only the result of the interest rate set by the Bank of Israel, and they are not at such a high level that requires an increase in the interest rate: mortgage volume stabilized, the increase in consumer credit moderated, and in parallel the increase in labor income continues, and the level of savings, even after declining, remains high by international comparison. One of the Committee members was of the opinion that the interest rate should be raised to 0.25 percent. He felt that the low inflation rate is impacted by, among other things, the level of prices in Israel being higher to begin with compared with other countries and the government working to reduce the cost of living, and it does not indicate a problem with demand. This Committee member was of the opinion that less emphasis should be placed on the over-appreciated level of the

exchange rate in view of the economy's switch from goods exports to services exports and the growth in world trade, which are expected to reduce the sensitivity of exports to the level of the exchange rate. It is therefore proper to decide on the policy while taking into account other considerations, including the manner in which the continued low interest rate impacts on asset prices and on saving.

**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:**

Daniel Hahiashvili, Chief of Staff to the Governor  
Daniel Nathan, Economist in the Research Department  
Esti Schwartz, Secretary of the Monetary Committee  
Yoav Soffer, Bank of Israel Spokesperson  
Prof. Michel Strawczynski, Director of the Research Department