Non-Technical Summary

The Effect of the Interaction Between Monetary Policy and Macroprudential Policy on Credit in Israel

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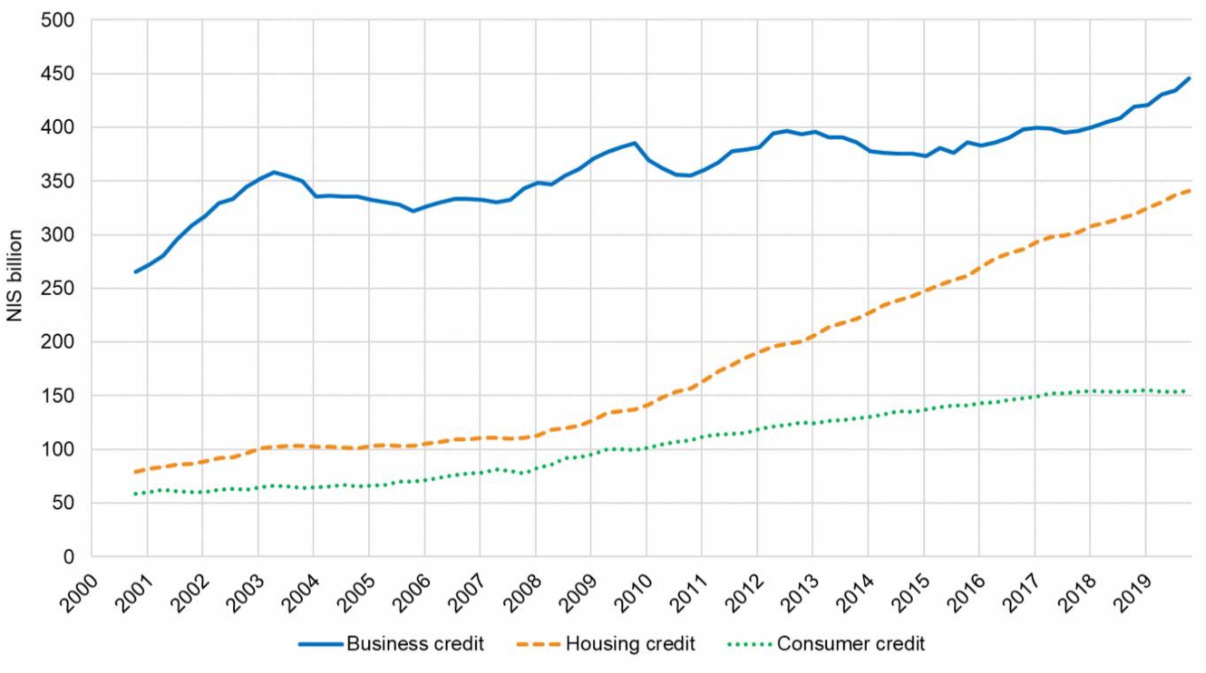
- Between 2004 and 2019, the interest rate in Israel was lowered from about 9 percent to near zero in view of the entrenchment of a price stability environment in Israel.
- Prior to the Global Financial Crisis that began in 2008, increases in the interest rate moderated the growth of credit.
- The study found that following that crisis, lowering the interest rate had a marked effect when combined with macroprudential measures, particularly in the housing market.

A new study published today by the Bank of Israel Research Department examines the effect of monetary policy and the macroprudential measures taken in Israel between 2004 and 2019 on bank housing credit, consumer credit, and business credit. Fig. 1 shows the development of credit in these segments.

Figure 1: Outstanding Bank Credit to Business, Housing and Consumer Segments



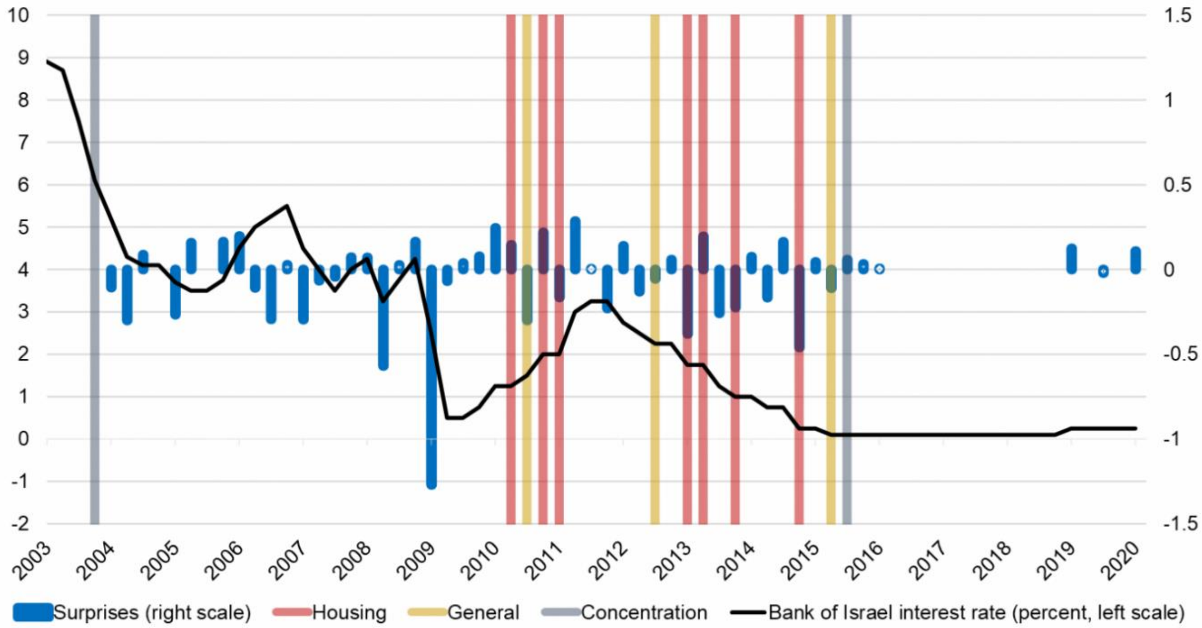
Note: Outstanding credit at the seven largest banks in Israel in billions of Shekel (NIS). Source: Bank of Israel, Banking Supervision Department.

This study was conducted as part of an international project (IBRN), in which researchers from a large number of central banks around the world, led by the Federal Reserve in the US and the Deutsche Bundesbank in Germany, carried out similar studies in their countries. The findings were shared among the participants and were analyzed jointly. The aim of the project is to examine the effect and effectiveness of monetary policy and macroprudential measures on credit, and thereby to formulate insights for policymakers based on international experience.

During the period included in the study, the Bank of Israel interest rate was lowered from about 9 percent to near zero, with some volatility during the period (Fig. 2). This decline took place in parallel with the entrenchment of a price stability environment in Israel. In addition to monetary policy, the Bank of Israel implemented macroprudential measures intended to minimize the risks to the financial system. For instance, it implemented restrictions on borrower groups, restrictions on the share of bank financing in the purchase of a dwelling (LTV), restrictions on the portion of housing loans taken at variable interest rates, capital requirements from the banks, and so forth (Fig. 2).

All in all, the Bank of Israel adopted 20 measures defined as macroprudential measures during the study period. Most of them were aimed at credit in the housing market, while others related to the banks' capital (mainly under the Basel III rules) and limiting exposure to borrower groups.[1]

Figure 2: Monetary Policy Rate, Surprises and Macroprudential Measures in Israel



Note: The columns relating to macroprudential measures show the date they took effect.
Source: Bank of Israel.

[1] The full list appears in Table 1 in the paper.

The study found that the macroprudential measures and monetary policy had an impact on every component of bank credit, particularly housing credit and credit to businesses. The macroprudential measures aimed at the housing market reduced the growth of housing credit, while contributing to the growth of business credit. Other general macroprudential measures (capital requirements from the banks) slowed the growth of business credit, but the effect was as expected with a relative lag, apparently due to the time frame given to the banks to complete the adjustment of capital and risk assets.

An increase in the Bank of Israel interest rate had a statistically significant negative impact on the growth of credit. However, this effect was found to be significant mainly before the Global Financial Crisis of 2008. Following 2008, it seems that the effect of interest rate policy (which was mainly lowered) contributed to an increase in consumer and business credit, but the effect was found to have statistical significance only when combined with the macroprudential measures that were taken, particularly in the housing market.

The study also found that the Federal Reserve's policy was negatively correlated with domestic credit in Israel (lower interest rates contributed to an increase in Israeli domestic bank credit), hinting that the Fed's policy was perceived as a leading indicator of monetary policy in Israel.

Reference

Benchimol, J., Gamrasni, I., Kahn, M., Ribon, S., Saadon, Y., Ben-Ze'Ev, N., Segal, A., and Shizgal, Y., 2021. **The Interaction Between Domestic Monetary Policy and Macroprudential Policy in Israel**, Bank of Israel Working Papers 2021.02, Bank of Israel. Link to the paper