BANK OF ISRAEL
Office of the Spokesperson and Economic Information

June 14, 2021

Press Release

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

The discussions took place on May 30 and 31, 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 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 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 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 May 31, 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 possible factors in the increase of the inflation environment and the extent to which they are expected to persist over time, foreign exchange market developments, and the monetary policy required with regard to these aspects; as well as the improved state of the labor market and the decline in the unemployment rate against the background of the economy returning to routine; the risks remaining despite the rapid recovery of economic activity; global activity, particularly the increase of inflation worldwide, and against this background the monetary policy in the various economies, and the housing market.

Main points of discussion

The Committee discussed the increase in the inflation environment reflected in the year over year inflation rate being near the lower bound of the target range, as well as the increase seen in inflation expectations. There is a more marked increase in inflation worldwide than in Israel (particularly in the US, where core inflation reached 3.1 percent) and there is a vigorous discussion as to what extent the price increase is transitory, or if it is a basis for more entrenched inflation. Committee members analyzed the possible reasons for the increase in the inflation environment in Israel. Supply problems, including delays in the supply chain of raw materials, difficulties in filling positions, and the increase in overall inflation being based mainly in an increase in prices of tradable goods, support the assessment that the increase in prices is transitory. In contrast, inflation expectations for all terms derived from the capital markets—short term as well as medium and long term—are showing an increase, and are already around the midpoint of the target, which could reflect market expectations that the increase in the inflation environment will remain for a considerable time. The Committee was of the opinion that it is still difficult to determine how transitory the increase in the inflation environment is, and that the development of inflation going forward should be followed, but it assessed that a breakout of inflation is not plausible.

Since the previous interest rate decision, the shekel strengthened by 0.4 percent against the dollar, and weakened by 0.5 percent in terms of the effective exchange rate and by 1 percent against the euro. The security deterioration increased the volatility moderately and for only a short time. The purchase plan for 2021 announced by the Monetary Committee supports the continued exit from the crisis and the return of inflation to the target range. It was noted that it will be possible to expand the program as necessary and in accordance with the development of economic conditions.

The Committee discussed the improvement of the labor market—against the background of the economic recovery, the expected termination of some of the assistance programs, the decline in the broad unemployment rate and the increase in the adjusted employment rate since emerging from the third lockdown—though the rates are still markedly low compared with the levels just before the coronavirus crisis. Alongside that, some of the data indicate difficulties in the labor market's recovery process: the number of job vacancies continues to increase sharply, together with an increase in employers' difficulty in recruiting workers in some industries—with a record number of manufacturing companies reporting constraints in hiring nonprofessional workers.

The Committee members agreed that despite the contraction of GDP in the first quarter of 2021, an examination of the composition of uses conveys a positive picture of the state of the economy and that the contraction is primarily a result of transitory factors. Therefore, the Committee assessed that the economy's recovery is expected to continue. In addition, the Committee assessed that the adverse impact on activity as a result of the deterioration in the security situation during May apparently had only a limited negative impact. The available indicators of economic activity point to a continued trend of improvement. The level of credit card expenditure returned to, and even crossed, the trend line that had been expected before the crisis; a notable increase in consumption also continued in industries that were markedly negatively impacted by the limitations; indices of mobility to stores increased until just before the conflict to the highest level since the beginning of the pandemic; the Central Bureau of Statistics Consumer Confidence index increased sharply until just before the confrontation, mainly as a result of a sharp improvement in expectations of the economic situation in the coming year; based on the Central Bureau of Statistics Business Tendency Survey for April, the overall net balance of the business sector continued its upward trend; and in addition, based on the latest real time survey of the Central Bureau of Statistics, it can be seen that the negative impact on companies' revenue in March was the lowest since the outbreak of the crisis. Together with that, the Committee discussed the risks remaining despite the rapid recovery of economic activity—and in this regard the risk of a renewed outbreak of the coronavirus, the security risks, the political uncertainty, and the financial risks.

The increased pace of vaccination worldwide is helping the global economic recovery, and the growth forecasts of investment houses were revised upward for most major economies, but in parallel there was a worsening of morbidity in several emerging markets. The integrated global Purchasing Managers Index increased in April to its highest level in the past decade, and the expansion in activity was reflected in both the services and manufacturing components. Main equity indices were mixed during the period but remain at record levels. The Committee was of the view that the pricing of some financial assets may not incorporate the range of risks. The monetary policy at major central banks continues to be very accommodative despite the increase in inflation, while in contrast, in emerging markets interest rates continue to be raised, against the background of higher inflation.

The Committee discussed the rising prices in the housing market, against the background of removing the limitations on investors and the ending of new government-initiated construction plans. The Committee expressed concern about the ramifications that may be created on the revenue distribution and the inequality in the economy if the trend of accelerated increases in home prices is renewed. Home prices increased in the past 12 months by 4.5 percent, a relatively high rate, against the background of the moderation in the pace of construction—both building starts and building completions. In addition, there was an increase in the prices of construction inputs, the share of investors in total home purchase transactions increased, and mortgage volumes continued to be high. With that, the rate of increase of rents remained at a moderate level.

Most Committee members assessed the current level of monetary accommodation, through its various tools, to be sufficient for now, particularly in view of the additional tools being implemented. The Committee will formulate its policy so that it will continue to provide macroeconomic support in the process of exiting the economic crisis, and to ensure that the credit market continues to function.

Five of the Committee members were of the opinion that the interest rate should be left unchanged at 0.1 percent. These five Committee members thought 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 Bank of Israel 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 believed that in order to support the recovery, an interest rate lower than 0.1 percent is more appropriate due to the intensity of the crisis and the unusually intense impact on the employment level in the economy.

The Committee noted that the process of returning to normal life in Israel supports continued rapid growth in the coming year. However, there are still challenges to economic activity—in view of the health risks in Israel and abroad and the adverse impact on the economy, and particularly on the labor market. The Committee will therefore continue to conduct very accommodative monetary policy for a prolonged time, using a range of tools as necessary, including the interest rate tool, in order to continue to support the attainment of the policy targets and the recovery of the economy from the crisis, and to ensure the continued orderly functioning of the financial markets.

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

Other participants in the narrow-forum discussion:
Ms. Dana Orfaig, Research Department
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. Arad May, Secretariat of the Monetary Committee
Ms. Shulamit Nir, Research Department
Mr. Yoav Soffer, Advisor to the Governor
Mr. Daniel Shlomiuk, Spokesperson's Office