

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

# November 27, 2023

Press Release:

**The Monetary Committee decides on November 27, 2023**

**to leave the interest rate unchanged at 4.75 percent**

* The war is having significant economic consequences, both on real economic activity and on the financial markets. There is great amount of 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 Israeli economy is strong. In the past, it has demonstrated its ability to recover from difficult periods. The various economic indicators since the beginning of the war have, as expected, pointed to a decline in economic activity, but after a few weeks of war, it seems that the economy is recovering in some components of activity.
* Inflation has moderated, but is still above the target range. Inflation expectations and forecasts are within the target range.
* Following a sharp depreciation of the shekel in the initial weeks of the war, there has been a sharp appreciation, and the shekel strengthened below its prewar level. In view of the recent volatility of the exchange rate, depreciation of the shekel continues to pose a risk to the convergence of inflation to the target range.
* The Bank of Israel Research Department lowered its growth forecast, and in its estimation, GDP will grow by 2 percent in each of 2023 and 2024. The forecast features an especially high level of uncertainty, and includes the assessment that government expenditures due to the war will total about NIS 160 billion. The debt-to-GDP ratio is expected to be 63 percent in 2023, and 66 percent in 2024.
* The volume of activity in the housing market continues to moderate, and the industry is experiencing difficulties as a result of the war. In the past 12 months, home prices have declined by 0.2 percent. The owner-occupied housing component declined by 0.3 percent, and its annual rate of increase continued to moderate, to 4.9 percent.
* In the credit market, there is a slowing trend of bank credit to small and micro businesses. The Bank of Israel has activated a number of targeted policy tools to support the process of providing credit to this segment.

**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 developments in the war and the uncertainty derived from it. Insofar as the recent stability in the financial markets becomes entrenched and the inflation environment continues to moderate toward the target range, monetary policy will be able to focus more on supporting economic activity.**

[**For the file of figures accompanying this notice, click here.**](מצגת%20הריבית%2027.11.23.pptx)

The State of Israel is in the eighth week of the “Swords of Iron” war. The war is having significant economic consequences, both on real activity and on the financial markets. Indicators of economic activity during the war point to an initial contraction of business activity, with some recent gradual recovery. 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 Israeli economy is strong, stable, and based on solid foundations, and in the past it has demonstrated its ability to recover from difficult periods. Since the outbreak of the war, the Bank of Israel has adopted a variety of policy measures to assist the public and the economy in dealing with the consequences of the war. While volatility in the markets has moderated and the financial markets are functioning properly, the economy’s risk premium remains high. In addition, while there seems to be some decline in inflation expectations, there remains a high level of uncertainty with regard to the war’s effects on supply and demand in the economy.

The CPI increased by 0.5 percent in October. Inflation in the past 12 months moderated slightly, but remained above the upper bound of the target range, at 3.7 percent (**Figure 1**). Net of energy and fruits and vegetables, inflation in the past year is 3.5 percent, and with the further neutralization of the effects of taxation and regulation, inflation is 3.6 percent (**Figure 2**). The pace of annual inflation of the nontradable components of the CPI, which mainly reflects the housing services component and the services industries, declined but remained high, at 4.2 percent. The annual pace of inflation of the tradable components has been more volatile, and stands at 2.9 percent (**Figure 3**). One-year inflation expectations derived from the capital market and forecasts declined, and are within the target range (**Figure 6**). Expectations for the second year and onward also declined and are within the target range (**Figure 7**). In view of the decline in demand, and along with supply-side constraints due to the war, there is considerable uncertainty with regard to the path of inflation in the coming period. The Monetary Committee’s assessment is that the current monetary policy supports the convergence of inflation to its target. With that, depreciation of the shekel continues to pose a risk to the inflation rate in view of the recent volatility of the exchange rate.

Following a sharp depreciation of the shekel in the initial weeks of the war, there has been a significant appreciation, and the shekel strengthened below its prewar level. Since the previous interest rate decision, the shekel strengthened by 8 percent against the US dollar, by 5.3 percent against the euro, and by 6.4 percent in terms of the nominal effective exchange rate (**Figure 8**). Since the beginning of the year, the shekel has weakened against most of the world’s major currencies (**Figure 9**), with high volatility. In view of the impact of the war, and in order to stabilize the markets, on October 9, 2023 the Bank of Israel announced a program to sell up to $30 billion, out of which the Bank sold $8.2 billion in October.

The Bank of Israel Research Department revised its macroeconomic forecast in accordance with information accumulated since the start of the war.[[1]](#footnote-1) The revised forecast was built under the assumption that the war’s direct impact on the economy will continue into 2024 although with declining intensity—as opposed to the assumption in the October forecast that the direct impact will be concentrated in the fourth quarter of 2023 alone. Similar to the October forecast, the assumption is that the war will be mostly concentrated on one front. The forecast contains an assessment of the fiscal impact of the war. According to Research Department assessments, government expenditure due to the war (gross, before adjusting for assistance from the US government and reductions in other expenditures) is expected to amount to about NIS 160 billion by the end of 2025, and there is an expected loss of revenue totaling about NIS 35 billion. Naturally, there is a particularly high level of uncertainty surrounding the forecast, partly in view of the uncertainty regarding the duration, scope, and nature of the war. The Research Department lowered its growth forecast, and its assessment is that GDP will grow by 2 percent in each of 2023 and 2024 (**Figure 16**). The broad unemployment rate among the prime working ages (25–64) is expected to be 4.3 percent in 2023 and 4.5 percent 2024. Annual inflation in the fourth quarter of 2024 is expected to be 2.4 percent. The assessment regarding the State budget for 2024 is currently exposed to significant uncertainty with regard to the impact of the war and the government’s decisions with regard to prioritizing the security and civilian needs arising from it. In view of the effects of the war, it is expected that the impact to economic activity will lead to a decline in tax revenue, while the government’s expenditures on defense and the civilian assistance program will increase. In the Research Department’s assessment, all these are expected to be reflected in an increase in the government’s budget deficit, which will total 3.7 percent of GDP in 2023, and 5 percent of GDP in 2024. In view of this, the debt-to-GDP ratio is expected to be about 63 percent in 2023 and about 66 percent in 2024.

The growth rate prior to the war was strong. National Accounts data published by the Central Bureau of Statistics show that GDP grew by 2.8 percent in annual terms in the third quarter relative to the second quarter of 2023 (**Figure 16**). An analysis of the data shows that the GDP level at that time reflected a high level of economic activity. The GDP level as of the third quarter had been above the trend line for eight consecutive quarters.

Activity indicators since the start of the war indicated a decline in economic activity, as expected, but after a number of weeks of war, it seems that some activity components are recovering. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for October declined, and currently reflects businesses’ negative assessments of their state. In November, companies representing about 45 percent of the business sector reported that declining demand is the main constraint on their activity. This constraint is stronger in industries that are particularly sensitive to the security situation, such as the food services industry (restaurants and event venues). The decline in demand was reflected in a decline in private consumption as expressed in the volume of credit card purchases. In October, there was a sharp decline in credit card purchases for most goods, with the exception of essential goods, for which there was a jump in consumption for a short period. In contrast, there was a recovery in credit card purchases in most industries in November, but the level of purchases has not yet returned to its prewar level. The government deficit increased in October to 2.6 percent of GDP. Total tax revenues for October 2023 were about 8.5 percent lower in real terms than in the same period last year. Goods and services exports remained stable (**Figure 25**). Goods imports remained in a downward trend in recent months (**Figure 26**).

The labor market was in a full employment environment prior to the war. The employment rate among those aged 15 and over declined slightly in October (61 percent, seasonally adjusted). Due to the war, the broad unemployment rate, which includes employees put on furlough, jumped from 3.6 percent in September to 9.6 percent in October. Since the beginning of October, about 170,00 new job seekers registered with the Employment Service, compared to just 30,000 in the same period last year. 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. The volume of those absent from work for other reasons (which may be connected with the war) amounted to an additional 10.9 percent of the labor force. Taken together, these indicate a significant decline in labor input in the economy in October. A flash survey taken by the Central Bureau of Statistics in October indicated that employee absence is the main constraint on business sector activity, but reports for November are showing an easing of this constraint. The most significant impact according to the flash surveys is in the food services and construction industries. In contrast, the impact to employment in the high-tech services industry is moderate. Companies that employ about 90 percent of all employees in that industry report that most of their employees are at work. In addition, demand for workers in all industries declined in October, with the exception of the construction industry where there is a lack of workers due to the halt in employment of Palestinian workers and the departure of foreign workers. The serious shortage of workers in the construction industry may pose a continued constraint to activity in the industry, which accounts for a significant share of GDP.

With that, the volume of activity in the housing market continues to moderate. In the past 12 months, home prices declined by 0.2 percent (**Figure 12)**. In August–September 2023, the Index of Home Prices and the prices of new homes remained unchanged. The downward trends in the number of housing transactions and in new mortgage volume slowed, but still cannot provide an indication for the future due to the uncertainty created by the war. In October, new mortgage borrowing totaled NIS 4.5 billion (**Figure 13**). The owner-occupied housing services component of the CPI declined by 0.3 percent, and its annual rate of increase continued to moderate, to 4.9 percent.

Financial risk indicators in most industries increased at the beginning of the war, but have since moderated slightly with the exception of the construction industry. In the capital market, following sharp declines at the beginning of the war, the trend has changed in the past two weeks, with local equity indices rising sharply, similar to the global trend. However, the underperformance relative to the start of the year remains significant (**Figure 37**). Long-term government bond yields declined at a more moderate rate than the global trend, and corporate bond spreads, which widened at the start of the war, returned to their prewar levels. The risk premium as measured by the CDS, and the spread between dollar-denominated government bonds and US Treasury bills, moderated slightly but remain high.

In the credit market, there is a slowing trend of bank credit to small and micro businesses (**Figure 15**). The banks and credit card companies adopted a broad loan repayment deferral program that was formulated by the Banking Supervision Department. The program is intended to assist households and businesses that have been harmed, and to ease their cash flow during the upcoming period. The agreed-upon program was expanded in November to include localities in the north of the country. In addition, the Monetary Committee announced a targeted program to assist the regular provision of credit to small and micro businesses that were impacted by the war. The credit risk indices for medium, small, and micro businesses increased, and there was an increase in the rate of checks returned due to cancellation of lack of cover, mainly those of small and micro business and of individuals. The Bank of Israel and the Ministry of Justice set out designated leniencies for eligible population groups, according to which checks without cover that were refused in October will not be included in the list of checks that leads to the imposition of restrictions on the account.

The security situation in Israel that led to increased geopolitical tension in the Middle East had a moderate impact on global markets. Investment houses’ growth forecasts for 2024 remained unchanged, and their assessment is that global growth in 2024 will be 2.6 percent (**Figure 31**). World trade increased in September, further to the increase in August, but for the year it remains unchanged, and has essentially not increased since the end of 2021. The purchasing managers’ indices in the main blocs declined in October. The purchasing managers’ index of the advanced economies remains at a level that reflects economic contraction (**Figure 32**).

In the US, third-quarter growth was higher than expected, while there was a contraction of 0.1 percent in the eurozone. Oil prices declined sharply, and fell below their prewar levels. The inflation environment moderated in many countries, but remains above their central bank targets (**Figure 36**). Core inflation, which has been more “sticky”, is also moderating. With that, there are signs that monetary tightening around the world is nearing its end. The Federal Reserve and the European Central Bank left their interest rates unchanged, and emphasized in their forward guidance that the interest rate is expected to remain high for some time. They also noted that future measures will depend on the data, and that there may even be further tightening if necessary. The markets are not pricing in further interest rate increases by the Fed or the ECB, and are pricing in a decline in the interest rate only during the second quarter of 2024.

The minutes of the monetary discussions prior to this interest rate decision will be published on December 11. The next decision regarding the interest rate will be published at 16:00 on Monday, January 1, 2024, followed by a press briefing with the Governor.

1. The full forecast is being published separately, and can be found at {link}. [↑](#footnote-ref-1)