

Stanley Fischer: Brief review of economic and financial developments in Israel in 2006

Address by Professor Stanley Fischer, Governor of the Bank of Israel, at the Press Conference on the Publication of the Bank of Israel 2006 Annual Report, Jerusalem, 11 April 2007.

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I would like to start by congratulating the team that prepared the report, headed by Karnit Flug, director of the Research Department, and Michel Strawczynski, Deputy Director of the Research Department. The team consisted of staff from the Research, Monetary, and Foreign Exchange Activity Departments and the Financial Stability Area.

This morning I presented the Report to the Acting President of Israel and Speaker of the Knesset, Ms Dahlia Itzik; the Prime Minister, Mr Ehud Olmert; and the Minister of Finance, Mr. Abraham Hirschson.

In economic terms 2006 was one of Israel's most successful years. This was reflected in the high rate of growth, the decline in unemployment, the improvement in employment, the impressive surplus in the current account, the amount of foreign investment in Israel, and price and financial stability. All this took place against the background of rapid global economic growth, but also in a year in which Israel was engaged in a war.

Despite the successes, there are three areas in which, although some progress was made, much work still needs to be done: the relatively high unemployment rate, the large share of public debt in GDP, and the high incidence of poverty. Helped by the high rate of growth, however, especially in the last three years, some improvement was evident in all these areas.

This drives home the importance of focusing on the main objective of macroeconomic policy – the maintenance of a high rate of growth and converting it into a long-term one.

The continued success of Israel's economy depends this year too on three main factors: (1) developments in the global economy, over which we have no influence; (2) the geopolitical situation, on which we have some effect; and (3) the continuation of the government's economic strategy as followed in the last few years, over which we in Israel do have control:

- Current fiscal strategy should persist, mainly the preservation of a low budget deficit, leading to further lowering of the debt/GDP ratio, which despite its reduction is still too high. It is important to avail ourselves of the good years we are currently enjoying to persist in reducing it. Reducing the share of debt in GDP would make the economy more resilient to shocks, release resources for other important needs, and enable the government to operate a counter-cyclical policy when necessary.
- The monetary strategy should be continued, acting to ensure price stability, as an intrinsic part of economic and financial stability and as a firm base for sustained growth.
- Economic reforms should continue. The structural reforms in the areas of privatization, education, competition and the infrastructure should be completed; this would help increase productivity and growth. Moreover, further development of the financial infrastructure and greater competition in the capital market, particularly between the institutions that operate vis-à-vis households, is the right path to follow, and would contribute to growth.

I would now like to address three specific issues: 1) monetary policy; 2) the economic situation in light of the political situation; and 3) Israel's membership of the OECD.

1) Monetary policy

We are currently at a stage where the economy is growing quickly, and inflation is very low, even lower than the target, and this is expressed among other things in price rises in the financial markets. In operating monetary policy we keep our eye on our primary target – the inflation target – and also on the secondary targets, i.e., to contribute to economic activity and financial stability. As every change in the interest rate also affects, to some extent, the rate of growth and the prices of financial assets, in making our interest rate decisions we have to take into consideration the trade-off between these three

factors – inflation, growth and financial stability. This is an essential consideration in the whole issue of monetary policy, and it will feature in our future decisions too, as it has till now.

2) The economic situation in light of the political situation

Whenever I speak to investors or analysts from abroad, they always ask the same question, "How can Israel's economic situation be so good despite all the political problems facing the country?" I answer: (a) the global economy is growing at an impressive rate; (b) the government has maintained fiscal discipline, one of the points on which there is a consensus in Israel; (c) in the last fifteen years we have erected a far stronger and more robust economic framework in Israel than existed previously, especially in the areas of the foreign currency market and the financial markets in general; and (d) the business sector, during the war last summer, showed its ability to carry on functioning well and more or less meet its delivery dates for domestic and export orders, and in so doing, contributed to the economy's resilience.

3) Israel's membership of the OECD

The OECD is currently deliberating on the enlargement of the organization, in the run-up to its Ministerial Council meeting in May of this year. The Bank of Israel, together with relevant government ministries, has been engaged in a process which we hope will lead to Israel's membership of the OECD. It is important that this retains its high priority in the work plans of all those in Israel involved in this. Israel's acceptance into the OECD would be an important stage in its further integration into the global economy, as an open and modern economy. I hope that we will achieve this.