Recent Challenges of Inflation Targeting in Israel

Bank of Canada

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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:** BoI makes active use of interest rate policy to attain an inflation target (a gradually falling inflation target)

- **1997:** BoI has a de facto fully flexible exchange rate regime

- **2003:** Introduction of the present day inflation target of 1%-3%
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)

SOURCE: IMF
Israel has a Strong Labor Market
Quarterly, 1995-2017, ages 25-64

Source: Central Bureau of Statistics Labor Force Survey
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

Total 4.3
Business sector 3.9
Public services 3.3

SOURCE: Central Bureau of Statistics.
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)

SOURCE: IMF and the Central Bureau of Statistics (Israel)
The Appreciation of the Effective Exchange Rate Contributed to Low Inflation and impacted Exports

Nominal Effective Exchange Rate, 2009-8/2017

Source: BoI
Israel’s inflation environment still low compared to trading partners

12-month Inflation in Israel and OECD, 2008-2017

Source: BOI & OECD
Inflation of Tradeable and Non-tradeable, 2006-2017,
Monthly, 12-month percent change

Source: BoI
Persistently low inflation – 2013-1017

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

Actual inflation

Source: BoI, CBS
Israeli Consumers Face High Prices, 2014

Source: OECD
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

Source: BoI report, 2016
Systematically overestimating inflation

One year inflation expectations deviation from actual CPI

01/2008 – 08/2017

Source: BoI
12 month CPI and BoI interest rate

01/2008 – 07/2017
Monetary Policy – FX Intervention
2007-07/2017

FX Reserves at the BoI
Billions of US $ and X times monthly Imports

FX INTERVENTION

Source: BoI
Monetary Policy: Forward Guidance

• Oct 27\textsuperscript{th} 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\textsuperscript{th} 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

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%

Source: BoI
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 works.
   
   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