

Stanley Fischer: Bank of Israel's objectives for 2009

Address by Professor Stanley Fischer, Governor of the Bank of Israel, at the Globes Conference 2009, Tel Aviv, 13 May 2009.

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A little over four years ago I took up my appointment as Governor, an appointment which was and is a rare privilege and a great honor for me. In about a year my term of office will be over. At the beginning of each year I write down for myself the main tasks for that year. The tasks for this year are:

1. First, to fulfill the function that a central bank is meant to perform. In other words, to formulate and implement a monetary policy that will help achieve the economic targets. At this time the correct monetary policy is an expansionary one that supports economic activity and an economic recovery, as long as inflation is expected to stay within the target range. The policy we are currently pursuing is expansionary in three aspects: (i) The interest rate is low. It is not at its lowest possible level, but is almost there. Research we carried out showed that a further reduction would be of limited help to growth. (ii) We are buying foreign currency. These purchases have almost certainly helped growth, as we export close to 45 percent of GDP. Of no less importance is the stability of the foreign currency market. We have noted on more than one occasion that despite the severe shocks in markets around the world, our foreign currency market has come through relatively unscathed. The foreign currency market showed stability even in exceptional circumstances, such as the resignation of the Minister of Finance and the incapacitation of the Prime Minister. (iii) We are buying government bonds. Despite these purchases, our longer-term (ten-year) interest is relatively high. The difference between long-term and short-term interest rates in Israel is much greater than those in the US and other countries. We are making these purchases to try to lower the cost of long-term credit. These three aspects of monetary policy are acting to steer the economy towards a recovery.

I would like to relate to the lag between events in the financial markets and those on the real side. If we are asked whether we see a turnaround in the real economy, we can answer that some of the data do present a more optimistic picture. Israel's economy is facing a difficult period, but in the Bank of Israel expectations for six months hence are optimistic. In my two-monthly meetings with other central bank governors, we discuss the economic situation. In the last meeting, two days ago, they started speaking of optimistic signs. We are currently following an expansionary monetary policy, but we must be ready to change direction if and when necessary, but not before. The markets and the Bank of Israel expect the April CPI to rise by about one percent. Nevertheless, nearly all forecasters expect inflation in 2009 to be below 2 percent, and we do not intend to react to one month's index, especially if it affected by seasonality.

The Governor of the Bank has the role of economic adviser to the government. The budget deficit is expected to be six-and-a-half percent of GDP this year, and five percent next year. Growth this year is expected to be a negative one-and-a-half percent, with a rise in the debt/GDP ratio. This is not an advisable direction for the economy to follow. What is of concern is that the debt/GDP ratio at the end of the decade may be back where it was at its beginning. In order to prevent the deficit reaching above 6.5 percent this year and 5 percent next year, expenditure must be reduced. There are several ways of achieving that, e.g., cutting public sector wages and/or postponing reductions in tax rates. With regard to the current deficit, I

suggest starting with the 6.5 percent of GDP deficit this year and 5 percent next year, to make it very clear that the path is a downward one.

2. The second of this year's objectives is the new Bank of Israel Law. The current Prime Minister and the Minister of Finance when I took up office expressed support on this issue, and that was one of my conditions on accepting the position. Why is the new law so important? There are several reasons: the new law will formalize the independence of the Bank; it will specify the Bank's obligation regarding transparency; there will be a Monetary Committee that will make interest rate decisions together with the Governor; and there will be an Administrative Council that will approve administrative decisions. Why is a decision by committee preferable to a decision by an individual? Research has shown that on average, decisions made by a committee are better than those of a single decision maker. The current Bank of Israel Law is 55 years old.
3. The third task relates to the integration of Israel's economy into the global economy. Progress has been made, and we are still advancing in this direction. We are following the procedure for joining the OECD, and expect to become members this year.
4. Finally, reform of the bank supervision in Israel. There is a worldwide consensus that supervision reforms are necessary, and this applies to Israel too, and it is important that we proceed rapidly in this area.

In conclusion, I would summarize by saying that before I came to the Bank of Israel I set myself several objectives, not all of which have been achieved yet. The list included a new Bank of Israel Law, a new wage agreement in the Bank, and the structural reorganization of the Bank. The reorganization that has taken place in the Bank certainly helped it deal correctly with the crisis. Other targets remain, albeit of somewhat less importance, but still worth mentioning: (i) to improve relations between the Ministry of Finance and the Bank – we share responsibility for the health of the economy, and with two doctors caring for the same patient, it is important that they agree on the correct course of treatment; (ii) to improve the level of public debate in Israel, and there is plenty of room for improvement in that area.