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Remarks by the Governor of the Bank of Israel at the press briefing on monetary policy held today at the Bank of Israel

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Good afternoon.

Yesterday and today, the Monetary Committee held discussions at the Bank of Israel in order to decide on monetary policy. At the previous interest rate discussion, we hoped that in the beginning of July most economic activity would be returning to normal. Currently it appears that the health situation is becoming more severe, and that the risk of additional deterioration in the economic situation has increased. In the Committee's discussions we attempted to assess how the growth in extent of morbidity would affect the path of economic recovery, and what the monetary policy response should be in view of the risk of deterioration in the economic situation. At the end of the discussions, the Committee decided to keep the interest rate unchanged at the low level of 0.1 percent, to launch a plan to purchase corporate bonds, and to renew the plan to extend 3-year low interest monetary loans to banks in order to provide them with incentives to extend credit on easy terms to small and micro businesses. In parallel, the bank created a mechanism that will increase the range of assets that the banks are able to put up as a collateral against these loans. Recall as well that the government bond purchase program continues and is easing the terms of credit in the overall economy. I will now describe how we view the situation through the discussions and our decisions.

After the unprecedented shock absorbed by the economy in the end of March and the beginning of April, a gradual recovery in economic activity began at the end of April, in tandem with the removal of limitations on movement and activity. A large portion of industries returned to activity, even if under various limitations, and most of the rapid indicators that the Bank of Israel developed at the onset of the crisis showed that while the economy had risen from the low level to which it had sunk at the height of the crisis, activity had not returned to pre-crisis levels. The Research Department estimates that the extent of the economy's closure declined from approximately 36 percent at the height of the crisis to about 12 percent currently. The scope of credit card purchases indicates that private consumption in several industries returned to its precrisis level despite the negative impact to income and economic security of numerous households, but in industries such as restaurants and tourism, by their very nature, the level of activity remains low. Overall expenditure is still about 10 percent lower than the level at the beginning of the year. Electricity use also points to a low level of economic activity. The various surveys conducted among businesses indicate that the business sector is still far from returning to routine and the overall adverse impact on sales is assessed to be about 20 percent. The most severe picture is conveyed by the labor market: at the onset of the crisis, more than 1 million workers were placed on unpaid leave. The data from the various sources are not uniform, but from all of them, a fairly clear picture emerges—that more than half a million employees still have not returned to the workplaces they were forced to leave, in addition to 150,000 people who were unemployed at the eve of the crisis, and likewise about one-fifth of self-employed people (as of May) have lost their livelihood partially or completely. A comprehensive analysis of the economic situation indicates that the while at the onset of the crisis, the main factor in the negative economic effect was an adverse impact on supply, as time goes by an adverse impact on the demand side is building up, the effect of which is liable to continue even after the restrictions on supply are lifted.

The continuation of the health crisis around the world is weighing on the global economy. According to the IMF's forecast, a contraction of 5 percent in global growth and of 12 percent in world trade is expected in 2020. Central banks continue to put into effect unprecedented policy measures and some have even expanded them, in parallel with governments' extensive assistance plans. Financial markets have mostly recovered from the sharp declines seen at the height of the crisis, but volatility remains very high, as do indices of risk and uncertainty. A further increase in morbidity or the realization of the risk in financial markets is liable to magnify the adverse impact to the global economy.

In financial markets in Israel as well, the crisis has been reflected in sharp price declines, substantial volatility, and at the height of the crisis, liquidity distress in shekels and foreign currency. The Bank of Israel worked rapidly to return the markets to orderly functioning, in parallel with policy measures by major central banks worldwide. The volatility in financial markets continues and equity and bond indices in Israel have not returned to their precrisis levels, but the markets are functioning in an orderly fashion. The banking system enabled approximately 530,000 households and businesses to defer loan repayments, thus easing the current financing needs of those adversely impacted by the crisis. However, data from the fund to extend government-guaranteed credit to small businesses indicate strong demand for credit.

According to the Research Department's updated macroeconomic forecast, the negative impact on economic activity will continue to be notable. The rise in morbidity data in Israel increases the uncertainty and is expected to delay the return to routine economic activity, and therefore the Department's forecast for growth in 2020 was revised downward: the economy is expected to contract by 6 percent, compared with 4.5 percent in the forecast published in May, and the unemployment rate as reported in the Labor Force Survey conducted by the Central Bureau of Statistics is expected to reach approximately 9 percent at the end of 2020. The GDP forecast for 2021 was revised slightly upward, from 7 percent to 7.5 percent, but the economy is not expected to return to full activity until the end of 2021, and the unemployment rate is expected to remain relatively high—6 percent at the end of 2021. The Department's assessment is that inflation at the end of 2021 will still be below the lower bound of the target range, and accordingly the Department forecasts that the interest rate will be in a range of 0–0.1 percent. The Department emphasized that the balance of risks in the forecast tends to the downside, and noted that under the severe scenario of increased stringency of the limitations on economic activity, GDP is expected to contract by 9 percent in 2020 and unemployment is expected to reach over 11 percent. It is important to emphasize that although we are presenting the figures as they derive from our calculations, it would not be correct to focus on the precise figures, as the forecast is compiled under conditions of tremendous uncertainty and it is difficult to assess the impact of the crisis on economic activity.

The crisis is first of all a health related one, which turned into a severe crisis in the real economy. Therefore, the response first of all has to be health related, and the main burden of dealing with the economic ramifications of the crisis is on fiscal policy. The government acted first and foremost to compensate those who, through no fault of their own, were adversely impacted by the crisis, and to help households and businesses to get past the adverse impact to income caused as a result of the shutdown of activity. Beyond that, the government has to provide as much economic certainty as possible to households and businesses, to support demand to the extent possible, to strengthen the health system in order to deal with the pandemic and curtail its spread, and to utilize as much as possible the shutdown period to invest in infrastructures. The government launched an economic plan that is unprecedented in its scope, and it is important that it continues to increase the efficiency of the execution mechanisms of the various plans. In view of the increased severity of the health situation and the likelihood that there will be a need for focused closures and shutdowns, it is considerably important that decisions on assistance are reached ahead of time and are based on parameters known in advance, so that the public can prepare for them. The labor market situation enables the government to hire and train workers to bolster the required systems and thus to reduce the unemployment rate as well. The government budget, which is very important to be formulated and presented as soon as possible, has to support the government's ability to implement the steps required for handling the economic and health crisis. As is known, the budget is expected to incorporate a marked increase in the deficit and in the debt to GDP ratio. However, so long as the deficit is the result of dealing with the crisis, even if it includes an increase to fund policy steps that encourage growth and productivity, the financial market will enable the government to continue funding the deficit at very low interest rates.

In parallel with the government's steps, the Bank of Israel put a range of monetary policy tools into operation that supported the financial markets' return to orderly functioning and eased the credit needs in the economy. The plan to purchase government bonds continues to operate and thus to support bond market yields remaining low, enabling the government, businesses, and households to continue to borrow at convenient terms and to endure the negative impact on income and liquidity caused by the crisis. In addition, the Bank of Israel continues to intervene in the foreign exchange market, so long as the Committee assesses that the exchange rate has deviated from the window that is consistent with price stability and adequate economic activity. It is important to remember that fluctuations in the exchange rate are liable to be sudden, and market participants should take that into account in managing their risks.

At the onset of the crisis, the inflation environment in Israel was low, and thus the interest rate was also very low. When the crisis began, our assessment was that it could have opposing effects on inflation—while the adverse impact on demand is expected to lead to reductions in prices, the adverse impact on production chains is liable to negatively impact supply of some products and work to raise prices. Although there are methodological difficulties in measuring the inflation rate due to the crisis, there is no doubt that as of now the demand effects have outweighed the supply effects, and inflation, in the world in general and in Israel in particular, is markedly lower than the target and is expected to remain low.

In view of the expected deterioration in the economic situation, the Committee examined which of the tools that are available to it should be used at this time in order to increase the extent of monetary policy accommodation and to expand the assistance to the economy. The Committee decided to keep the interest rate at 0.1 percent, and to put 3 additional policy tools into operation, which will increase the extent of monetary policy accommodation and monetary passthrough, and will assist in providing a response to the economy's credit needs. The Committee decided to launch a plan to purchase corporate bonds, at a scope of NIS 15 billion, and to renew the plan to extend 3-year monetary loans at low interest rates to banks against credit that the banks extend to small and micro businesses. In addition, the Bank of Israel is creating an operational and legal infrastructure that will enable banks to expand the range of assets that they can set as collateral against credit within the framework of this plan, to assets that are not highly liquid. It is important to emphasize that the Bank of Israel's government bond purchase plan continues, and will continue to support activity in the economy via low interest rate levels along the entire curve, and that the Bank of Israel continues to intervene in the foreign exchange market so long as the Committee is of the opinion that the exchange rate deviates from the window that is consistent with price stability and adequate activity.

This range of steps will strengthen the passthrough from the Bank of Israel interest rate to interest on actual credit, and will ensure the efficient continued flow of credit to companies. The Committee noted that it will expand the use of existing tools, including the interest rate tool, and will be able to operate additional tools, to the extent that it assesses that the crisis is continuing and that such a step is necessary to achieve the monetary policy goals, and to moderate the negative economic impact created as a result of the crisis.

At this point, it is difficult to assess when the crisis will end and what its ramifications will be. Informed and determined economic policy can reduce the magnitude of the negative impact of the crisis on the standard of living of Israel's citizens. The Bank of Israel will continue to do all that is required and all that it is authorized to do to minimize to the extent possible the adverse impact on the economy and citizens, to assist businesses and households to get through the crisis, and to support the recovery and rapid return of the economy to a path of robust growth and full employment.

Thank you.