Leumi Economic Weekly

May 23, 2023

The Bank of Israel hiked its interest rate by 25bps to 4.75%

In line with forecasters' expectations, the Monetary Committee of the Bank of Israel (BoI) decided to hike its benchmark interest rate, for the tenth consecutive time, by an additional 25bps to 4.75%. This brings the central bank rate to its highest level since the beginning of 2006. This move comes against the backdrop of the actual inflation rate, which is above the upper limit of the price stability target range (1% - 3%). With that said, the BoI notes that the market-based inflation expectations and forecasts for inflation one year forward are near the upper border of the price stability target range.

However, looking over the past two years, market-based inflation expectations proved to be too low; therefore, looking ahead, and also for the sake of policy making, it is important to take into consideration the possibility for upward surprises in inflation. To illustrate this point, in April 2022 inflation expectations looking one year forward stood at 3.4%, and ultimately, actual inflation ended at 5.0%. In April 2021, market-based inflation expectations looking one year forward stood at 1.5%, yet 12 months later actual inflation amounted to 4.0%. Similarly, The BoI presents in the material it added to the interest rate announcement their measures of seasonally adjusted inflation data. These data are below the actual rate of inflation that is used as the basis for indexation and linkages in Israel, and also with respect to inflation according to the definition of the price stability target.

The BoI notes that some economic indicators are showing a slight moderation in activity, while the labor market continues to be tight and the economy appears to be at full employment, yet the rate of available jobs is trending downward (see details below). It is likely this is a signal from the BoI, which is acting to highlight indices on real activity that are likely to support a halt to the process of interest rate hikes later on. However, the chief goal of the BoI is price stability, and inflation is not expected to moderate in the upcoming CPI (for May 2023). In our estimation, following the upcoming CPI release, the rate of increase over the trailing 12-month period is expected to remain at about 5%, this alongside an increasing number of news reports regarding waves of additional price hikes that are on the agenda, alongside the minimal immediate efforts by the government to halt the rise in the cost of living.

Similarly, the BoI emphasized developments in the housing market, particularly the fact that the number of transactions and the sum of mortgages are continuing to fall, and housing prices remained unchanged in April, following March's slight decline in prices. However, this component is not calculated in the CPI. In contrast, housing rental prices, which are calculated in the CPI, and by a relatively high proportion, continued to climb, and the rise in the housing services component that is in the CPI accelerated to 7.2% in the past year.

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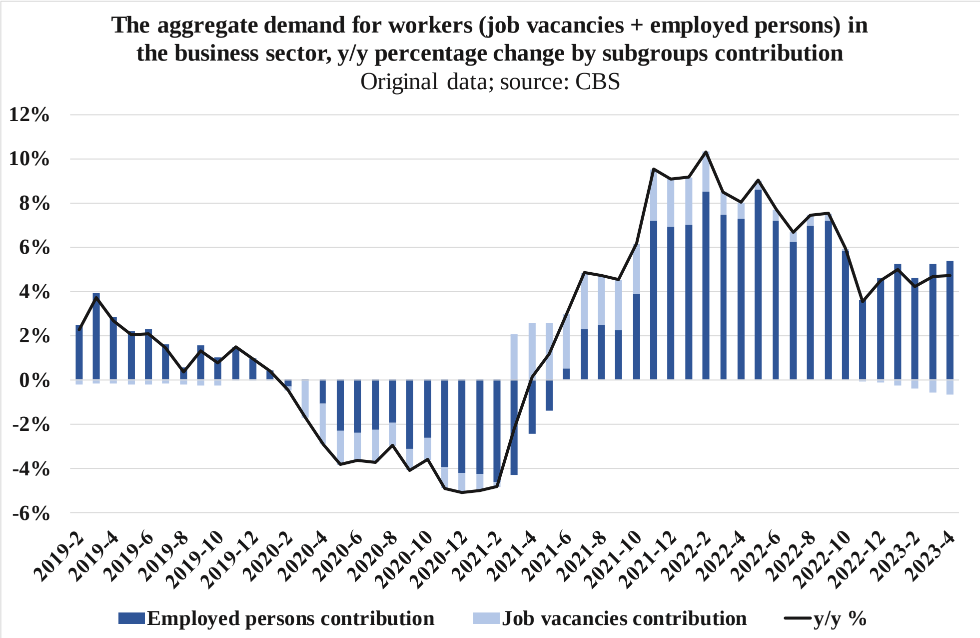
Looking ahead, by the time of the coming interest rate decision, which is scheduled for July 10, 2023, the CPI for May 2023 is scheduled to be released. This figure is expected to indicate a continuing notable deviation from the upper border of the price stability target range. In addition, further rate hikes are expected in the euro bloc as well as in England. These moves are being closely watched by the BoI, since these countries are experiencing difficulties in halting inflation, and mainly core inflation, similar to the situation in the local economy. Consequently, we believe there is a relatively high probability for an additional rate hike of 25bps, to a level of 5%, in the upcoming July 2023 interest rate decision.

Despite the decline of job vacancies, the labor market in Israel remains tight

Data from the Central Bureau of Statistics (CBS) show that the number of job openings fell for the eighth consecutive month, amounting in April 2023 to 128,175 positions (seasonally adjusted data). This figure reflects a 1.5% decline compared to the preceding month and a 16.3% drop compared to the parallel month in 2022. Despite the declines in recent months, the current number of available jobs is substantially above that registered before the outbreak of the coronavirus pandemic. Similarly, the rate of available jobs declined as well in recent months, reaching 4.0% in April 2023, this compared to 5.0% in April last year; however, it remains substantially above the pre-coronavirus period (an average of 3.5% in 2019). The drop in the number of job openings stems from, among other things, declining demand for new workers in certain sectors, this in light of developments in the local and global macro-economic environments, e.g. the information and communication sector (under the shadow of the decline in investments in the high-tech realm). But also the high number of job fillings in the recent period has affected current job openings.



Despite the decline described above, the cumulative demand for workers in the business sector has continued to grow strongly over recent months. A known estimate of the overall demand for workers in the business sector is taken by combining the number of available jobs and the number of employees (original data). As can be seen in the accompanying chart, which presents this estimate, the cumulative demand for workers in the business sector has increased from the beginning of this year by more than 4% each month (compared to the parallel month last year), which is high compared to the pre-coronavirus period when this figure stood at 2.6% (the average from 2015-2019). This is to say, even though the drop in the number of available jobs is leading to weakness in overall demand for workers in the business sector, the relatively high rise in the number of actual employees compensates for this, and thus the overall demand for workers has increased by a high rate compared to the past.

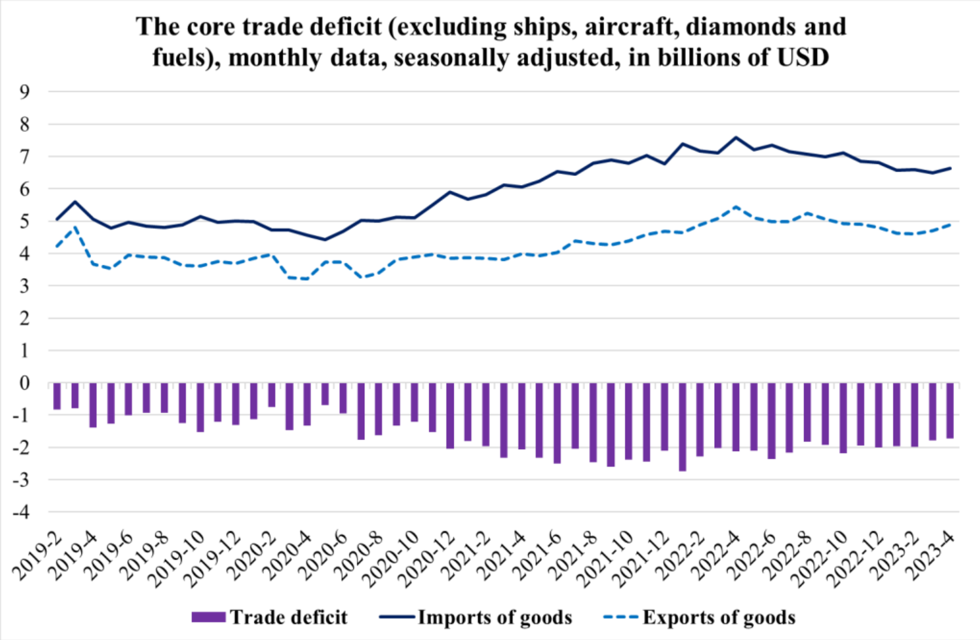
The relatively high demand for workers in the business sector is just one of several expressions of Israel's tight labor market, a factor that served as one of the reasons supporting the May 22nd hike in the BoI interest rate (as detailed in the preceding section). This was coupled with the continuing downward trend in the unemployment rate, which stood at 3.6% in April (adjusted for seasonality) for persons aged 15 and above, and at 3.1% for persons aged 25-64, which represent the main working ages in the economy. These figures indicate the labor market is at a state of "full employment". Furthermore, the high demand for workers, in combination with the high inflation in the economy, which is leading to demands for higher wages by salaried employees, supports a rapid increase in salaries in the business sector at the current time.

The import and export of goods increased in April; the core trade deficit continued to contract

CBS data show that in April 2023 goods exports from Israel amounted to US$4.9bn (seasonally adjusted data; excluding ships, aircraft, and diamonds). This figure indicates a 3.9% increase (in nominal US dollar terms) compared to the preceding month, and a 10.3% decline compared to the parallel month last year. A substantial increase in exports compared to the preceding month was registered in the sector involving the manufacture of chemicals and chemical products. The drop in exports in the annual comparison reflects, among other things, weakness in external demand, against the backdrop of the slowdown in global economic activity, coupled with moderation in global trade.

Goods imports in April 2023 amounted to US$6.6bn (excluding ships, aircraft, diamonds, and energy materials). This figure reflects a 1.9% increase compared to the preceding month, and a 12.6% drop compared to the parallel month last year. The rise compared to the preceding month stemmed from an increase in imports of consumption goods and investment products.

In summary, the deficit in Israel's core trade account (excluding ships, aircraft, diamonds, and fuel) continued a downward trend that has characterized this figure since the beginning of the year. The deficit continued to contract also in the beginning of the second quarter of this year (see accompanying chart). This decline, on the assumption it will continue through the end of the quarter, has within it the ability to support the country's GDP growth rate, as well as the surplus in the current account of the balance of payments, in the second quarter of 2023.



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