

**BANK OF ISRAEL**

Office of the Spokesperson and Economic Information

January 1, 2024

**Press Release:**

**The Monetary Committee decides on January 1, 2024**

**to reduce the interest rate by 0.25% to 4.5%**

* The war is having significant economic consequences, both on real economic activity and on the financial markets. There is a great amount of uncertainty with regard to the expected severity and duration of the war, which is in turn affecting the extent of the impact on activity.
* The pace of inflation continues to decline, and an analysis of the inflation dynamic, measured both quarterly and semiannually, also shows that the pace of inflation is moderating. Inflation expectations from various sources are that inflation will enter the target range in the first quarter of the year.
* In the financial markets, there is has been a sharp recovery following the declines at the beginning of the war. Since the previous interest rate decision, the shekel strengthened by 2.7 percent against the US dollar, by 1.7 percent against the euro, and by 2 percent in terms of the nominal effective exchange rate.
* The Bank of Israel Research Department published its staff forecast, and in its estimation, GDP will grow by 2 percent in each of 2023 and 2024, and by 5 percent in 2025. In view of the war, the forecast features an especially high level of uncertainty, including with regard to decisions that the government will need to make regarding how the budget will deal with the defense and civilian needs arising from the war.
* Indicators of economic activity and the state of employment point to a gradual recovery following the sharp decline that took place with the outbreak of the war, but there is a lot of variance between industries.
* In the past 12 months, home prices have declined by 1.3 percent. The volume of activity in the housing market continues to moderate, and the industry is experiencing difficulties as a result of the war.
* In the credit market, the slowing trend of bank credit to businesses and households continues, in parallel with the general slowdown in economic activity.
* Globally, economic activity and inflation in the major countries are moderating, as world trade continues to indicate weakness and there are assessments that central banks will begin a process of monetary accommodation during 2024.

**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.**

**For the file of figures accompanying this notice, click here.**

The State of Israel has been at war for three months. Beyond the security effects of the war, it is having significant economic consequences, both on real activity and on the financial markets. Indicators of economic activity point to a gradual recovery of activity, following a significant contraction in business activity with the outbreak of the war. Volatility in the markets has moderated, and the financial markets are functioning properly. There is great uncertainty with regard to the expected severity and duration of the war, which is in turn affecting the extent of the impact on activity. The foundations of the Israeli economy are strong, and in the past the economy has demonstrated its ability to recover from difficult periods. Since the outbreak of the war, the Bank of Israel has adopted a variety of policy measures to assist the public and the economy in dealing with the consequences of the war.

The pace of inflation continues to decline, while inflation expectations are stable within the target range. The CPI declined by 0.3 percent in November. Inflation in the past 12 months moderated, but remained above the upper bound of the target range, at 3.3 percent (**Figure 1**). Net of energy and fruits and vegetables, inflation in the past year is 2.9 percent (**Figure 2**). An analysis of the inflation dynamic, measured both quarterly and semiannually, also shows that the pace of inflation is moderating (**Figure 3**). The pace of annual inflation of the nontradable components of the CPI, which mainly reflects the housing services component and the services industries, declined but remained relatively high, at 3.8 percent. The annual pace of inflation of the tradable components declined to 2.4 percent (**Figure 4**). Inflation expectations from various sources are that inflation will enter the target range in the first quarter of the year (**Figure 5**). One-year inflation expectations derived from the capital market and forecasts are also within the target range (**Figure 6**), as are expectations for the second year and onward (**Figure 7**). However, there are still a number of risks of a potential acceleration in inflation: the effects of the war and its progress on economic activity, a depreciation of the shekel, and fiscal behavior.

Since the previous interest rate decision, the shekel strengthened by 2.7 percent against the US dollar, by 1.7 percent against the euro, and by 2 percent in terms of the nominal effective exchange rate (**Figure 8**). Since the beginning of the year, the shekel has weakened against most of the world’s major currencies, with high volatility.

The Bank of Israel Research Department revised its macroeconomic forecast in accordance with information accumulated since the start of the war.[[1]](#footnote-1) The revised forecast was built under the assumption that the war’s direct impact on the economy reached its peak in the fourth quarter of 2023, and that the war will continue with declining intensity until the end of 2024. Similar to the previous forecasts, the assumption is that the war will be mostly concentrated on the southern front. According to the forecast, GDP will grow by 2 percent in each of 2023 and 2024 (as in the November forecast), and by 5 percent in 2025 (**Figure 16**), such that the GDP gap is expected to close in 2025. The broad unemployment rate among the prime working ages (25–64) is expected to be 5.3 percent in 2024 and 3.2 percent 2025. Annual inflation in 2024 is expected to be 2.4 percent, and in 2025 it is expected to be 2 percent. The forecast features a particularly high level of uncertainty, partly in view of uncertainty with regard to the severity and duration of the war. The assessment regarding the state budget for 2024 is currently still exposed to uncertainty with regard to decisions that the government will make regarding how the budget will deal with the defense and civilian needs derived from the war. In view of the effects of the war, the impact to economic activity is expected to lead to a decline in tax revenues, while government expenditures on defense and civilian assistance programs will increase. In the Research Department’s assessment, all these are expected to be reflected in a marked increase in the government’s budget deficit, which is expected to total 4 percent of GDP in 2023, 5.7 percent of GDP in 2024, and 3.8 percent of GDP in 2025. In view of this, and assuming that the government makes adjustments of a persistent nature in 2024 and 2025 totaling about NIS 30 billion, the debt-to-GDP ratio is expected to be about 66 percent at the end of 2024 and at the end of 2025, and to decline in the following years toward a ratio of about 63 percent in 2030.

Indicators of economic activity and the state of employment point to a gradual recovery following the sharp decline that took place with the outbreak of the war, but there is a lot of variance between industries. The aggregate balance of the Central Bureau of Statistics Business Tendency Survey for November remained low, and reflects businesses’ negative assessments of their situation. In November and December, there was a recovery in the volume of credit card transactions, with total purchases returning to a level resembling the prewar levels, but there is variance between industries. The level of usage of public transit improved gradually, but the gap compared to the level prior to the war has not been closed (**Figure 19**). Goods and services exports stabilized, following a downward trend (**Figure 23**), and the decline in goods imports deepened in recent months (**Figure 24**). Alongside these, tax revenue in November was about 18 percent lower in real terms than in the same period last year.

The labor market was in a full employment environment prior to the war. The employment rate among those aged 15 and over declined slightly in November (60.5 percent, seasonally adjusted). With the outbreak of the war, the broad unemployment rate[[2]](#footnote-2) jumped sharply, and it remains high. The total number of work hours in the economy remained lower than before the war, and the job vacancy rate continued to decline (**Figure 25**). However, in recent months, there has been a significant improvement in the state of employment. In November, the broad unemployment rate declined from 9.7 percent in October to 8.5 percent, and the volume of those absent from work for other noneconomic reasons (which may be linked to the war but not due to reserve army duty) declined from 7.8 percent in October t0 0.4 percent in November. Moreover, the daily number of job-seekers registered with the Employment Service declined from about 100,000 when the war broke out to about 2,000 in recent days, alongside a return to work of at least 85,000 employees. A flash survey taken by the Central Bureau of Statistics shows the improvement in the state of the labor market according to businesses’ reports as well.

Activity in the housing market continues to moderate. In the past 12 months, home prices declined by 1.3 percent (**Figure 11)**. In September–October 2023, the Index of Home Prices remained unchanged and new home prices declined by 0.4 percent. The number of housing transactions and new mortgage volume remained at levels lower than in recent years. In November, new mortgage borrowing totaled NIS 5.5 billion (**Figure 12**). The owner-occupied housing services component of the CPI declined by 0.4 percent, and its annual rate of increase continued to moderate, to 3.9 percent. Central Bureau of Statistics construction data for the third quarter show that prior to the war, the number of building permits, building starts, and building completions were relatively high, despite the slowdown in activity in the industry in the past year. However, the lack of Palestinian laborers since the outbreak of the war has led to a sharp decline in activity, which is expected to be reflected in fourth quarter data. Maintaining a high construction supply over time, and not just the need to maintain activity in the short term, will support the stability of housing prices.

In the capital market, local equity indices rose, similar to the global trend during the period. However, the underperformance of the domestic market relative to the global market since start of 2023 remains significant (**Figure 35**). Long-term government bond yields declined, similar to the global trend, with the increase in expectations that interest rates will be lowered. Corporate bond spreads, which widened at the start of the war, returned to close to their prewar levels. The risk premium as measured by the CDS, and the spread between dollar-denominated government bonds and US Treasury bills, declined but remain high.

In the credit market, the slowing trend of bank credit to businesses and households continues, in parallel with the general slowdown of economic activity (**Figure 15**). The banks and credit card companies expanded and extended the loan repayment deferral program that was formulated by the Banking Supervision Department to ease the cash flow of households and businesses during the upcoming period. The credit risk indices for medium, small, and micro businesses increased slightly.

Economic activity in the major economies is moderating, with the global manufacturing sector and world trade continuing to weaken. The defense situation in Israel, which has led to an increase in geopolitical tension in the Middle East, has had a moderate impact on the global financial markets. The growth forecasts by investment houses remained unchanged, and their assessment is that global growth will be 2.7 percent in 2024 (**Figure 28**). The purchasing managers index for the advanced economies increased slightly in November, but remains at a level indicating economic contraction. In contrast, the purchasing managers index for emerging economies, which also increased slightly, is at a level indicating an expansion of activity (**Figure 32**).

In the US, the general and core PCE indices declined more than expected, to 2.6 and 3.2 percent respectively. Inflation continues to draw closer to the Federal Reserve’s target. In the eurozone, there was also a sharper-than-expected decline in inflation, with the general index at 2.4 percent and the core index at 3.6 percent. Oil prices continued to declined slightly, with high volatility, and prices are below their prewar levels. Accordingly, the inflation environment moderated in many countries, but remains above their central bank targets (**Figure 33**). Core inflation, which has been more “sticky”, is also moderating. The Federal Reserve and the European Central Bank left their interest rates unchanged, but the interest rate path expected by the markets declined significantly, and accordingly, a number of interest rate declines are expected during 2024.

The minutes of the monetary discussions prior to this interest rate decision will be published on January 15, 2024. The next decision regarding the interest rate will be published at 16:00 on Monday, February 26, 2024.

1. The full forecast is being published separately, and can be found at {link}. [↑](#footnote-ref-1)
2. In addition to unemployed persons under the normal definition, the broad unemployment rate includes employees who are temporarily absent for economic reasons (including those put on furlough). The definition of broad unemployment does not include employees who were absent from their jobs for other reasons, such as reserve duty, caring for children in the absence of day care or educational frameworks, and others. [↑](#footnote-ref-2)