



BANK OF ISRAEL

Office of the Spokesperson and Economic Information

April 18, 2019

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

The discussions took place on April 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 April 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 committee members supported the decision to leave the interest rate unchanged, while one member supported increasing it to 0.5 percent.

The discussion focused primarily on real economic activity and uncertainty regarding real activity in the near future, apparent trends in the level of world trade, the appreciation of the shekel since the beginning of the year, and the expected path of monetary policy.

Main points of discussion

The Committee's assessment was that the economy is continuing to grow at a pace similar to the potential rate, and that the relative slowdown in second and third quarter data in 2018 was transitory. This assessment is supported mainly by the tight labor market—a high employment rate and a low unemployment rate together with a high job vacancy rate (demand for workers), which are reflected in continued wage increases, primarily in the business sector. Private consumption recovered, evidence of the high level of demand in the economy. For now, the concern of unusual fluctuations in the financial market that would negatively affect real activity has subsided. The Committee members noted that this assessment is also supported by Composite State of the Economy Index data for the first quarter of 2019, foreign trade data, and the Consumer Confidence Index. However, they noted that a number of indicators point to the possibility that the labor market strength has reached its peak. There is an apparent slight easing in the labor shortage constraint as reported by employers in a number of industries, and the job vacancy rate remains high but is declining moderately. The Committee members noted that first and second quarter data are expected to be "noisy" in view of increased vehicle imports in the first quarter, which will apparently have a beneficial effect on investment, private consumption, and GDP data, while the effect is expected to be offset in the second quarter, and this should be noted when analyzing developments and setting policy. Regarding the housing market, the Committee members noted that the number of transactions continued to increase, particularly among first-time home buyers, alongside the prolonged decline in investment in residential construction.

The Committee members discussed the moderation of global economic activity, the downward revision of global growth forecasts, and the change in expectations regarding the path of global interest rates and monetary policy. In the US, current expectations are that the interest rate path will be lower than previous expectations, and in Europe, the expected start of interest rate increases has been delayed. The Committee members stated that the decline in world trade is expected to continue affecting activity in Israel.

The Committee discussed other risk factors that are affecting the global economy, including the uncertainty surrounding Brexit and a possible trade agreement between the US and China. The Committee believed that some of the risks may also be to the upside. It is possible to expect, for instance, that if the US and China do reach a trade agreement, optimism will return to the global markets, which will support the continued increase of activity in the domestic market.

The Committee members discussed the fiscal situation, the measures that the future government may take to deal with the expected deficit, and their possible effects on economic activity and on the inflation path. They believed that it is still too early to assess what effect fiscal policy may have on real activity or on the inflation path, because in any case, fiscal uncertainty is expected to remain for some time, at least until the formation of the new government.

Regarding the inflation environment, the Committee members noted that there was no major change since the previous interest rate decision. The annual inflation rate remains above the lower bound, and the members' assessment was that in the coming months inflation will hover near it. The Committee members stated that the trend of widening gaps between inflation in the prices of nontradables (an estimate for the domestic component of inflation) and of tradables continued—while the former is approximately 2.5 percent, the latter became even more negative. They noted that since the previous interest rate decision, 1-year expectations and forecasts from the various sources increased slightly, and continue to range around the lower bound of the target range, while medium-term expectations are slightly below its midpoint. In the Committee members' assessment, the full employment environment is expected to strengthen the pass-through from wages to inflation. The Committee also discussed the continued strengthening of the shekel since the previous interest rate decision. Since the beginning of the year, the shekel has strengthened by about 4.5 percent in terms of the nominal effective exchange rate. In the Committee's assessment, if the appreciation continues, it is liable to make the inflation rate's return toward the midpoint of the target more difficult, and if necessary, the Bank of Israel will consider using the tool of intervention in the foreign exchange market.

As stated, four of the Committee members believed that the interest rate should be left at its current level. The fifth Committee member believed that the current interest rate is not in line with the state of the economy, and that it is proper to raise it to 0.5 percent, since inflation has been within the target range for some time. In contrast, the other Committee members believed that even though there has been some increase in the inflation environment, the interest rate should be left at its current level for the time being, in view of the uncertainty regarding the forecasts of global real economic activity and monetary policy, and regarding the future path of inflation in Israel. Their assessment was that narrowing the extent of monetary accommodation should be done

in a gradual and cautious process to support the continued increase of inflation to the midpoint of the target range.

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:

Eddy Azoulay, Chief of Staff to the Governor
Uri Barazani, Deputy Spokesperson of the Bank
Dana Orfaig, 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
Yaakov Chen-Tzion, Economist in the Research Department