BANK OF ISRAEL

March 10, 2025

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

The discussions took place on February 23, 2025 and February 24, 2025.

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 February 24, 2025, 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 at 4.5 percent. All members of the Monetary Committee supported the decision.

The discussion focused on the impacts of the geopolitical environment on the economy and on economic developments: inflation and inflation expectations, the level of economic activity in view of the war, the labor market, fiscal developments, developments in the financial markets and in the foreign exchange market, the housing market, and global developments.

Main points of discussion

The Committee discussed the state of the economy in view of the Swords of Iron War, and the significant economic ramifications on Israel's economy, as the economic recovery continues at a moderate pace.

The Committee discussed the inflation environment. As expected, the annual inflation rate increased, due as well to the tax increases, and it is above the upper bound of the target range. Based on forecasters' assessments, the inflation rate is expected to enter the upper portion of the target range in the second half of the year. Inflation expectations for the second year and onward remain within the target range. In the Committee's assessment, there are several risks for a possible acceleration of inflation or for its not entering the target range—the geopolitical developments and their impacts on economic activity, prolonged supply constraints, shekel volatility, and fiscal developments.

Economic activity continues to recover moderately in view of the geopolitical developments. Based on the first estimate of National Accounts data for the fourth quarter of 2024, it appears growth slowed, and was lower than expected at 2.5 percent (seasonally adjusted). Fourth-quarter GDP growth was impacted mainly by an increase in domestic uses: private consumption, public consumption, and investment in fixed assets, alongside a decline in services exports. In parallel, GDP data for the third quarter of 2024 were revised upward to 5.3 percent. For the year overall, and in view of the revision in the past data, GDP grew by 1 percent—slightly above earlier assessments by the Research Department in January 2025. The Composite State of the Economy Index increased by 0.6 percent in January, and the indices for November and December were each revised upward by 0.2 percent.

The Committee members discussed the possible developments for aligning supply and demand in the economy, and the potential ramifications of those processes on inflation. The most recent data indicate that the gap between the level of GDP in actuality and the level expected according to the long term trend was 4.4 percent, and the business sector product gap was approximately 6 percent. Supply constraints in some industries continue to delay the reduction of the gap. The notable increase in domestic uses was met primarily by growth of imports, which reflect surplus demand against the background of supply constraints.

The labor market remains tight, the broad unemployment rate contend to decline, reaching 2.8 percent (seasonally adjusted) in January, lower than its prewar level. The share of those temporarily absent due to military reserves service continued to decline. The employment rate in January reached its prewar level, and the participation rate for those aged 15+ continues to increase, and is slightly lower than its prewar level. The growth rate of nominal wage accelerated in December 2024, completing an increase of 6.8 percent since September 2023 (5.4 percent in annual terms). The real wage increased, though its level is lower than the long term trend. In the construction industry, activity continues to be impacted by labor force constraints, though the gap between the number of those employed in the construction industry and their number in the period preceding the war contracted.

The cumulative deficit in the past 12 months was 5.8 percent of GDP in January, a decline from the 6.9 percent in December, in view of the sharp growth in government tax revenues. Net of seasonality and of anomalous revenues, they are in line with the nominal growth rate of GDP and higher than their real long-term path.

The Committee discussed developments in the foreign exchange market and in the financial markets. In the reviewed period, the shekel appreciated by approximately 1.9 percent against the dollar and by approximately 1.3 percent against the euro. The risk premium—as measured by the CDS and by government bond spreads—continued to decline, but its level remains high compared to the prewar period. Yields declined in the government bond market, beyond the global trend.

The Committee members discussed housing market developments. The year over year rate of increase in home prices was 7.3 percent. In January, the housing component in the CPI (which reflects rents) was unchanged, while owner-occupied housing services declined by 0.7 percent. Mortgage volume in December was NIS 13.8 billion, among other reasons against the background of tax increases, and mortgage volume in January was NIS 7.3 billion, similar to the level of recent months.

The Committee discussed global conditions. Economic activity worldwide continued to expand in the last quarter of 2024, but at a more moderate pace. The global Purchasing Managers Index for January declined and indicated continued moderate expansion of activity. US growth in the fourth quarter of 2024 was 2.3 percent in annual terms, slightly below expectations. Private consumption remained strong and is the main component contributing to growth, and the labor market remained stable. In the eurozone, there was moderation in the pace of economic expansion, with growth of 0.4 percent in annual terms in the final quarter of 2024, In the US, inflation rates based on headline CPI increased by 3 percent and core CPI increased by 3.3 percent, above expectations. Inflation expectations for the coming 2 years continued to increase, among other things in view of the concern of the government's tariff policy. The interest rate path priced in to the markets remained essentially unchanged in the reviewed period. Inflation in the eurozone increased in January above expectations, to a level of 2.5 percent, and the core CPI remained unchanged at 2.7 percent. Many central banks in advanced economies continued the round of interest rate reductions. The ECB reduced the interest rate by 25 basis points. After 3 consecutive interest rate reductions, the US Federal Reserve kept the interest rate unchanged in January.

All 5 Monetary Committee members supported the decision to keep the interest rate unchanged at a level of 4.5 percent.

In view of the continuing 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 convergence of inflation to its target, continued stability in the financial markets, economic activity, and fiscal policy.

The next monetary policy decision will be published on Monday, April 7, 2025.

The dates of interest rate decisions for 2025:
https://www.boi.org.il/en/economic-roles/monetary-policy/interest-rate-announcement-dates-2024/

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Monetary Committee Chairperson
Dr. Golan Benita, Markets Department Director
Dr. Adi Brender, Research Department Director
Prof. Naomi Feldman
Prof. Zvi Hercowitz

Other participants in the narrow-forum discussion:
Mr. Uri Barazani, Outgoing Spokesperson of the Bank
Dr. Oded Cohen, Chief of Staff to the Governor
Mr. Nadav Eshel, Assistant to the Governor
Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department
Ms. Liat Indig, Deputy Spokesperson
Dr. Ziv Naor, Bank of Israel Spokesperson
Ms. Dana Orfaig, Research Department
Ms. Nava Ostrov, Monetary Committee Secretariat