

## **BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

June 10, 2024

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

**The discussions took place on May 26, 2024 and May 27, 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 May 27, 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, fiscal developments, developments in the financial markets and in the foreign exchange market, the labor market, the housing market, and the global conditions.

### **Main points of discussion**

The Committee discussed the state of the economy after approximately 8 months from the eruption of the Swords of Iron War and examined the developments that have occurred since then. The discussion also dealt with the geopolitical uncertainty and the high risk premium, and the potential future impacts on the economic variables were discussed. Notwithstanding the gradual improvement in economic activity, a long distance remains until the complete recovery of the economy.

There has been some increase in the inflation environment. The CPI for March increased by 0.6 percent and the index for April 2024 increased by 0.8 percent. The travel abroad component, which accounts for less than 2 percent of the CPI, contributed 0.4 percentage points to the monthly change in the CPI for April. The year over year inflation rate continues to increase—due to the tradable component, while the rate of increase of the nontradable component moderated. Net of energy and fruits and vegetables, inflation is at an annual pace of 2.4 percent. Inflation expectations for the coming year from various sources increased, and are around the upper bound of the target range. Expectations for the second year and forward are within the target range, in its upper portion. The Committee's assessment is that there are several main risks of a potential acceleration in inflation: geopolitical developments and their effects on economic activity, a depreciation of the shekel, continued supply constraints on activity in the construction and air travel industries, fiscal developments, and global oil prices.

National Accounts data point to recovery of the economy in the beginning of the year. However, the economy has not yet returned to the activity level that characterized it before the war. GDP expanded by 3.4 percent in the first quarter of 2024, following a significant decline of 5.9 percent in the fourth quarter of 2023, but remains 2.8 percent lower than its level in the third quarter of 2023, prior to the war. Private consumption

and investments are the main components that contributed to the high growth in the first quarter and the most significant negative gap is of fixed capital formation (excluding ships and aircraft). The level of activity measured based on the rapid indicators for April reflects moderate recovery. The aggregate balance of the Business Tendency Survey by the Central Bureau of Statistics for April remained stable relative to the previous month.

The Committee discussed the fiscal situation. The cumulative deficit over the past 12 months continued to increase due to the growth in government expenditures; after netting out the specific deferral of VAT payment collection, it totaled 6.7 percent of GDP as of April. The cumulative annual deficit is expected to continue to increase in the coming months and to converge back to an environment similar to the current one toward the end of 2024, so long as there is not a material deviation in defense expenditures.

The Committee discussed the impact of the war on financial markets. Israel's risk premium, as measured by the spread between dollar-denominated government bonds and US government bonds, increased in the reviewed period. In addition, the CDS spread remains at high levels.

The Committee members discussed foreign exchange market developments. Since the previous interest rate decision, the shekel strengthened by 1.1 percent against the dollar and against the euro, and by 1.2 percent in terms of the nominal effective exchange rate. There was high volatility in the exchange rate, impacted mainly by developments in the defense area.

The labor market continues to recover, against the background of continued growth in demand for workers and alongside an easing in the labor supply constraint due to a contraction in the number of those serving in the reserves. In the past year there has been an acceleration in wage increases, though this increase was accompanied by notable growth in the labor productivity in the business sector.

In the housing market, the recent months' increase in home prices continues, alongside continued moderation in rents. The home prices index increased, and its annual rate of growth is 1.1 percent, after being negative at the end of 2023. Transaction volume was relatively stable in the past 3 months, after recovering from its low level with the eruption of the war. The year over year rate of increase in rents stabilized in recent months and is 2.7 percent.

The Committee discussed global conditions. First quarter growth data indicated continued expansion of the global economy. US growth, including some of the most recent data in the reviewed period, moderated, but data related to consumption continue to indicate strong activity. In the eurozone, growth surprised broadly to the upside. In

China, as a result of better than expected growth data, investment houses increased their growth forecast for the coming year. World trade volume returned to a decline in March, after recovering slightly in February, and for the first quarter as a whole, world trade recovered slightly and expanded relative to the previous quarter. Oil prices declined during the period, and maritime shipping prices continued to increase. In the US, the general CPI declined in April to an annual rate of 3.4 percent, while the core index moderated slightly to 3.6 percent. Markets are currently pricing in the start of interest rate reductions in the US only in the fourth quarter of the year. In the eurozone, inflation continues to moderate and the overall CPI was 2.4 percent in April. Core inflation is moderating as well, and is at 2.7 percent. The ECB kept the interest rate unchanged but the market is pricing in a high probability for a decline already in the next meeting.

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

**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, Spokesperson of the Bank

Dr. Golan Benita, Director of the Markets Department

Dr. Oded Cohen, Chief of Staff to the Governor

Mr. Nadav Eshel, Advisor to the Governor

Ms. Nurit Felter-Eitan, Director of the Communications, Public Affairs & Community Relations Department

Mr. Arie Knopf, Monetary Committee Secretariat

Ms. Dana Orfaig, Research Department

Ms. Nava Ostrov, Monetary Committee Secretariat

Ms. Liat Indig, Bank Spokesperson's office  
Mr. Tzvi Sussmann, Monetary Committee Secretariat