

# Recent Challenges of Inflation Targeting in Israel

---

Bank of Canada



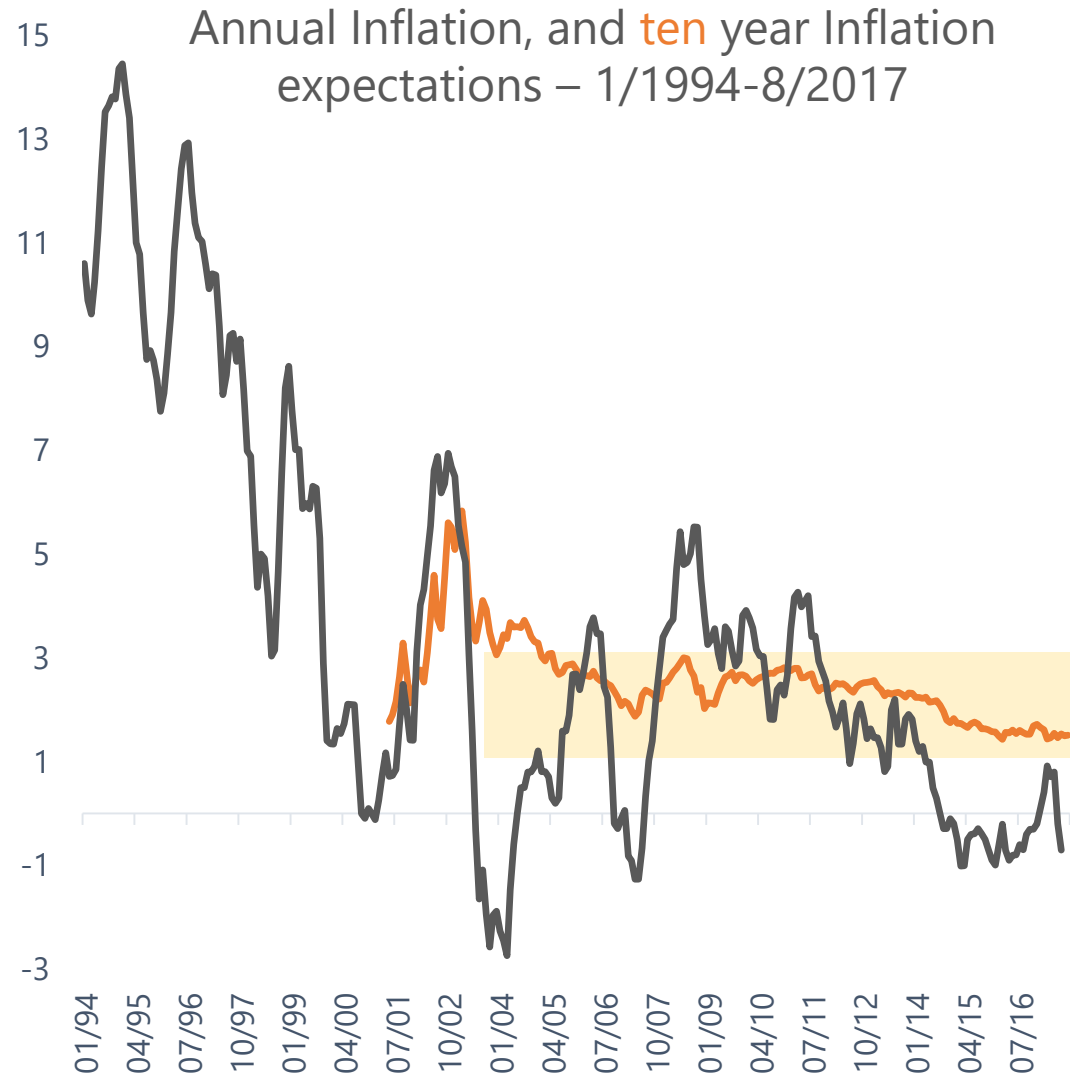
Dr. Nadine Baudot-Trajtenberg

Deputy Governor of the Bank of Israel

September 14<sup>th</sup>, 2017

# After a decade of disinflation process, Israel roughly reaches Price Stability in 2003

- **1970's and early 80's:** Hyperinflation
- **1985:** Tackling Hyperinflation with both orthodox and unorthodox policies
- **1994:** Bol makes active use of interest rate policy to attain an inflation target (a gradually falling inflation target)
- **1997:** Bol has a de facto fully flexible exchange rate regime
- **2003:** Introduction of the present day inflation target of 1%-3%





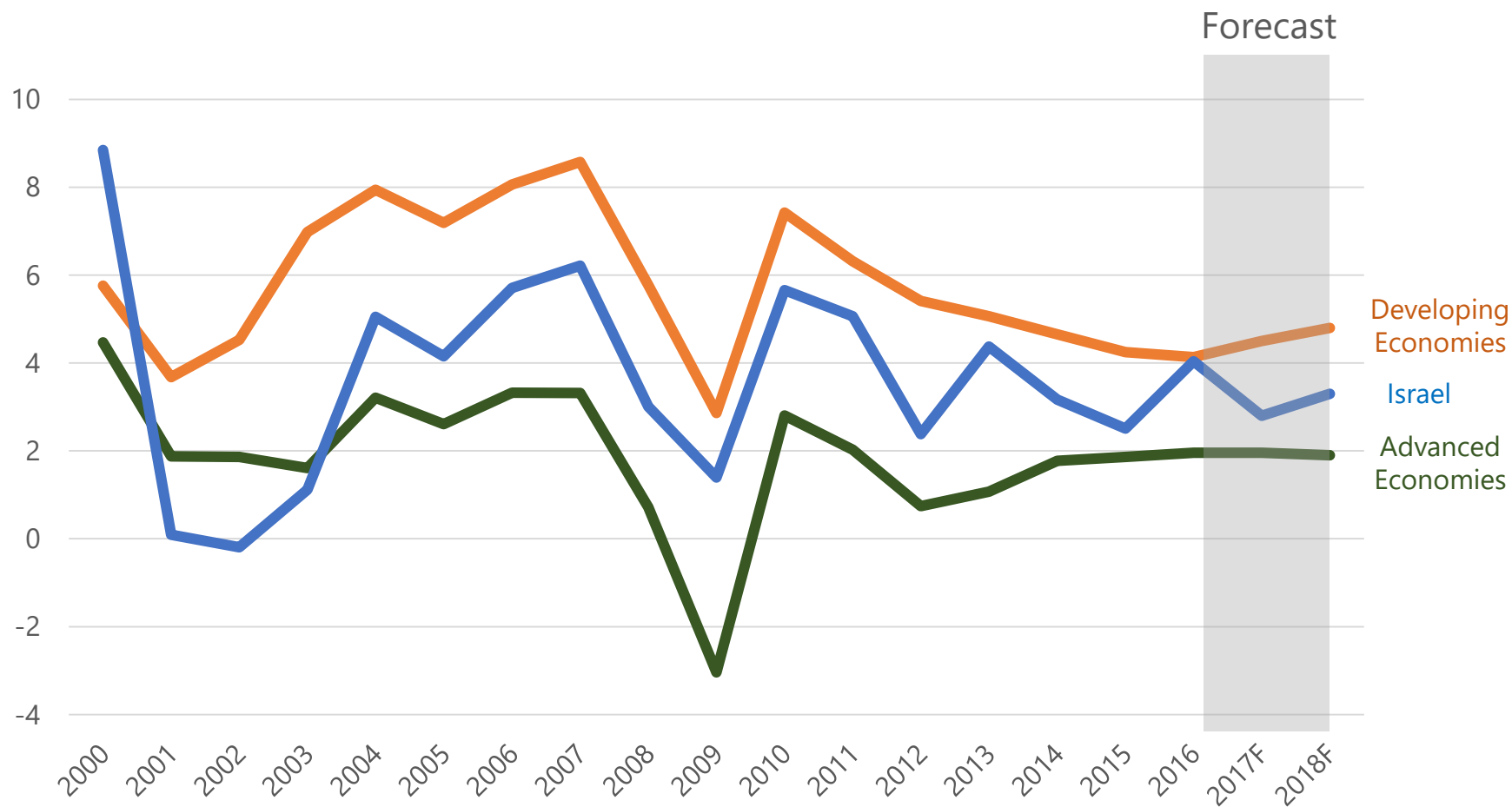
# Bank of Israel's Objectives as defined by the Bank of Israel Law of 2010

- 1) Maintain price stability** – top line inflation target of between 1%-3% within a 24 months period
- 2) Support economic policy:** growth, employment and reducing social gaps
- 3) Support the stability** and orderly activity of financial system



# Israel weathered successfully the GFC

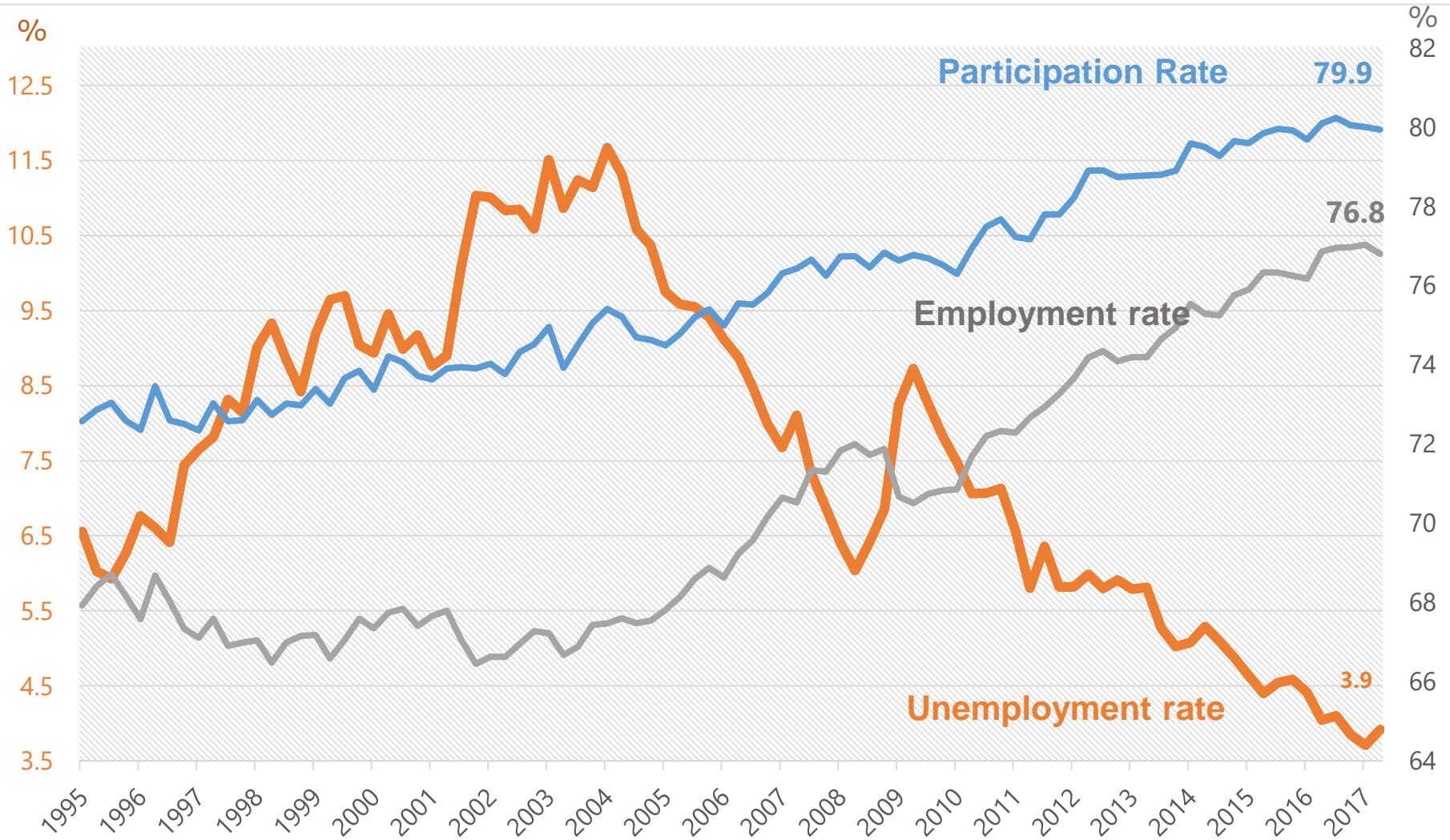
## GDP annual % change (2000-2018F)





# Israel has a Strong Labor Market

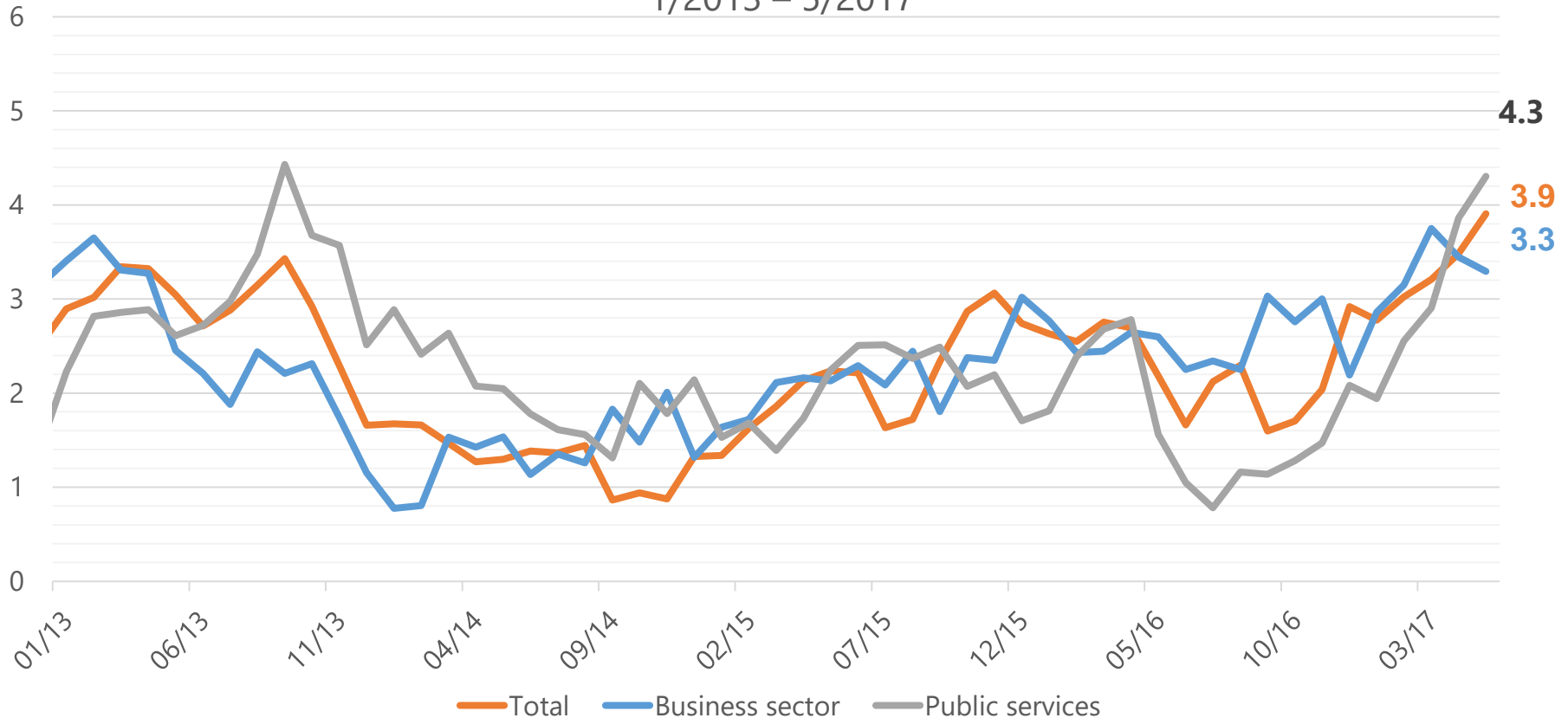
Quarterly, 1995-2017, ages 25-64



# Nominal wages continue to increase

## Nominal Wages per Employee Post

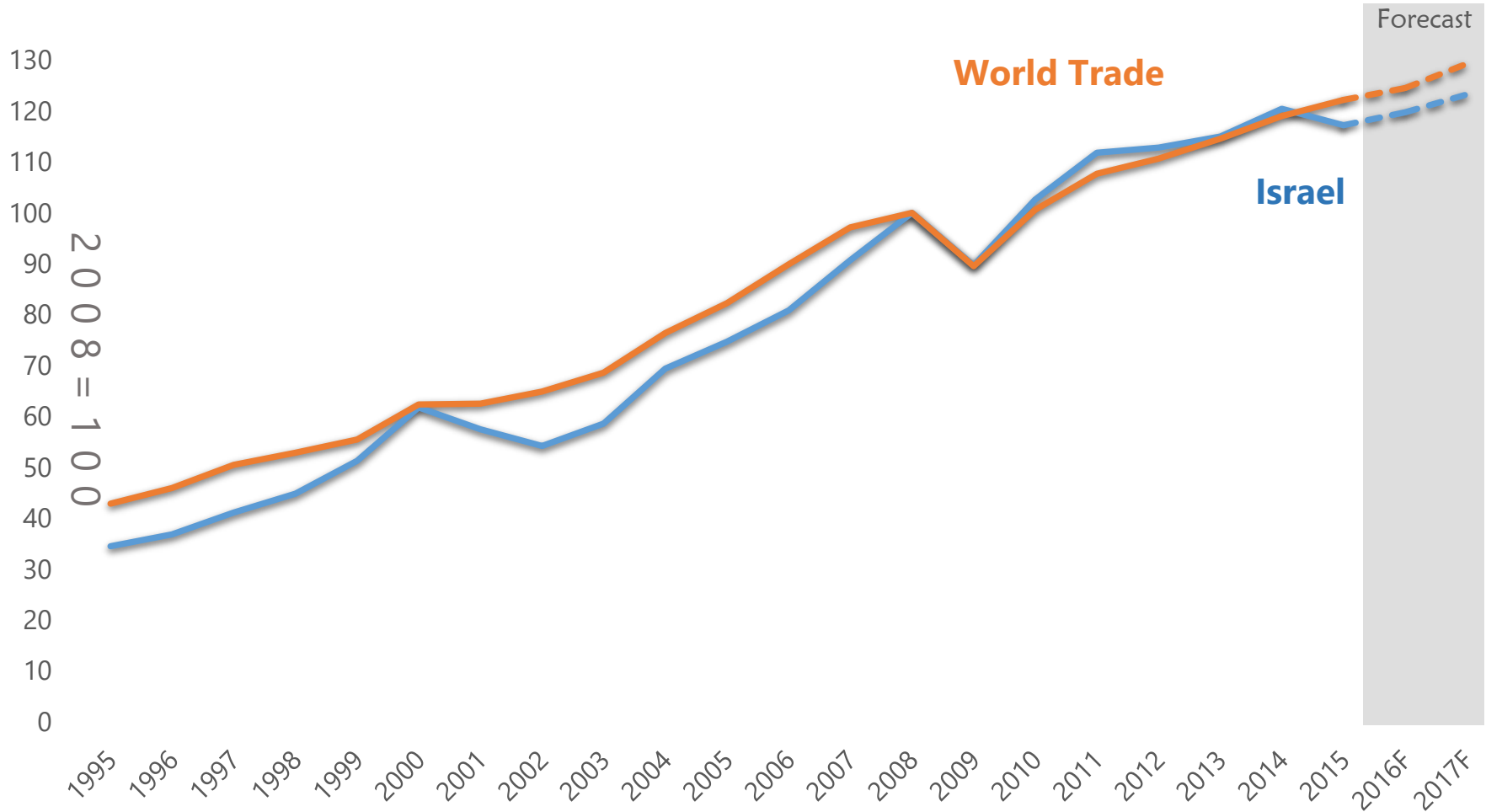
Seasonally adjusted, moving 3-month average, % change compared with the same period in the previous year, 1/2013 – 5/2017





# Israel's G&S Exports\* and World Trade\*\*

2008=100, 1995-2017F



\*\* What the MPC was seeing in January 2017

\* (excl. diamonds and start-ups)

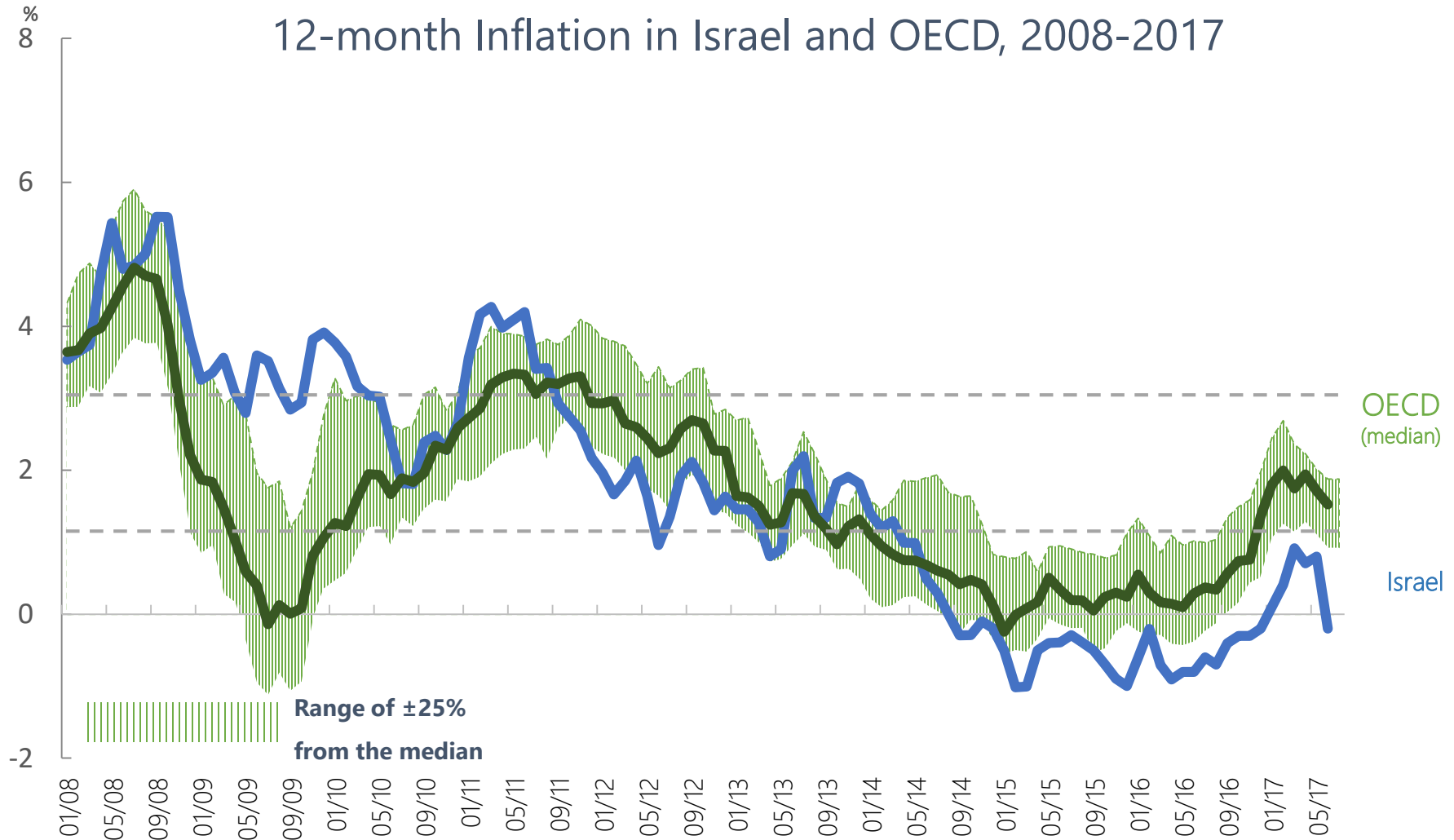
# The Appreciation of the Effective Exchange Rate Contributed to Low Inflation and impacted Exports

Nominal Effective Exchange Rate,  
2009-8/2017



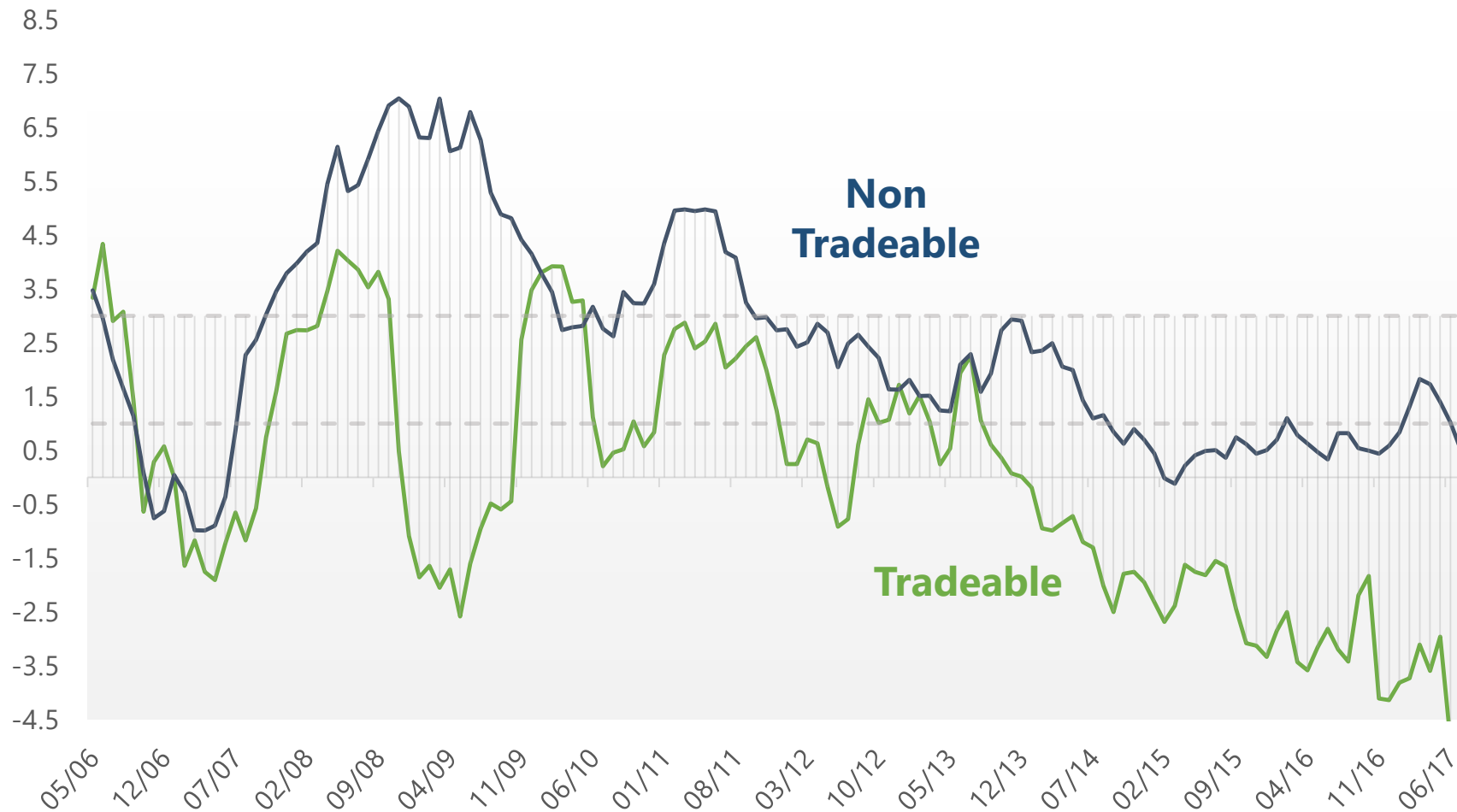


# Israel's inflation environment still low compared to trading partners





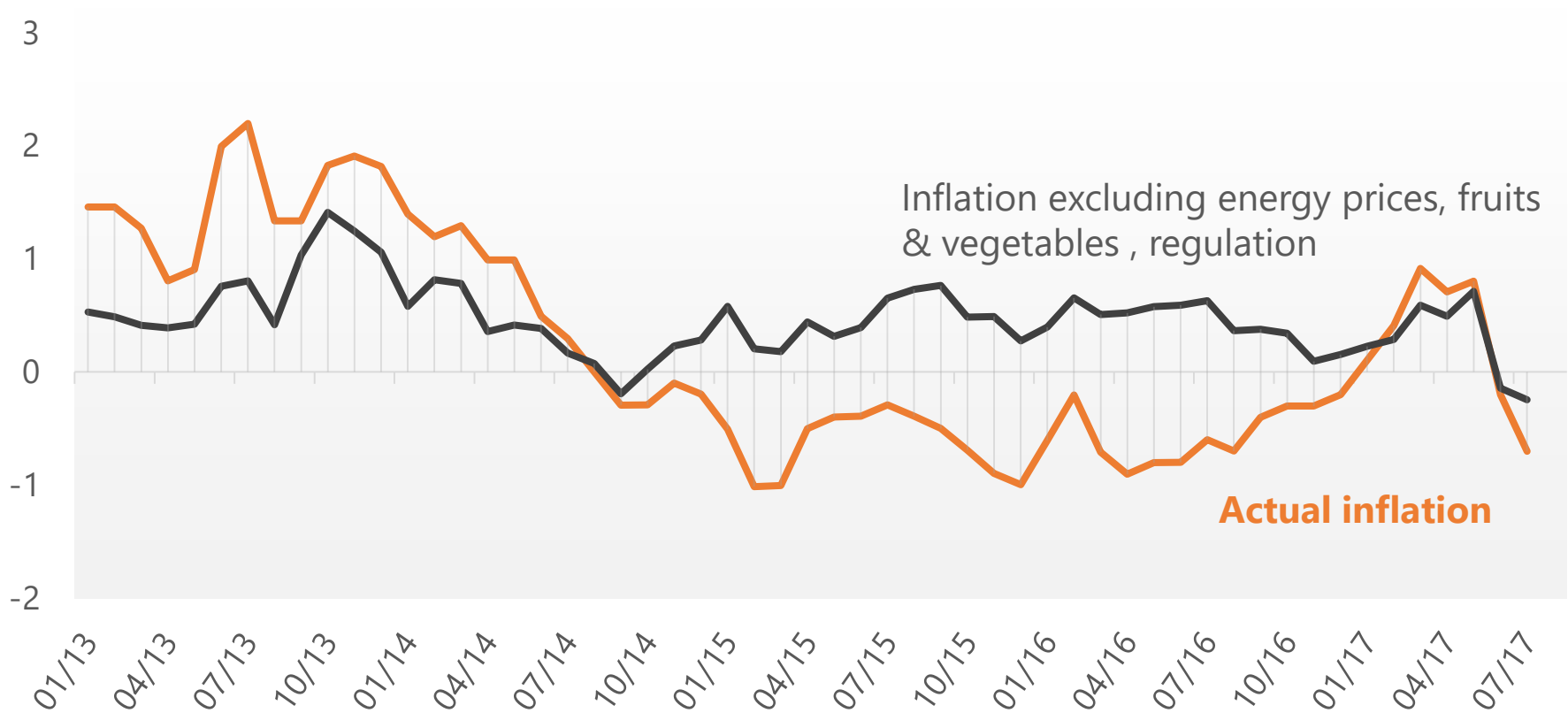
# Inflation of Tradeable and Non-tradeable, 2006-2017, Monthly, 12-month percent change



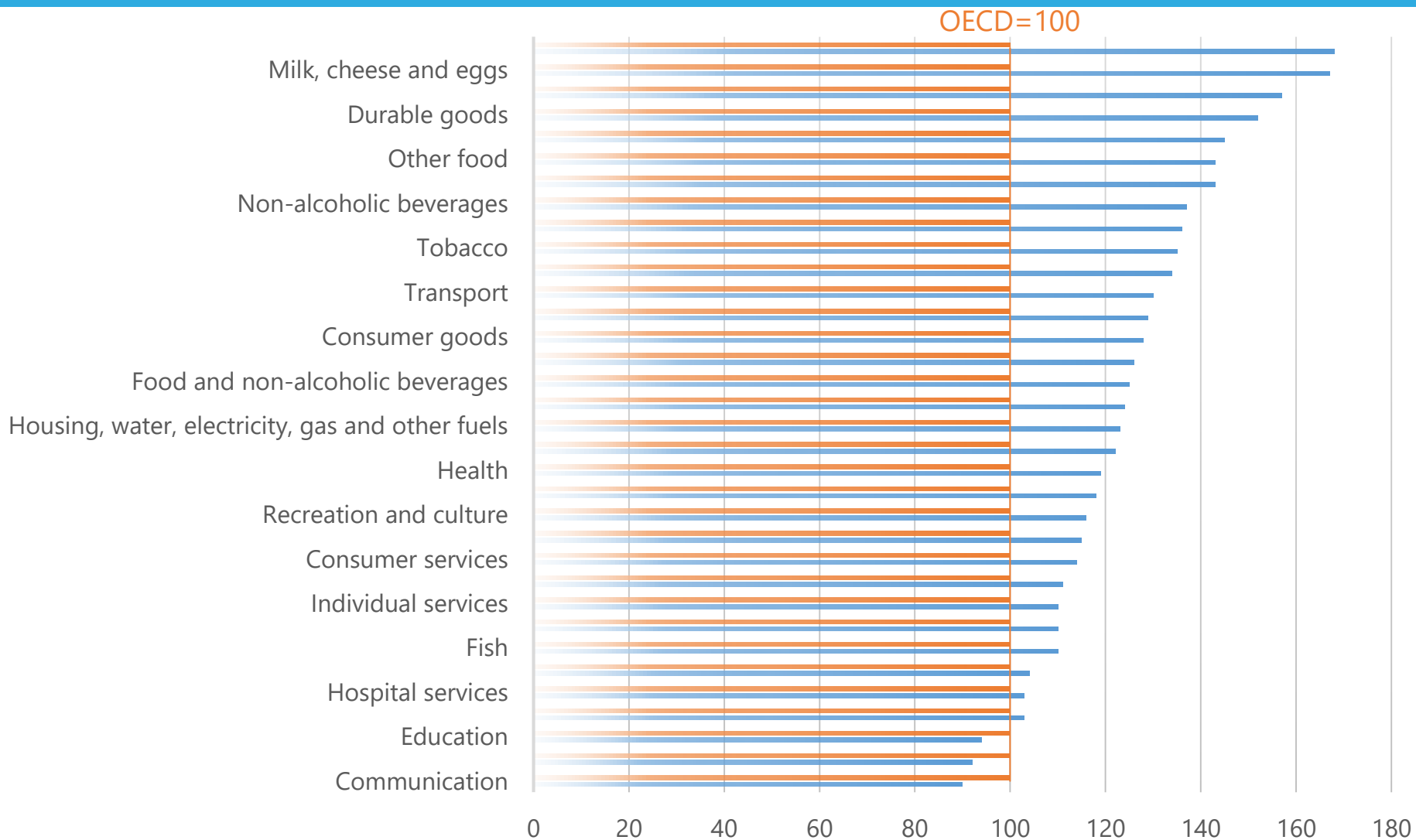
# Persistently low inflation – 2013-1017

## Actual inflation

Inflation excluding energy prices, fruits & vegetables , regulated prices  
2013-2017



# Israeli Consumers Face High Prices, 2014



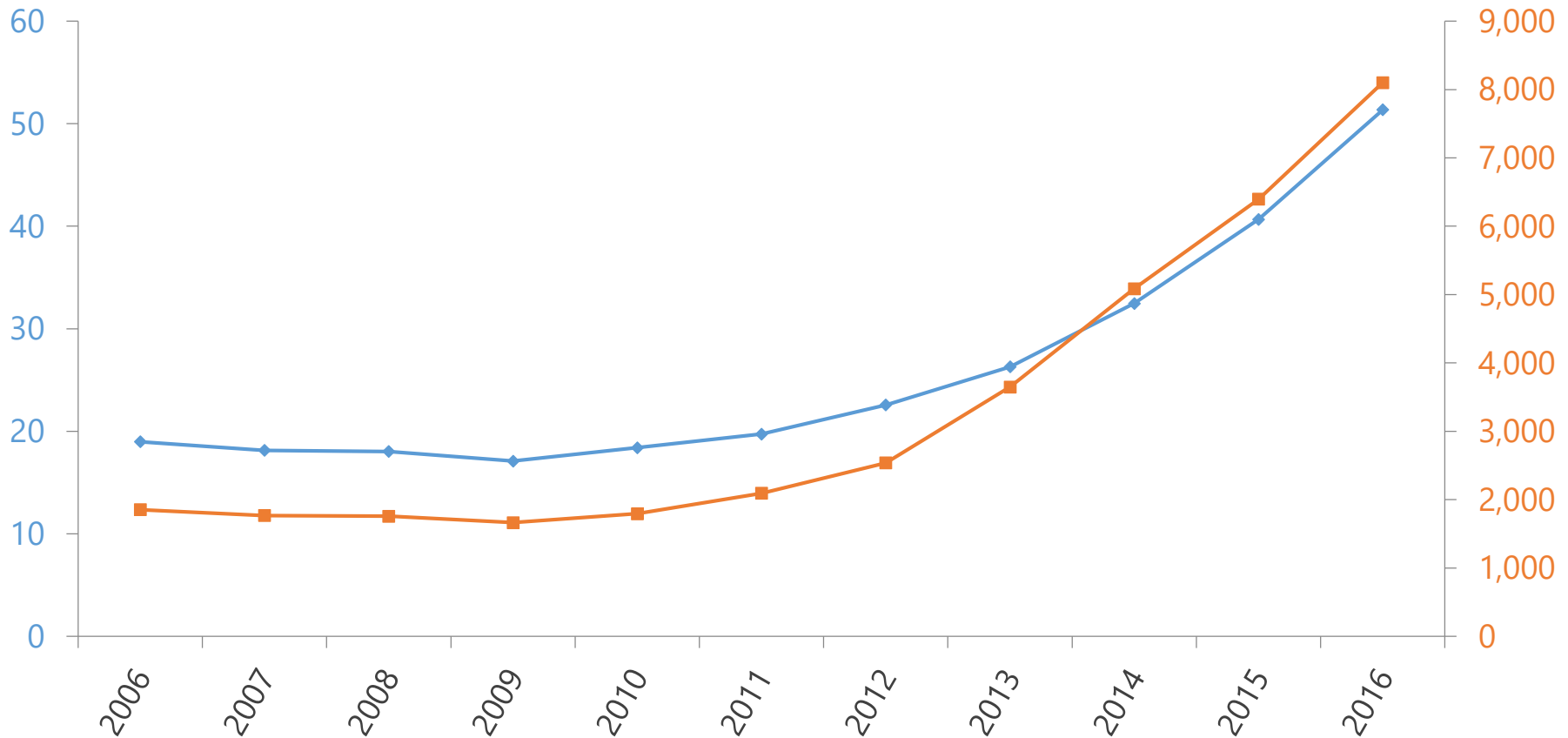
# The expansion of personal imports from abroad in recent years as part of a change in consumer behavior

## An increase in the transfer of packages from abroad to Israel

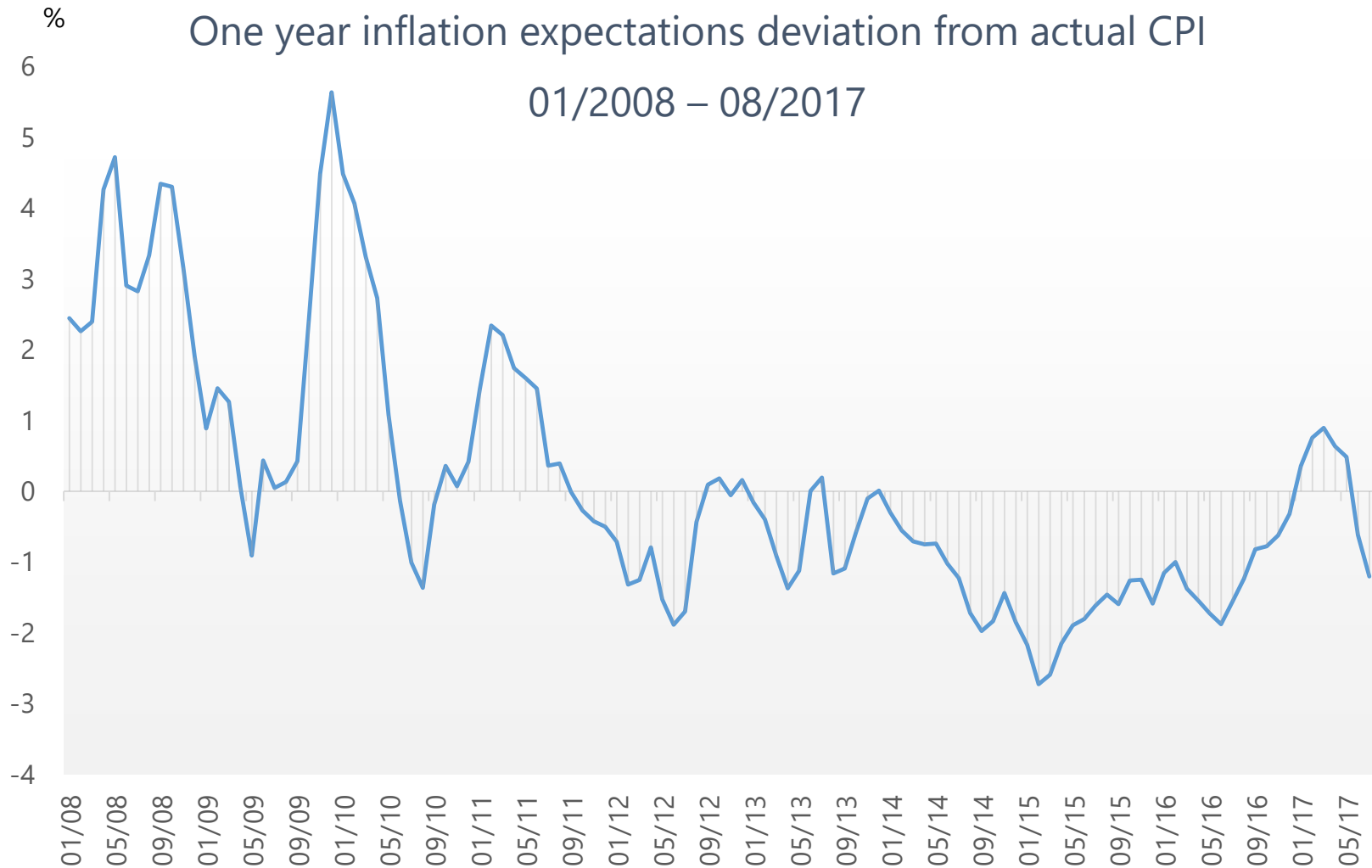
Annual, 2006-2016

Millions of units

Tons



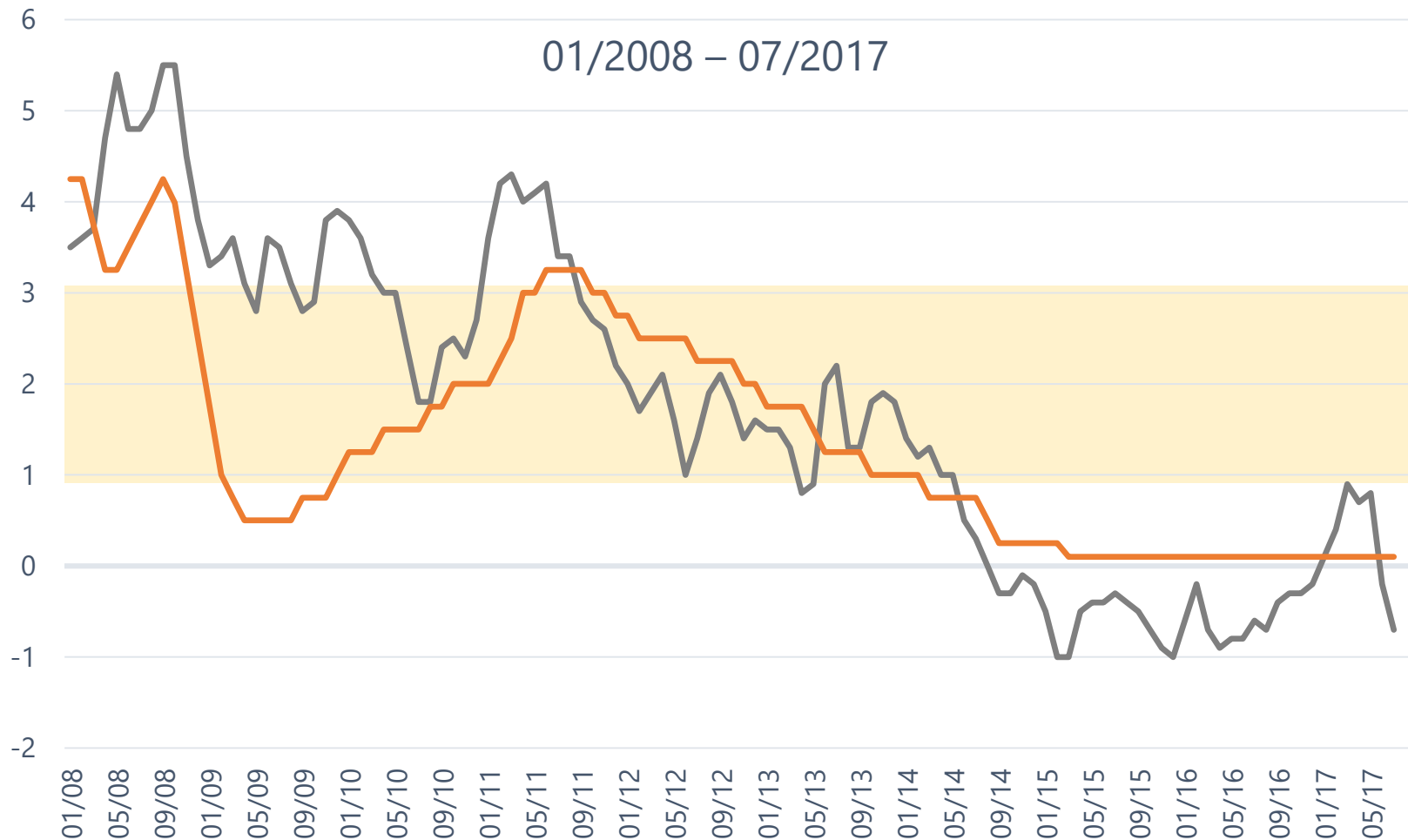
# Systematically overestimating inflation





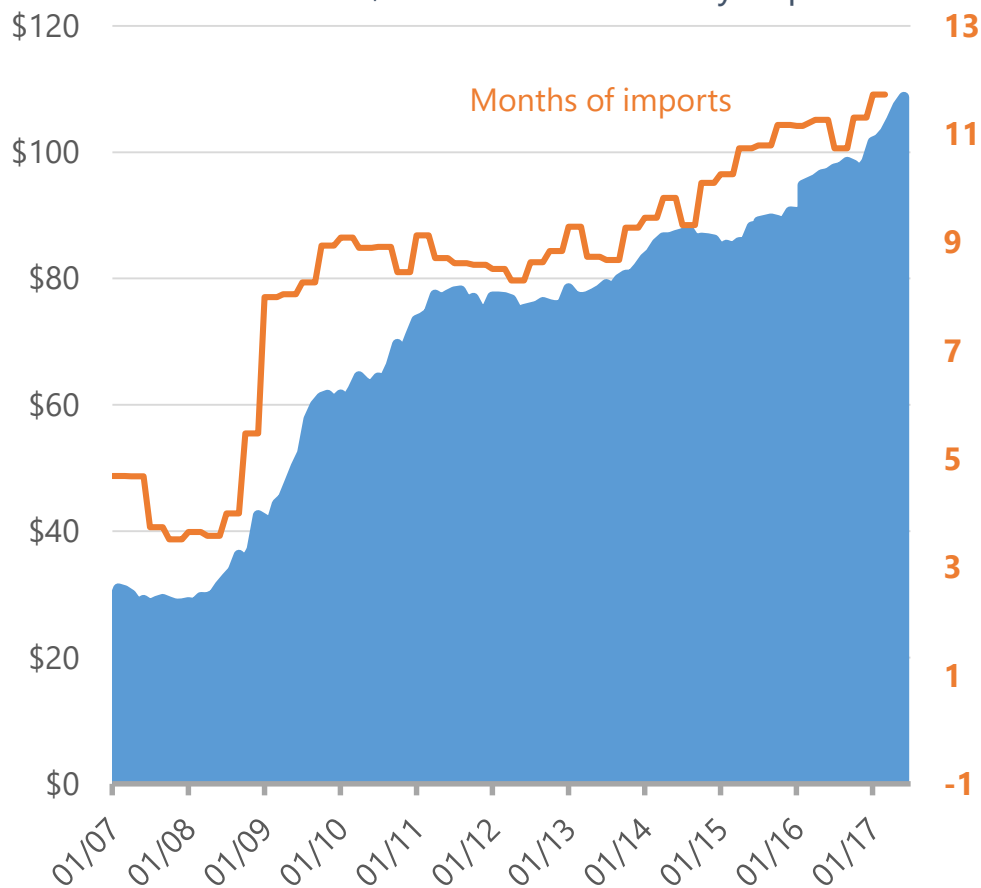
# Bank of Israel dropped its interest rate til 0.1% 01/2008-8/2017

12 month CPI and Bol interest rate

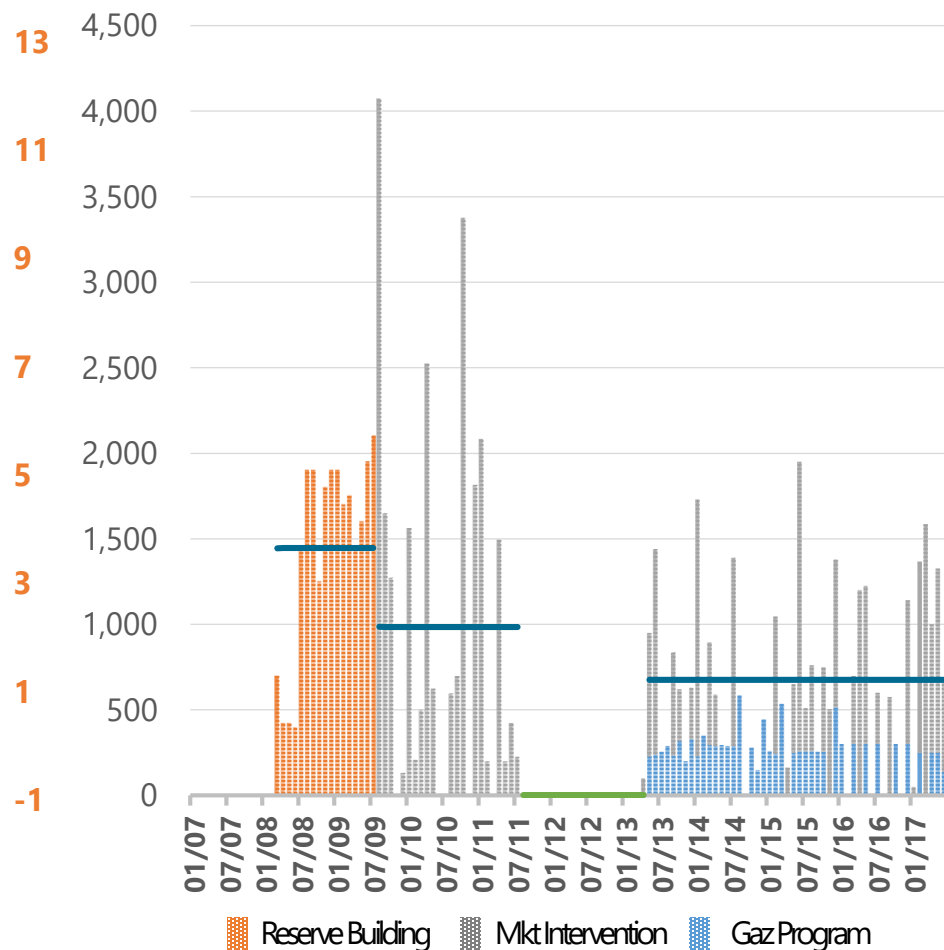


## FX Reserves at the Bol

Billions of US \$ and X times monthly Imports



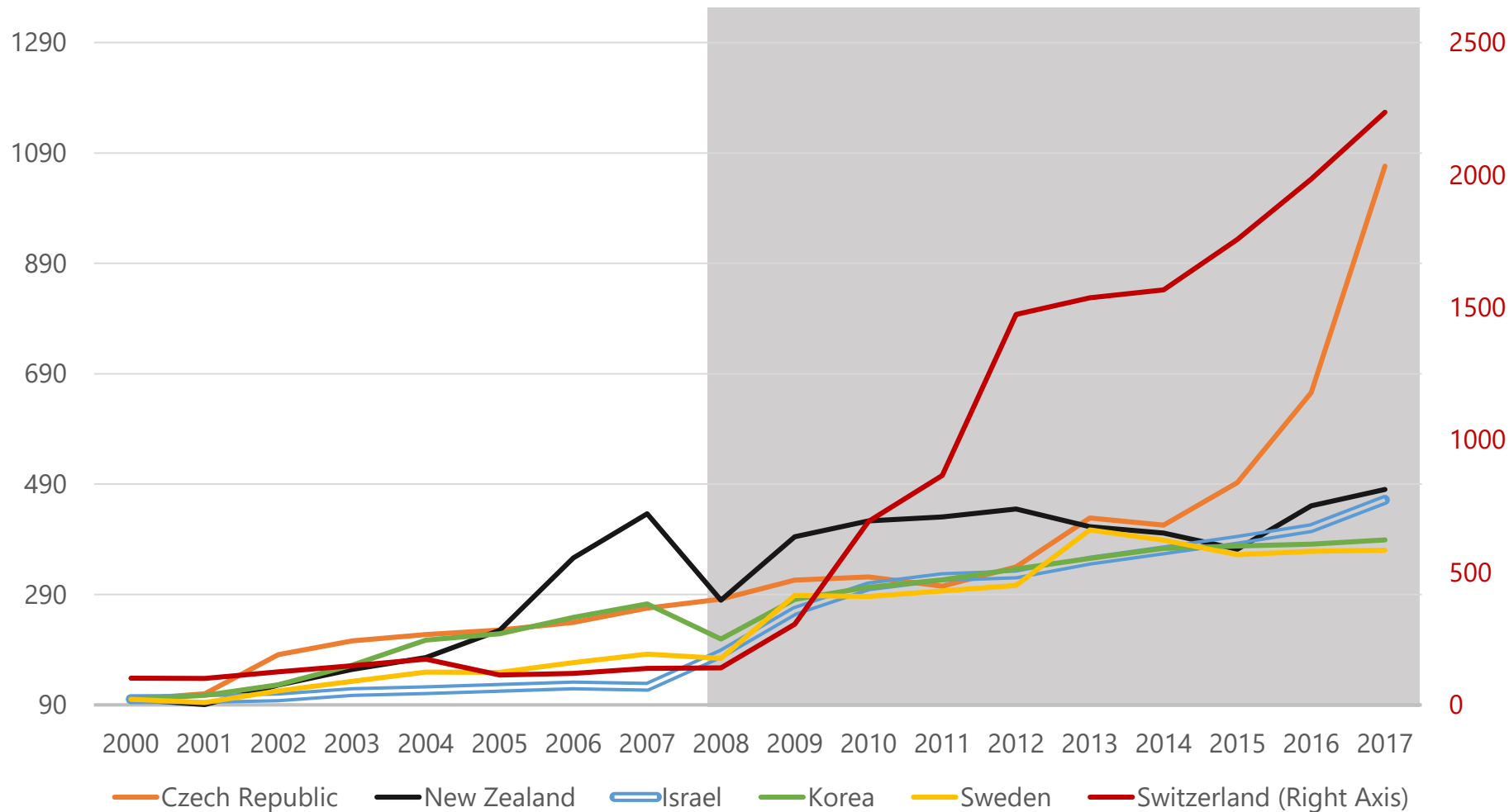
## FX INTERVENTION







# Central Bank FX Reserves Index, SOE's index 2000=100, 2000-2017





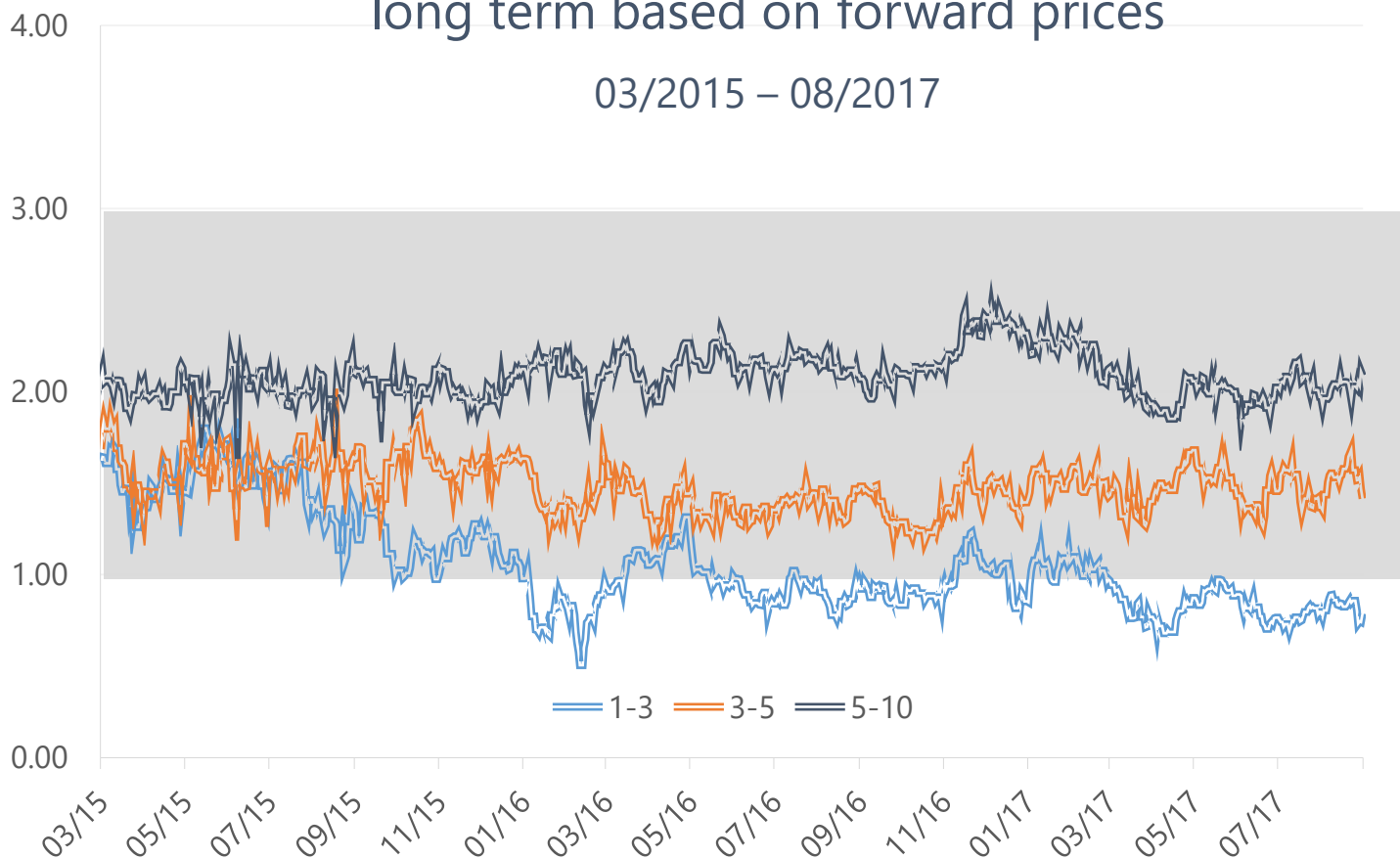
# Monetary Policy: Forward Guidance

- Oct 27<sup>th</sup> 2016 : *"The Monetary Committee continues to assess that in view of the inflation environment, and of developments in the global economy, in the exchange rate, as well as in monetary policies of major central banks, monetary policy will **remain accommodative for a considerable time.**"*
- April 6<sup>th</sup> 2017 : *"The Monetary Committee intends to maintain the accommodative policy **as long as necessary in order to entrench the inflation environment** within the target range."*

# Medium Term expectations returning within the target range and LT Expectations well anchored

## Inflation Expectations for the medium and long term based on forward prices

03/2015 – 08/2017



- 1-3 year inflation expectations stand at **0.79%**
- 3 year inflation expectations in 3 years 'time (inflation forward 3-5 years) stand at **1.42%**
- 5-10 year inflation expectations are stable at about **2%**



# Concluding words

## 1. Patience does not entail inaction

Protracted periods of below target inflation do not entail an automatic loss of monetary policy credibility.

Better understand, and better explain, how the transmission mechanism

Use more tools and more targeted tools

## 2. The Israeli experience does not lead to the need of changing the inflation target

An important anchor for the economy must not be amenable to easy change unless there is strong evidence that it is no longer at the appropriate level.

## 3. Monetary policy must take into account financial conditions as signaled by the markets.

As upholder of a necessary and crucial nominal anchor it must be able to withstand noise and “flavor of the day” pressures.

Open discussions and clearer explanations



Thank you