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**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

July 8, 2024

**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 and today, the Monetary Committee held discussions in order to reach the policy decision. At the end of the meetings, the Monetary Committee decided to leave the interest rate unchanged at 4.5 percent.

Since October 7th we have been in the midst of a prolonged war. The geopolitical uncertainty has increased and the economy’s risk premium has risen. However, from a macro perspective, the Israeli economy continues to display resilience in dealing with the challenges of the period.

As we have noted on several occasions, the war has considerable economic ramifications, which impact on Israel’s economy. Notwithstanding the improvement seen in the economy’s recovery, there is still a very long way to go before fully returning to normal activity. The Bank of Israel continues working to help the Israeli economy and public get through this challenging period. Among other things, since the outbreak of the war, we have taken several steps with the goal of ensuring the orderly functioning of the markets and to assist specific population groups who have been adversely impacted.

The Committee’s discussions dealt with the analysis of the impact of the war on different aspects of economic activity, and inflation. Further to the increase in the geopolitical uncertainty, the monetary policy is focused on stabilizing and reducing the uncertainty in the markets, alongside price stability and support for economic activity. The interest rate path will continue to be determined in accordance with the convergence of inflation to its target, continued stability in financial markets, economic activity, and fiscal policy.

I would like to refer now to some of the considerations that we took into account when reaching the decision and to a review of major economic developments in Israel and worldwide.

Although the inflation rate in Israel is within the target range, it continues to be in the upper part of the range, and there has been some increase in the inflation environment in the past quarter. Recall that inflation is a process that negatively impacts the economy and growth, and makes financial conduct difficult for the economy overall, and particularly for weaker population groups. Therefore, we continue to adopt monetary policy that supports the moderation of inflation.

The Consumer Price Indices net of tax changes, energy, and fruit and vegetables continue to hover around the midpoint of the target range. However, inflation expectations for various ranges—which are an important component in our analysis for examining the monetary process—are at the upper bound of the target, and some of them have even been above it in recent months. I note that the expectations incorporate expected tax increases as well.

The Committee’s assessment is that among the factors that are liable to lead to an increase in the inflation environment are: the continuation of the war and its impact on economic activity, including shekel depreciation, housing market activity and the limitations on it, fiscal developments, and global oil prices.

An analysis of real activity in the economy indicates that:

The overall level of activity in the economy is still lower than what prevailed just before the war. Since the previous interest rate decision, the strong recovery in economic activity seen in the first quarter of the year has moderated. Based on current indicators, the economy’s growth rate moderated in the second quarter, and supply constraints are weighing on the convergence of economic activity to the prewar trend. The growth rate of private consumption, which recovered in the first quarter of 2024, also declined slightly during the second quarter, as reflected in credit card expenditure data. However, we see encouraging improvement in the amount of capital raised by startup companies in the second quarter, which serves as a significant indicator in view of the high tech industry’s importance to the Israeli economy.

We closely follow housing market developments. In recent months, home prices have increased markedly, after declining in 2023. In May, mortgage volume increased compared to previous months, to NIS 7.8 billion. In parallel with an increase in demand, the construction industry is still not operating at its full potential and is impacted mainly by a shortage of workers; the return of construction sites to full activity is proceeding slowly. As the main bottleneck on the supply side is the manpower constraint, it is important to continue promoting the process of bringing in foreign workers from various countries to the construction industry. In addition, subject to security related guidelines and limitations, maximizing Palestinian workers’ potential in the industry should be considered. In addition to maintaining the activity in the immediate term, measures should also be taken to maintain the high supply of construction over time. As I have noted in the past, this is the key to moderating housing prices.

The labor market remains tight. After a rapid recovery in previous months, the most recent data for April and May indicate stability in employment. The employment rate among ages 15+ in May was 60.7 percent, similar to April. After a decline in the broad unemployment rate, the rate of decline moderated in May. The share of those absent from work due to military reserves service was stable in April and May, despite the increased intensity of military activity.

I would like to switch now to the various financial developments that were in the background of the decision:

Since the beginning of the war, we have continued to see underperformance in equity markets and in government bond yields. Since the previous monetary policy decision, the shekel has weakened by about 1.3 percent against the dollar, with high volatility in view of the various developments in the geopolitical environment. Israel’s risk premium, as measured by, among other things, the CDS, is at a high level and has continued to increase in the recent period. The spread between dollar-denominated government bonds and US Treasury bonds also continued to increase. A high risk premium for a long period of time has an adverse impact on real economic activity.

In the business credit market, the expansion trend continues, mainly among large companies. Nonhousing credit to households is moderating. In addition, risk indices in all credit activity segments are increasing somewhat, but are still at levels that are not high relative to the past decade. In addition, the outline for deferring payments 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 3 additional months, with some minor adjustments.

The updated macroeconomic forecast published today by the Research Department incorporates the various developments. Compared to the previous forecast in April, the Department assumes that the war will continue at a higher intensity until the end of 2024, and will wind down in the beginning of 2025 (later than in the previous forecast). The Department assesses that GDP is expected to grow by 1.5 percent in 2024 and by 4.2 percent in 2025. This growth is lower by about a cumulative 1.3 percent from the forecast in April, and distances the economy from the growth trend of recent years. The inflation rate increased slightly from the previous forecast and is expected to be 3 percent in 2024 and 2.8 percent in 2025.

The government budget deficit is expected to be 6.6 percent of GDP in 2024. Assuming that fiscal adjustments of a permanent nature totaling NIS 30 billion will be made by the government, the deficit in 2025 is expected to decline to about 4.0 percent of GDP. Under these assumptions, the public debt is expected to increase to a level of 67.5 percent of GDP in 2024 and to 68.5 percent of GDP in 2025. It is important to emphasize the uncertainty regarding military developments, which could have a significant impact on the forecast.

The general size of the budget adjustments required is significant, and thus the early start in the Ministry of Finance of a budget formulation process is a positive step. I emphasize that if decisions will be taken that involve additional permanent increases in the defense budget, further adjustments will have to be made accordingly. It is the government’s responsibility to take the necessary steps, even if some of them may not be popular, to ensure economic stability and to promote sustainable growth.

If the government only partially implements the fiscal adjustments required, or defers the approval of the budget into 2025, and/or approves further increases in military expenditures and permanent expenditures, it is liable to lead to an additional increase in Israel’s risk premium. This would be a result of the formulation of the perception in the markets that the debt to GDP ratio is on an uncontrolled path. Such a situation is liable to lead to an adverse impact on the economy’s growth path and to an additional increase in interest payments on the government debt that will ultimately be passed on to the public.

To conclude this section, the economy is facing very high uncertainty. This situation heightens the need for the government to continue adopting fiscal responsibility in the current period. The fiscal responsibility has to be reflected in the composition of government expenditures in the budget such that the budget adjustments will not adversely impact growth-supporting expenses and in the debt to GDP ratio declining in the coming two years.

Worldwide, it can be seen that economic activity continues to be at relatively low levels and that the most recent data present a mixed trend in the various blocs; the global growth forecast of investment houses remained unchanged. Purchasing managers indices for May indicate the strengthening of the positive sentiment in the manufacturing component in the US and in China, and continued weakness in the eurozone. Inflation trends show continued convergence toward the central bank targets, though at a slower pace compared to previous forecasts from the beginning of the year. In view of this, major central banks continue to signal to the market that they won’t hesitate to keep the interest rate at a restrictive level for a longer period of time and will continue the data dependent approach.

To conclude, we are in a complex period in which significant processes are occurring. Some of them indicate recovery and point to a return to solid economic activity, while others show the continued challenges weighing on the ongoing functioning of the economy, primarily the continued uncertainty and the high level of the risk premium and supply constraints in some industries.

Israel’s economy has shown impressive resilience in the past, and has succeeded in growing and thriving even in periods of uncertainty. This accomplishment became possible mainly when responsible economic policy was implemented, and structural reforms that supported economic growth were promoted. We at the Bank of Israel are prepared for a range of scenarios and will continue to assist the Israeli economy to get through the various challenges we still expect.

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 deep condolences to the families of those killed, including the family of Captain (Res.) Eitan Koplovich, may his memory be a blessing, a Bank employee. We wish for a full recovery for the injured, and hope for the speedy return of the captives and the missing.

Our thoughts are with you.

Thank you.