BANK OF ISRAEL

Office of the Spokesperson and Economic Information

October 21, 2021

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

The discussions took place on October 6 and 7, 2021.

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 October 7, 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 unchanged at 0.1 percent. The decision was reached with a majority of 5 members, while one member supported increasing the interest rate to 0.25 percent. In addition, it was decided that the continued economic activity and sound growth will make it possible to end the various quantitative easing programs over the coming months.

The discussion focused on the state of real activity and the return of data on GDP and inflation to their environment of just before the COVID-19 crisis, the increase in the inflation environment and assessments regarding the transitory components and the fixed components in it, global economic trends, the exchange rate, and the continued upward trend of housing prices.

Main points of discussion

The Committee discussed data on activity and the labor market. National Accounts data indicated high growth and that the level of GDP moved closer to around the level that would have been expected if not for the COVID-19 crisis. The broad unemployment rate and the adjusted employment rate stabilized and job vacancies in the economy are being filled at a relatively slow pace due to labor market frictions; the total net balance of the business sector is at a high positive level; business activity continues to expand, and continued recovery from the fourth wave can be seen as well in credit card purchases. In particular, there were increases in purchases in industries that were markedly adversely impacted by the COVID-19 crisis. Goods exports are higher than just before the crisis, and services exports are characterized by a steep upward trend. In addition, based on the Research Department’s forecast, solid economic growth is expected in 2021 and 2022.

The Committee discussed the increase in inflation to around the middle of the target range and the extent to which inflation is expected to persist. Inflation over the past 12 months is 2.2 percent. One-year inflation expectations, from all sources, increased and are within the target range. Based on the various forecasts, the inflation rate is expected to moderate going forward. There was a discussion that dealt with the inflationary factors and the extent to which they will continue—the global economic recovery, the removal of limitations, and an increase in disposable income, brought with them notable waves of demand. At the same time, the supply side is recovering more slowly and so far has not yet fully recuperated. As a result, we are seeing disruptions in economic activity, which are accompanied by increases in energy prices and by delays in various production and supply chains—delays that it is reasonable to presume are transitory. These two processes—sharp growth in demand and difficulties on the supply side—naturally lead to inflationary pressures worldwide, and to a lesser extent in Israel. It is important to emphasize that their magnitude and extent to which they will last is still not clear. However, the Committee members emphasized that while the inflation environment in Israel has increased, it is still markedly lower than in many countries and is within the target range, as are expectations, and that there is no concern of an inflationary outbreak.

The global economy continues to recover in light of the moderating pace of morbidity and an increase in vaccination rates. However, it appears that the momentum is weakening due to difficulties in the global production chain and an increase in energy prices that increases the existing risks of inflation. Investment banks' growth forecasts essentially did not change regarding the expected rate of global growth, but in a segmentation by blocs, there was a decline in the forecasts for the US and Japan, and an increase in the forecast for Europe and developing economies. The inflation environment worldwide continues to be high, but the baseline forecast of central banks in major economies and in capital markets is that a considerable part of the increase is not expected to persist. In the US, the Federal Reserve kept the federal funds rate and its asset purchase program unchanged, but signaled a reduction in the purchase program in the near term by bringing forward the forecast for an initial interest rate increase to the end of 2022. In the eurozone, the ECB kept the interest rate unchanged, but announced its intention to slightly slow its purchase program.

Since the previous interest rate decision, the shekel weakened by 0.5 percent against the dollar, by 0.3 percent in terms of the effective exchange rate, and by 1.1 percent against the euro. It was noted that the intervention in the foreign exchange market this year is not limited to $30 billion, and at the end of the program the Bank will intervene in the foreign exchange market at its discretion, taking into account the state of the economy.

The rate of increase of home prices remains high; in the past year the rate reached 8 percent, against the background of a continued decline in building completions. Due to an increase in home prices and growth in the number of transactions, mortgage volume continues to rise at an increasing pace.

Five members of the Monetary Committee were of the opinion that the interest rate should be kept unchanged at 0.1 percent. These five members claimed that the low level of the interest rate supports the continued recovery of economic activity. They were of the view that despite the economy's dealing with the current wave of morbidity without severe limitations on activity, there is still a great deal of uncertainty regarding economic activity in the medium term, particularly in view of the risk of cyclicality of additional waves of morbidity as well as regarding the extent of how transitory the inflation is. One Committee member voted in favor of increasing the interest rate to 0.25 percent. He was of the view that economic data make that possible, in view of the strong National Accounts data, the increase in the inflation environment and expectations for all terms being anchored in the target range, and the increase in financial risks.

The Committee noted that the Israeli economy's process of recovery from the crisis continues. However, there are still challenges to economic activity. The Committee will therefore continue to conduct accommodative monetary policy for a prolonged time. Continued economic activity and sound growth will make it possible to end the various quantitative easing programs in the coming months. This is all in order to continue supporting the attainment of the policy targets and the recovery of the economy from the crisis, and to ensure the continued orderly functioning of the financial markets.

Participants in the narrow-forum discussion:

Members of the Monetary Committee:
Prof. Amir Yaron, Governor of the Bank and Chairperson
Mr. Andrew Abir, Deputy Governor of the Bank of Israel
Prof. Reuben Gronau
Prof. Moshe Hazan
Prof. Zvi Hercowitz
Prof. Michel Strawczynski

Other participants in the narrow-forum discussion:
Ms. Dana Orfaig, Research Department
Mr. Tal Biber, Head of the Markets Division, Markets Department
Dr. Golan Benita, Chief of Staff to the Governor
Mr. Uri Barazani, Spokesperson of the Bank
Mr. Arad May, Monetary Committee Secretariat
Mr. Daniel Shlomiuk, Bank Spokesperson’s Office