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**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

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**Press release:**

**Remarks by the Governor of the Bank of Israel at the press briefing on monetary policy held today at the Bank of Israel**

Good afternoon.

Yesterday we marked half a year since that terrible day of October 7th. Since the fighting started, we have witnessed the resilience of Israel’s economy. Geopolitical uncertainty remains high, and recently has been increasing. Despite the gradual improvement in economic activity, there is a long way to go until the economy fully recovers. Right at the onset of the war, we took several steps aimed at ensuring orderly functioning of the markets and focused aid to population groups that were particularly adversely impacted. These programs have succeeded to date in creating stability in the foreign exchange market and in other financial markets.

The Monetary Committee meetings held over the past 2 days continued to deal with the economic impacts of the war. In the Monetary Committee, we analyzed the various processes and their impact on economic activity and inflation. As we have noted several times in the past, the interest rate path will continue to be determined in accordance with the continued convergence of the inflation rate to its target, continued stability in the financial markets, economic activity, and fiscal policy. In view of recent developments, which indicate a substantial increase in the geopolitical uncertainty, the Monetary Committee decided to side with caution and kept the interest rate unchanged. This is consistent with the policy we have been taking since the eruption of the war, in which the Committee has focused on stabilizing the markets and reducing the uncertainty, alongside price stability and support for economic activity.

Let me turn now to an overview of the main economic developments.

Year over year inflation continues to moderate gradually. The CPI for February 2024 increased by 0.4 percent, and year over year inflation is 2.5 percent, within the target range. The moderation of inflation is reflected in both the tradable and nontradable components. Consumer Price Indices excluding tax changes, energy, and fruit and vegetables are around the midpoint of the target. Inflation expectations for the various ranges are an important component in our analysis when considering the monetary process. These have increased over the course of the period, are still within the target range but near its upper bound, and incorporate the expected tax increases as well.

The Committee assesses that at this time there are several main risks for a possible acceleration of inflation: the development of the war and its impact on economic activity, depreciation of the shekel, the limitations on activity in the construction industry, fiscal developments, and global oil prices. Recall that high inflation creates increasing difficulty for households and businesses and adversely impacts weaker groups first and foremost.

I will move now to discuss the real economy:

The level of overall economic activity remains lower than just before the war, but economic activity is adjusting to the situation and consistent recovery can be seen in recent months. The Composite State of the Economy Index and the aggregate balance in the Business Tendency Survey remain on an upward trend and credit card purchases in most industries have returned to their prewar level, and even beyond. However, the expansion of aggregate supply in the economy is slower than the development of demand. This development is liable to lead to inflationary pressures.

The construction industry has considerable weight in economic activity. The return of construction sites to activity is progressing, but the activity is still lower than its prewar level, and is impacted by the shortage of workers. In particular, bringing in foreign workers from abroad is a complex process and is expected to take a prolonged period of time. I reiterate that a high supply of construction needs to be maintained over time in order to ensure the stability of housing prices. Similarly, I want to refer to an analysis presented by the Research Department in the Bank of Israel Annual Report that we published several days ago, which shows that more advanced construction methods need to be integrated in Israel. This is reinforced by indicators showing that productivity in the construction industry in Israel is low relative to OECD countries. In recent months, we have seen a moderation in rents, and some increase in housing market transaction volume, with prices increasing in the past two months, after declining in the 10 preceding months.

I will focus now on financial developments.

Since the previous monetary policy decision, the foreign exchange market has been very volatile, in view of the various developments in the war and in the geopolitical environment. For the period overall, the shekel weakened against the dollar by approximately 2.7 percent, with high volatility, and weakened against the euro by 2.6 percent, and by 2.3 percent in terms of the nominal effective exchange rate.

Israel’s risk premium, as measured by the CDS premium, is at a high level, and increased in recent days against the background of the geopolitical tension. The spread between government bonds denominated in dollars and US government bonds remained unchanged at a relatively high level. The increase in the level of uncertainty also impacts on the extent of vulnerability in activity and in the various financial indicators.

Compared internationally, Israel’s equity market continues to underperform, and government bond yields increased markedly. Similar to the global trend, corporate bond spreads contracted markedly and are at a level lower than their prewar level. The slowdown in activity in the credit market continues. Moreover, the risk indices in all credit activity segments are increasing somewhat, but are still a level that is not high relative to the past decade. Furthermore, the framework for deferring payments that was formulated by the Banking Supervision Department and adopted by the banking system with the goal of providing relief for borrowers in this difficult period was extended for another 3 months.

These developments and others were analyzed by the Research Department, which today published an updated macroeconomic forecast. The Department assesses that GDP is expected to grow by 2 percent in 2024 and by 5 percent in 2025, similar to the January forecast. The forecast assumes that the war’s direct economic effect will continue until the end of 2024, with decreasing intensity. For 2025, the assumption is that there will not be additional direct effects from the combat. Similar to previous forecasts, the Department assumes that the lion’s share of the war will take place on just one front. It is important to emphasize that the uncertainty regarding the various developments of the war will probably have a substantial impact on the forecast. The inflation rate estimated by the Department during the course of 2024 increased slightly from the previous forecast and is expected to total 2.7 percent. As a result of the revised budget, the government budget deficits for 2024 and 2025 are expected to increase compared with the previous forecast by a cumulative 1.7 percentage points, totaling 6.6 percent of GDP in 2024 and 4.6 percent of GDP in 2025. In view of these changes, the debt to GDP ratio, one of the most important fiscal indicators, is expected to increase to 67 percent in 2024 and remain at a similar level in 2025 as well.

Due to the war, the defense establishment has presented needs that require a marked increase in the scope of the defense budget over time. I call again to promptly establish a committee made up of military and civilian professionals that will delineate Israel’s defense needs in the coming years, and will formulate an adequate multiyear budget plan. To the extent that the government will decide, based on the committee’s recommendations, to expand the defense budget beyond what was approved in the previous budget, it is important it will be accompanied by offsetting budgetary adjustments that will prevent the development of an increasing path of the debt to GDP ratio.

I would like now to refer to the decision by the Fitch credit rating agency, which affirmed Israel’s credit rating of “A+”, but changed its ratings outlook from stable to negative. Recall that the State of Israel has experienced geopolitical crises in periods when the debt to GDP ratios were much higher than 67 percent, and there has never been any delay at all in Israel’s debt repayments. Continued responsible fiscal policy by the government, and the maintaining of the debt to GDP ratio, which is a strategic asset for the State of Israel, are important for strengthening the markets’ trust.

I would like now to discuss developments in the global environment, which impacts considerably on us as a small and open economy. In the US, economic data indicate that in 2024 the above-trend growth continues, despite the restrictive monetary policy. In contrast, in the eurozone, the economic weakness continues. Most major central banks continue to signal a path of interest rate reductions that are gradual and cautious. In the US and in the eurozone, central banks kept the interest rate unchanged, and signaled that the beginning of the process of reducing the interest rate will be pushed off and will only begin around the second half, which moderated market expectations regarding the interest rate path.

To conclude, I would like to emphasize again that the Israeli economy has strong economic foundations that can support a continued process of recovery, and assist in the growth of the economy even in the difficult period through which the State of Israel is going. The Bank of Israel will continue to assist the Israeli economy to get through the various challenges that are still expected for us.

The Bank of Israel and the Monetary Committee express our support for the soldiers and other security forces who are risking their lives for us on the various fronts. We extend our condolences to the families of those killed, we wish for a full recovery for the injured, and we hope for the speedy return of the captives and the missing. Our thoughts are with you.

Thank you.