BANK OF ISRAEL
Office of the Spokesperson and Economic Information

January 18, 2020

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

The discussions took place on January 3 and 4, 2021.

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 economic background 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 Markets), who prepare and present the material for discussion.

In the narrow forum—which consists of the Monetary Committee and a representative of the Markets Department—the Research and the Markets 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 of the economic situation as viewed by the Committee at the time of its discussion is presented in the notice regarding the interest rate decision, which was published on January 4, 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 0.1 percent. Five Committee members supported the proposal to keep the interest rate unchanged, and one Committee member supported the proposal to reduce it to 0 percent.

The discussion focused on the economic ramifications of entering a further lockdown and the state of the labor market, the path of recovery of economic activity in view of the inoculation campaign in Israel, economic developments worldwide, the development of the exchange rate, fiscal uncertainty, the extent of monetary policy accommodation, and the functioning of the domestic credit market.

Main points of discussion

The Monetary Committee discussed the economic ramifications of the entering a further lockdown in view of the significant increase in morbidity. The Committee members noted that as of the date of the discussion, the restrictions on economic activity are lighter than those that were imposed in previous lockdowns. The Committee's assessment was that the earlier-than-expected start of the inoculation campaign and the rapid pace of inoculations support a rapid recovery of the economy. The available indicators regarding activity in November and December (such as data on credit card expenditures and mobility) show an improvement in activity following the exit from the second lockdown. However, the variance in the damage between the major industries continues. Businesses and those employed in industries such as tourism, restaurants, education, and leisure were impacted more significantly and for a more prolonged period.

The Committee discussed the state of the labor market. The broadly defined unemployment rate declined to about 13 percent in the first half of December, after having reached approximately 23 percent during the second lockdown. However, unemployment is expected to increase due to the new restrictions on activity. The impact to employment is greater in industries where wages are lower. A real-time survey conducted by the Central Bureau of Statistics indicates an increase in the volume of business closures and a higher impact rate among small businesses. Committee members expressed concern over the ramifications of the crisis on inequality in the economy.

The Committee discussed the two scenarios that appear in the Research Department's staff forecast. The first scenario includes the rapid inoculation of the population by May 2021 ("the rapid inoculation scenario"), in which case there will be a rapid recovery of the economy such that by the end of 2022, GDP will be about 2 percent lower than its long-term trend. In the second scenario ("the slow inoculation scenario"), the inoculation process will be more prolonged, and last until June 2022, such that by the end of 2022, GDP will be more than 4 percent lower than the long-term trend. In both scenarios, there will be no restrictions with significant economic repercussions on activity following the completion of the public inoculation campaign. In addition, in both scenarios, activity will be at a higher level than what was projected in the previous forecast in October. The Committee members agreed that in view of the rapid pace of inoculation, the rapid inoculation scenario is more likely. In contrast, they noted the high level of uncertainty surrounding the forecast. Among other things, they noted the possibility of various scenarios: a scenario in which the virus mutates so that it is resistant to the vaccines that have been developed, lower effectiveness of the vaccine in the longer term ("immune memory"), and a renewed increase in morbidity that would require additional restrictions on activity.

The Committee discussed the appreciation of the shekel in recent months, as well as its effect on the export and import substitute industries and on the decline in inflation. The Committee noted that thus far, services exports (excluding tourism) are showing strength, and are continuing to grow strongly, and that in recent months, there has also been an apparent recovery of goods exports. In addition, the Committee noted the recovery in world goods trade. However, looking forward, it was noted that the appreciation may have a cumulative nonlinear effect on exports, which may lead to a serious impact that could occur with a lag. In view of this, the Bank of Israel has in recent months purchased large volumes of foreign exchange in order to moderate appreciation pressures. The Committee members were of the opinion that the appreciation pressures are partly due to the relatively strong macroeconomic conditions of the Israeli economy, particularly the current account surplus, together with the continued growth of services exports and investments by foreign companies in Israeli hi-tech companies, as well as hedging activity by institutional investors against their investments abroad. The Committee members' assessment was that continued appreciation may lead to the closure of export companies, particularly small ones.

Regarding budgetary policy, the Committee's assessment was that the economy's operation under an interim budget is leading to a tighter fiscal policy. However, the Committee noted the government increased the budget base for 2020 so that the interim budget for 2021 will be less contractionary than had it remained unchanged. Some of the Committee members expressed the assessment that in view of the third lockdown, additional economic relief packages would be necessary, particularly if a decision is made to further tighten the restrictions on activity. The Committee noted that so far, developments in the capital market reflect investors' trust in the Israeli economy despite the budgetary uncertainty.

The Committee discussed developments in the global economy. Data were presented regarding the pace of inoculation around the world, which is increasing persistently, and which in many cases is in line with set targets. However, in some countries, the rate of morbidity is higher than the pace of inoculations, and morbidity is therefore expected to increase in the short term. The pace of growth in 2021 is expected to vary greatly between economies, and some economies are not expected to recover even in 2022. Monetary policy in the major blocs remains very accommodative, and additional fiscal packages were launched. The Committee noted that the morbidity increase in

Europe is expected to lead to fourth quarter data that show contraction in activity. In addition, there is a decline in the 2021 forecast for Europe. Growth forecasts for the US were revised upward, but American labor market data indicate moderation.

The Committee discussed monetary policy and whether it is sufficiently accommodative in view of the economic conditions, the rapid pace of inoculation in Israel, the start of a third lockdown in view of the increasing morbidity rate, and the fact that the economy is operating under an interim budget that is leading to tighter fiscal policy. The Committee discussed the financial conditions in Israel relative to the world. Most of the Committee members expressed the assessment that the current extent of monetary accommodation, with the variety of tools being used, is sufficient for the time being, particularly in view of the additional tools being used in the credit market, such as the payment deferral program. They noted that the financial system is functioning in an orderly fashion and that the various indicators are not pointing to serious credit distress. However, they noted that the small and micro business segment is encountering greater difficulty in raising credit. The Committee was informed that the legal and operational infrastructure for one of the new components of long-term monetary loans, the use of mortgage portfolios as collateral on the part of the banks, has been completed, and that the implementation of this component has already begun. The Committee expressed the assessment that this step will enable the banking system to increase business credit, particularly to small businesses. The Committee members noted that interest rates in the economy have remained low, despite the increase in credit risk, partly due to policy measures taken by the Bank of Israel and the Ministry of Finance. The Committee expressed the assessment that in the coming months, the use of additional accommodative measures may become necessary.

Five Committee members were of the opinion that the interest rate should be kept at its current level of 0.1 percent. These five Committee members were of the opinion that the low level of the interest rate supports a recovery of economic activity and a gradual return of inflation to the target range, particularly in view of the fact that the Bank of Israel is using additional tools in the credit market and in the foreign exchange market. One Committee member voted in favor of reducing the interest rate to 0 percent. He was of the opinion that an interest rate lower than 0.1 percent is more appropriate due to the magnitude of the crisis and the adverse impact, anomalous in its magnitude, on the employment level. He added that he does not rule out the possibility that a more accommodative monetary policy will be necessary in the future and that the interest rate may need to be lowered to a negative rate. The Committee decided to leave the other policy measures previously decided upon in place.

The Committee noted that the rapid pace of inoculations in Israel increases optimism regarding a rapid return of the economy to a path of growth in the coming year. However, the risks to activity remain high, and the adverse impact to the economy, and particularly on the labor market, is expected to be prolonged. The Committee will therefore continue to utilize a range of tools in order to increase the extent of monetary policy accommodation and to ensure the continued orderly functioning of the financial markets. The Committee will expand the use of existing tools, including the interest rate, and will operate additional tools, to the extent that it assesses that it is necessary in order to achieve the monetary policy goals and to moderate the adverse economic impact resulting from the crisis.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski, Director of the Research Department

Other participants in the narrow-forum discussion:
Mr. Tal Biber, Head of the Markets Division, Markets Department
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Uri Barazani, Spokesperson of the Bank
Mr. Ari Kutai, Economist in the Research Department
Mr. Arad May, Secretariat of the Monetary Committee
Ms. Shulamit Nir, Economist in the Research Department
Ms. Dana Orfaig, Economist in the Research Department
Mr. Yoav Soffer, Advisor to the Governor