

BANK OF ISRAEL

Office of the Spokesperson and Economic Information

October 22, 2019

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

The discussions took place on October 6 and 7, 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 October 7th, 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. Three Committee members supported the proposal to keep the interest rate unchanged, and two Committee members supported the proposal to reduce it to 0.1 percent.

The discussion focused primarily on the inflation environment and the contribution of the shekel's appreciation to the decline in the inflation rate; the picture of real economic activity and the development of exports in view of the risks to the global economy in particular; global economic developments, and in particular accommodative monetary steps taken by several central banks; the fiscal uncertainty; and the expected path of monetary policy.

Main points of discussion

The Committee held a broad discussion on the change that has taken place in the inflation environment in recent months. The Committee members noted that the year over year inflation rate remained low, below the lower bound of the target range. Although most 1-year expectations are near the lower bound of the target range, medium-term expectations rose, and long term forward expectations remained anchored near the midpoint of the target range, inflation is still expected to decline further in the coming months, before returning to around the lower bound of the target. The Committee noted in this regard the significant negative contribution deriving from relatively volatile components and from the strengthening of the shekel. The Committee members assessed that the marked appreciation since the beginning of the year is the result of the relatively good state of Israel's economy and the surplus in the current account, but the change in global relative interest rates also had an effect, as well as the impact of Israel being included in the WGBI index. The Committee assessed that enhanced competition in the economy, and the expansion of the phenomenon of retail purchases online, have also created downward pressure on prices. However, one Committee member claimed that it could be that the moderation in economic activity worldwide also made a negative contribution to domestic inflation despite it seeming that it has not yet impacted activity in Israel. The Committee members noted that the uncertainty regarding the future path of inflation is high. Looking ahead, it was noted that if the government will decide to raise indirect taxes, it will have a one-off impact on prices, but is not expected to impact on the inflation path.

With regard to economic activity, the Committee members noted that most indicators point to the economy having continued to grow at around its potential rate in the third quarter. They emphasized the strength of private consumption that in recent years has

been a growth driver for the domestic economy. In addition, it was noted that exports are growing at a solid pace, led by services exports, but the Business Tendency Survey shows some increase in the share of companies reporting a severe constraint in export profitability, after a decline in this share during 2018. They added that to date there aren't signs of a negative impact from Israel's political situation on the economy, but they agreed that the uncertainty regarding the steps the government, when it is established, will take to reduce the deficit increases the uncertainty regarding developments in the domestic economy.

The Committee was of the opinion that the labor market remains tight, as indicated as well from comprehensive analyses of Labor Force Surveys. The Committee discussed the moderation in the rate of increase of nominal wages, but noted that wages in the business sector, in particular, continue to increase adequately.

The Committee discussed the increased risks to global economic activity, primarily in view of the "trade war" and the uncertainty regarding Brexit. It emphasized the deterioration in world trade and in growth forecasts of advanced economies. It was noted that until now, the Israeli economy apparently has not been impacted by the global slowdown, but the Committee members noted that should the slowdown reach capital markets and the technology industries, a more notable impact on the Israeli economy would be expected.

After an extended discussion, three Committee members were of the opinion that the interest rate should be kept at its current level. One of them claimed that at the current level of the interest rate, monetary policy is very accommodative and is not in line with real conditions in the economy, and that the deviation of inflation from the target range does not derive from a slowdown in economic activity, but from an extended adjustment process of the price level in Israel to the price level of prices worldwide. The two other Committee members claimed that in view of the economy growing at a solid pace and inflation being expected to converge to within the target range beginning in another year, the interest rate can be left at its current level, but they noted that the risks to activity and to inflation are significant, therefore it could be that there will be a need to increase the extent of monetary-policy accommodation in the future.

In contrast, two Committee members voted in favor of reducing the interest rate to 0.1 percent. They claimed that the cumulative appreciation, the pressures for continued appreciation due to the monetary accommodation worldwide and the inclusion in the WGBI index, are liable to act toward a continued decline in inflation, which in any case is at a low level. They added that the moderation of activity worldwide is a significant risk, and therefore action should be taken now already to avoid negative consequences later, especially as the current growth in Israel is positively impacted by the expansionary fiscal policy so far.

The Committee members were of the opinion that in view of the inflation environment in Israel, the monetary policies of major central banks worldwide, the slowing in the global economy, and the continued appreciation of the shekel, it will be necessary to leave the interest rate at its current level for a prolonged period, or to reduce it in order to support a process at the end of which inflation will stabilize around the midpoint of the target range, and so that the economy will continue to grow at an adequate pace. Moreover, the Committee members agreed that if necessary, the Committee will take additional steps to make monetary policy even more accommodative.

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
Ms. Shulamit Nir, 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