



BANK OF ISRAEL
Office of the Spokesperson and Economic Information

December 9, 2024

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

The discussions took place on November 24, 2024 and November 25, 2024.

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 November 25, 2024, 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, in the foreign exchange market, and in the housing market.

Main points of discussion

The Committee discussed the state of the economy in view of the continuation of the Swords of Iron War. The war has significant economic ramifications on Israel's economy. The prolonged geopolitical uncertainty continues to weigh on economic activity and is delaying the economy's return to its prewar level of activity.

The Committee discussed the inflation environment. Inflation over the preceding 12 months is 3.5 percent, above the upper bound of the target range, and similar to previous months. The year over year inflation rate excluding energy and fruits and vegetables is 3.3 percent. Based on forecasters' assessments, inflation is expected to continue increasing in the beginning of 2025, against the background as well of the expected increase in VAT, and then is expected to moderate toward the upper bound of the target range in the second half of the year. Inflation expectations and forecasts for the coming year, from the various sources, declined and entered the target range, near the upper bound. Expectations for the second year and onward are in the upper part of the target range. In the Committee's assessment, there are several risks for a possible acceleration of inflation—the geopolitical developments and their impact on economic activity, prolonged supply constraints, shekel volatility, and fiscal developments.

Regarding the level of activity in the economy—after growth in annual terms of 0.3 percent in the second quarter, GDP expanded in the third quarter of 2024 by 3.8 percent in annual terms. The deviation from the long term growth trend remained similar, at 3.6 percent. A considerable portion of the gap is explained by supply constraints deriving mainly from a shortage of workers—a shortage of non-Israeli workers, absence of workers due to military reserves service, and limitations on employment in the North. Private consumption grew by 8.6 percent in the third

quarter of 2024, and its level is 3.7 percent higher than its prewar level. Investment also grew, but its level is lower than its prewar level. Current indicators of economic activity point to a mixed picture with regard to the level of economic activity in the fourth quarter, with a slight bias toward weakening. The most recent data of credit card usage indicate some moderation. The Business Tendency Survey, similar to credit card expenditure, indicates a marked decline in activity in the Haifa district, against the background of the deterioration in the North.

Notwithstanding the moderation in recent months, the labor market remains relatively tight. The job vacancy rate declined slightly, but is still higher than its prewar level, although it is lower than in the beginning of the year. The participation and employment rates remained stable, the rate of those temporarily absent due to military reserves service increased, and the broad unemployment rate declined. The nominal wage continues to increase, even if at a more moderate pace, and the real wage is below the long term trend.

In terms of fiscal policy, the deficit target for 2024 was set at 7.7 percent of GDP, after the government's decision to expand the expenditure ceiling by NIS 33 billion. The budget framework for 2025 was approved by the government and includes a planned deficit of 4.3 percent of GDP, and a special reserve allocation increment of half a percentage point of GDP in the case of continued intense fighting in 2025. The budget framework includes fiscal adjustments of about NIS 35 billion, similar to the Research Department's assumptions in its October forecast, and in line with the Bank of Israel's recommendations. After deciding on a deficit target of 4.3 of GDP for 2025, the government decided to increase it to 4.4 percent of GDP. The Committee members were of the view that approving the budget in the government is a significant step, but it is important to maintain the framework decided on by the government for the continuation of the legislative process.

The Committee discussed the impacts of the war on financial markets and on the foreign exchange market. In the reviewed period, equity indices in Israel increased sharply, and stood out compared to most markets. The risk premium declined—the CDS spread decreased markedly, though its level is still very high relative to the prewar period, and there was also a sharp decline in government bond yields. The spread between yields on government bonds denominated in dollars and US government debt yields also decreased. Since the last interest rate decision, the shekel has strengthened notably and in nominal effective exchange rate terms the shekel appreciated by 3.7 percent.

The Committee members discussed housing market developments. Activity in the construction industry is recovering gradually but the limitations on activity in view of the war, mainly limitations of human resources, are still considerable. The rate of

increase in home prices moderated—in August-September home prices declined, in contrast to the significant increases in preceding months—and the rate of annual increase declined to 6.1 percent. In October, new mortgage volume was NIS 6.9 billion.

The Committee members discussed global conditions. In the US, the services component continued to increase, and indicated expansion, while in the Eurozone, the CPI declined, indicating expectations of a contraction in activity. World trade increased by about 1 percent in August after remaining unchanged in the previous month. Since the last interest rate decision, the price of oil has declined. There was a mixed trend in equity indices worldwide, with considerable increases in the US. Third quarter growth in the US was 2.8 percent, showing the robustness of the US economy, driven by strong private consumption, although the labor market continues to cool off. In the eurozone, third quarter growth surprised to the upside, but looking forward, eurozone recovery is expected to remain moderate. In China, third quarter growth was an upward surprise, but the most recent data are still relatively weak. Year over year inflation in the US increased in the period reviewed, with the CPI increase at 2.6 percent. In the eurozone, year over year inflation increased from 1.7 percent to 2 percent. Central banks worldwide continue their round of interest rate reductions. In line with expectations, the Fed reduced the interest rate another time, by 25 basis points. However, the interest rate path being priced in by markets increased in the period reviewed. In addition, the ECB continued its path of interest rate reductions and lowered the interest rate by 25 basis points.

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 focused 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, January 6, 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
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Dr. Adi Brender
Prof. Naomi Feldman
Prof. Zvi Hercowitz

Other participants in the narrow-forum discussion:

Mr. Uri Barazani, Outgoing Spokesperson of the Bank
Dr. Golan Benita, Director of the Markets Department
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, Bank Spokesperson's office
Dr. Ziv Naor, Incoming Bank of Israel Spokesperson
Ms. Dana Orfaig, Research Department
Mr. Tzvi Sussmann, Monetary Committee Secretariat