

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

# February 26, 2024

**Press Release**

**The Monetary Committee decides on February 26, 2024**

**to leave the interest rate unchanged at 4.5 percent**

* There is a great amount of uncertainty with regard to the expected severity and duration of the war. The war is having significant economic consequences, both on real economic activity and on the financial markets, and the country’s risk premium remains high.
* Inflation in the past 12 months has moderated, and is within the target range. Expectations and forecasts for the coming year increased slightly, and are around the upper bound of the target range. Expectations for the second year onward are within the target range.
* Since the previous monetary policy decision, the shekel weakened by about 0.25 percent against the US dollar, with high volatility, and strengthened by about 1.9 percent against the euro and by 1.4 percent in terms of the nominal effective exchange rate.
* GDP contracted by 5.2 percent in the fourth quarter of 2023, compared with the third quarter, due to the effects of the war. Over the year as a whole, GDP grew by 2 percent. The GDP growth was in line with the Research Department’s forecast from January 2024.
* Indicators of economic activity and the state of employment point to a gradual recovery following the sharp decline that took place with the outbreak of the war, but there is variance between industries.
* Activity in the housing market remained moderate, despite the increase in home prices in the past month. The constraints and activity difficulties in the construction industry in view of the war have moderated, but remain significant.
* Economic activity in most countries remained moderate, while the relatively strong economic growth in the US is prominent. Inflation moderated in many countries, but in most it remains above the central bank targets.

**In view of the war, the Monetary Committee’s policy is focusing on stabilizing the markets and reducing uncertainty, alongside price stability and supporting economic activity. The interest rate path will be determined in accordance with the continued convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.**

**For the file of figures accompanying this notice, click here.**

The State of Israel has been at war for more than four months. Beyond the security effects of the war, it is having significant economic consequences, both on real activity and on the financial markets. Indicators of economic activity point to a gradual improvement in activity, following a significant contraction in business activity with the outbreak of the war. Volatility in the markets has moderated, and the financial markets are functioning properly. There is great uncertainty with regard to the expected severity and duration of the war, which is in turn affecting the extent of the impact on activity.

The CPI remained unchanged in January, following a decline of 0.1 percent in December. Inflation in the past 12 months moderated, and is within the target range, at 2.6 percent (**Figure 1**). Net of energy and fruits and vegetables, inflation in the past year is 2.4 percent (**Figure 2**). The annual pace of inflation of the tradable components declined to 1.4 percent. The pace of annual inflation of the nontradable components of the CPI, which mainly reflects the housing services component and the services industries, remained relatively high, at 3.3 percent (**Figures 4**). Inflation expectations from various sources for the coming year increased slightly, and are around the upper bound of the target range (**Figure 6**). Expectations for the second year and onward are within the target range, in its upper portion (**Figure 7**). The Committee’s assessment is that there are still a number of risks of a potential acceleration in inflation: the effects of the war and its progress on economic activity, the constraints on activity in the construction industry, a depreciation of the shekel, and fiscal behavior.

Since the previous interest rate decision, the shekel weakened by about 0.25 percent against the US dollar, with a high level of volatility, and strengthened by 1.9 percent against the euro and by 1.4 percent in terms of the nominal effective exchange rate (**Figure 8**).

National Accounts data published by the Central Bureau of Statistics show that GDP contracted by 5.2 percent in the fourth quarter of 2023, relative to the third quarter, due to the effects of the war (seasonally adjusted), and that for the year as a whole, GDP grew by 2 percent. The contraction of GDP in the fourth quarter was in line with forecast assessments by the Bank of Israel Research Department published at the beginning of January 2024. The decline in GDP partly reflects sharp declines in construction activity and in private consumption, while public consumption increased in view of the war.

Indicators of economic activity and the state of employment point to a gradual recovery following the sharp decline that took place with the outbreak of the war, but there is variance between industries. The level of activity as measured on the basis of rapid indicators is lower than what it was prior to the war. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for January continued to indicate recovery, and while businesses’ assessments of their situation returned to positive outlooks, they are lower than they were prior to the war (**Figure 17**).

An analysis of the constraints on industry activity as reported in the Central Bureau of Statistics Business Tendency Survey shows that the seriousness of the constraints on the demand side is moderating, after increasing with the outbreak of the war. In contrast, there is no marked improvement in the constraints on the supply side. The rate of companies reporting a moderate or serious constraint in the volume of orders in the manufacturing and services industries moderated, mainly with regard to orders for the domestic market. However, the rate of companies in the construction and manufacturing industries that reported a moderate or serious constraint in equipment and raw materials increased in October, and remained high in November and December. A shortage of workers was reported as a significant constraint mainly in the construction industry.

The recovery in the volume of credit card transactions continued in February, and total purchases even slightly exceeded the 2023 prewar average. However, there is variance between industries. The Composite State of the Economy Index for January increased by 0.3 percent, further reflecting the gradual recovery of the economy. Following a decline in maritime traffic to Israel at the start of the war, there has been some recovery (**Figure 23**). Goods exports remained stable in January, after increasing sharply in December, and services exports declined in December (**Figure 25**). Goods imports continued to decline in January, further to the downward trend that deepened in recent months (**Figure 26**). The cumulative deficit in the past 12 months continued to increased, to 4.8 percent of GDP. The budget that was approved includes a deficit forecast of about 6.6 percent of GDP, and is expected to lead to a debt to GDP ratio of about 67 percent at the end of the year. Alongside these, tax revenue in January was about 4 percent lower in real terms than in the same period last year, representing some improvement over previous months.

The labor market continued to recover in view of the increase in demand for workers and stability in the labor supply. The broad unemployment rate[[1]](#footnote-1) continued to moderate in January, to 4.8 percent compared with 6.1 percent in December. The decline is mainly due to a decline in the number of employees temporarily absent for economic reasons. The rate of employees absent from their jobs for noneconomic reasons also moderated, and now reflects almost solely those performing reserve duty, after most workers who were absent for other reasons (such as school closures) returned to work in November. Labor input (the total number of work hours in the economy) increased by about 1.7 percent in December, but its level remains low. The job vacancy rate increased in January, which mainly reflects an increase in demand for workers in the construction industry and in the accommodation and food services industry (**Figure 28**). The average wage per employee post increased slightly in October, and increased significantly in November, apparently affected by the change in the composition of employees due to furloughs. According to a flash survey for December, wages are expected to remain unchanged.

Activity in the housing market continues to moderate, despite the increase in home prices in the past month. In the past 12 months, home prices declined by 1.4 percent (**Figure 11)**. In November–December 2023, the Index of Home Prices increased by 0.7 percent, and new home prices increased by 0.9 percent. However, the number of housing transactions and new mortgage volume stabilized at levels lower than in recent years. In January, new mortgage borrowing totaled NIS 5.5 billion (**Figure 12**). The owner-occupied housing services component of the CPI increased by 0.2 percent, and its annual rate of increase continued to moderate, to 3.3 percent. Alongside these figures, the shortage of workers at construction sites since the outbreak of the war led to a sharp decline in the pact of construction. Supply constraints in the construction industry and the need for housing solutions for those evacuated from their homes due to the war may make continued moderation of housing and rental prices more difficult in the future. Maintaining a high construction supply over time, and not just the need to maintain activity in the short term, will support the stability of housing prices.

In the capital market, local equity indices rose. However, the underperformance of the domestic market relative to the global market since the start of 2023 remains significant, and has continued into 2024 (**Figure 40**). Long-term government bond yields increased during the reviewed period, similar to the global trend, but with a more moderate intensity. Corporate bond spreads, which widened at the start of the war, returned to close to their prewar levels. The lowering of Israel’s credit rating from A1 to A2 by Moody’s, and the change of the ratings outlook to “negative”, mainly reflected the agency’s uncertainty regarding the economic consequences of the war, the timing and nature of the end of the war, and the change in the fiscal situation, as per the agency’s explanation. Despite the lowering of the rating and the change in the outlook, the market reacted moderately, and it is clear that these were already priced into the market. Israel’s risk premium as measured by the CDS increased again during the reviewed period, and the spread between dollar-denominated government bonds and US Treasury bills remained unchanged at a relatively high level.

In the credit market, the slowing trend of bank and nonbank credit continued. Credit to households and to small and micro businesses continued to decline. According to the Central Bureau of Statistics Business Tendency Survey for January, it seems that the difficulty in obtaining credit declined, and returned to its prewar level (**Figure 14**). The credit risk indices in the various segments increased somewhat. In addition, the deferral periods that the banks gave in October were extended for some loan repayments.

Economic activity in most of the major economies remained moderate, while the strong economic growth in the US in the fourth quarter is prominent. The International Monetary Fund’s assessment is that global growth will be 3.1 percent in 2024. The growth forecasts of the IMF and the investment houses were revised upward in view of the effect of the high growth in the US. (**Figure 33**). The purchasing managers index for the advanced economies increased in January, and returned to a level indicating an expansion of activity. The same is true of the purchasing managers index for the emerging economies, which also increased and continues to indicate expansion (**Figure 34**).

World trade continues to indicate weakness, but the volume of global goods trade improved in December. Shipping prices jumped sharply in view of the tension with the Houthis in the Red Sea, but moderated slightly in the past month. Oil prices increased, but remained lower than before the war.

In the US, fourth quarter growth was significantly higher than previous forecasts (3.3 percent in annual terms). The general CPI declined in January to an annual rate of 3.1 percent, while the core PCE index remained at 3.9 percent. In the eurozone, fourth quarter growth was 0 percent, and GDP has not grown at all in the past five quarters. Inflation increased at the end of 2023, and following a slight decline in 2024, the general CPI is 2.8 percent. Core inflation is moderating, and stands at 3.3 percent. The inflation environment moderated in many countries, but remains above the central bank targets in most of them (**Figure 37**). Most central banks are still concerned about inflation in the price of services, which remains sticky and is making it difficult for inflation to converge to the targets. The Federal Reserve and the European Central Bank left their interest rates unchanged, and signaled that the interest rate is not expected to decline in the coming months, which has moderated market expectations regarding the interest rate path.

The minutes of the monetary discussions prior to this interest rate decision will be published on March 11, 2024. The next decision regarding the interest rate will be published at 16:00 on Monday, April 8, 2024, and will be followed by a press briefing with the Governor.

1. In addition to unemployed persons under the normal definition, the broad unemployment rate includes employees who are temporarily absent for economic reasons (including those put on furlough). The definition of broad unemployment does not include employees who were absent from their jobs for other reasons, such as reserve duty, caring for children in the absence of day care or educational frameworks, and others. [↑](#footnote-ref-1)