Yaron Amir: Setting goals and embracing innovation to meet the challenges of a changing environment

Remarks by Mr Yaron Amir, Governor of the Bank of Israel, at the opening of the Globes newspaper's "Governors' Conference", Tel Aviv, 1 September 2019.

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Good evening.

I am very happy to have the opportunity to sit here today with three of my predecessors and to discuss core central banking issues—I cannot think of a more appropriate group with whom to hold such a discussion. There is no need for me to introduce the previous governors, but nonetheless, **it is important not to take for granted their achievements,** which placed the Bank of Israel at the forefront of economic activity in Israel and in central banking worldwide, and strengthened the Israeli economy, its stability and its robustness. They led us to the situation in which we can today take the steps necessary to prepare the economy for the challenges of the future.

Prof. Jacob Frenkel was the stabilizing Governor, who drove forward the foreign exchange market liberalization. When he took office, there were those who thought that after we had succeeded in eliminating the hyperinflation of the 1980s, a further decline from the level of 20 percent to a lower level was not worth the cost involved. Jacob led an extended, persistent and committed process, at the end of which Israel reached low inflation, and the economy benefited from stability and certainty for many years in that area. As you know, today we are dealing with inflation that is slightly lower than the target (perhaps it would have been better to work just a drop less, Jacob). Today it is clear to all that this effort was worth it in the long run. Jacob conducted the liberalization process in the foreign exchange market and in the balance of payments, and thanks to him, the overall economy benefits from full openness of the foreign exchange market and from the free flow of funds between the domestic economy and abroad.

Prof. Stanley Fischer is the Governor who successfully withstood the global crisis. Under his leadership, and while the global economy trembled, the Bank of Israel was an island of stability, judgment, original thinking, and brave actions, which instilled confidence in market participants, companies, and the general public, and was one of the factors in Israel's economy being among those that suffered less from the global crisis. Stan determinedly led the legislation of the new Bank of Israel Law, in the framework of which, in contrast to human nature, he led the process of cutting the powers of the Governor, who until that change was almost all-powerful. Due to him, monetary policy decisions today are reached by a committee, which enhances the public legitimacy and the independence of the Bank of Israel in reaching decisions. The Bank also operates, from an administrative perspective, under the watchful eye and guidance of the Supervisory Council. These and other changes did not make the lives of the Governors who succeeded him easier (and I'm not complaining, Stanley—not yet), but they improved and strengthened the functioning of the Bank of Israel.

Prof. Karnit Flug was the Governor who grabbed the bull by the horns and dealt with the fundamental problems of the Israeli economy. Karnit put on the table, clearly, the problem of the Israeli economy's low productivity—maybe the factor that will have the most impact on the welfare of Israel's citizens in the coming decades. Due to a series of research studies and analyses carried out during her term in office, today everyone is able to point to the problem. Karnit's term was characterized by a significant reform in the financial system. Under her leadership, the Bank took on itself the establishment of the Credit Data System, which we launched five months ago; the Bank collaborated with the Ministry of Finance and other entities in designing, legislating, and carrying out the reform to enhance the competition in banking. With the clear recognition of the importance of financial stability, Karnit insisted on promoting the legislation of the Financial Stability Committee, which is an important infrastructure in reducing risks if and when a crisis occurs.

So immense thanks to you, my predecessors, and of course thank you as well to Globes for the distinguished platform you have gathered here. I will take this opportunity to tell my predecessors, and the public, about what has been going on at the Bank of Israel since I took office, and about our plans for the future.

The economic world as we knew it is undergoing great changes. In order to continue to function in a changing environment, and to know how to optimally advance in the face of potential crises, we have to speak, think, and breathe technological, financial, and research-related innovation.

In the first months of my term, we completed several processes that had begun in previous years. As I noted, we went live with the Credit Data System, which is operating satisfactorily. A large number of financial entities, including those not obligated by law, joined the system and began reporting to it and receiving data from it. We also set out the separation of two credit card companies, while ensuring that the parameters of the separation support the goals of the reform. I am also happy to update that the Financial Stability Committee has already met several times and is making progress with the formulation of its tools and work procedures. We presented to the government an extensive and clear analysis on the need to carry out fiscal adjustments. In parallel, we presented a plan to improve the standard of living and productivity in the economy—with an emphasis on operative policy proposals.

We are not blind to the housing issue, and its impact on the young generation. Therefore, I asked the Research Department to begin formulating operative recommendations in the housing area, in order to help the new government identify the order of priorities and to act to remove obstacles that weigh on increasing the supply of homes.

In a joint initiative with the IMF, we are developing a new macroeconomic model, which takes into account two sectors that to date have not been included in the common models—the housing market and the financial system. Recall that these two were among the main factors in the 2008 crisis. The model will serve us in macro assessments but will also contribute to the work of the Financial Stability Committee. In another joint initiative with the IMF, we are working on an international conference on cyber risk in the financial and banking system, with the understanding that looking forward, this is one of the main risks to financial stability.

Given the changes in the global economy, and with eyes to the future, I initiated **a strategic process to define the Bank's goals for the coming years.** The entire management has been enlisted in this process, which is being conducted by the Director General of the Bank, Hezi Kalo. It is not straightforward to carry out such a process in the midst of the ongoing work that is always very intensive, but it was clear to me that we must look beyond the immediate issues. Therefore, we added a slogan to the process—"Working today, thinking about tomorrow". I asked the members of management to think outside the box, and to try to identify the important challenges that the Bank of Israel and the Israeli economy will deal with in the coming years. To that end, we set up several teams, with the participation of tens of staff and managers, in all the relevant areas:

- The first deals with monetary policy in the modern era, and **asks the big questions.** In view of the changes in the global and domestic economies, and in view of the changes that are likely to occur in the structure of money in the modern age, it is crucial to understand how monetary policy should be conducted and what is the toolbox required to do so. Thus, already in the coming year we intend to carry out a process of rethinking the monetary policy framework, and we have already invited senior officials from central banks around the world to come to Israel and participate in a conference we plan to hold on the issue. It is certainly possible that at the end of the process we will reach the conclusion that the current regime is the correct one and there is no need to change it, but we must challenge that thinking from all sides before reaching that conclusion.

- Another team is dealing with the **financial system of the future,** and how to prepare for the changes expected in it. The team is formulating a strategy, the goal of which is to maintain financial stability while aligning the financial and regulatory system to the changing environment, enhancing competition, and implementing innovation. The technological developments that are changing the financial system were at the core of the team's work, as were the challenges deriving from the growth in the number of type of participants in the system, alongside questions raised regarding the role of the Bank of Israel as a main factor in the financial system and in the capital market overall.
- The third team is having a ball. It is focused on **advanced technologies in the digital era.** The team thought about the effects of the digital era on financial infrastructures—open banking, blockchain, digital currencies, and the need to update the payment systems in the economy to an immediate and fast payment system—an area in which Israel lags behind the global frontier. They discussed the contribution of the fintech industry to the Israeli economy, how innovation can be promoted in the financial system and in the economy overall, as well as how to change the Bank itself into a digital and innovative organization.
- Anyone who knows me knows that I **live and breathe research and data.** The fourth team that we established deals with that. I'm afraid that since I took office I have caused more than a few white hairs among the excellent people in the Bank's Research Department and the Information and Statistics Department, with the requirements and requests I set for them. The statistical data are among the main building blocks in a central bank's work. Looking ahead, there will be a need to collect new data of various types from new sources. Big data, visual data, audio-visual, geographic data, artificial intelligence—these are all areas that are being developed at a rapid pace and the Bank will have to examine how to derive the maximum from them in order to fulfill its various functions, and how to make the data accessible to the public in the most efficient and convenient manner.
- We are also looking inward—to the human resource—**the most important asset a central bank has.** We are comprehensively examining our operational setup, what strategy will ensure the adequate inputs for carrying out the Bank's functions over time; and our communication with the public—whether, and how, to adjust how we explain ourselves to the public in view of the sharp changes occurring in the world in communication in general, and in how central banks communicate with the public in particular.

This process is complex and comprehensive. Our goal is **to question every convention,** and to leave no stone unturned. And obviously, our test will be in the implementation. In view of how the entire bank was enlisted into this process, I am sure that ultimately the Bank will be better prepared to fulfill its objectives optimally, in view of our upcoming challenges over the coming years.

And from these lofty ideas, **let's move for a moment to some current issues.**

As you know, last week the Monetary Committee decided to keep the interest rate unchanged, though it conveyed a different message than the one we conveyed in recent months. The message was changed because the data changed—in central banking jargon that is called data dependency. Within a relatively short period of time, we saw a decline in inflation, a change in the direction of monetary policy worldwide, a worsening of the risks to the global economy, and a relatively sharp appreciation of the shekel. We noted with satisfaction that the domestic economy is in a good situation—and indeed, when looking beyond the technical volatility, we see that the economy is growing at a solid pace, the labor market remains tight, and it appears that to date the slowdown in the global economy is not trickling down to the Israeli economy, not even to exports, which continue to grow, particularly due to services exports.

If the economy is in a good state, why did we note that if necessary we will take steps to make monetary policy more accommodative? First, because the trend of inflation changed. It is not clear to us at this point if it is noise in the data—loud noise, to be sure, but noise—or a fundamental decline in inflation. However, it is clear to us that we have to continue to strive and raise the inflation rate toward the midpoint of the target range. Second, the risks have intensified. Should the risks be realized, we will want to act in a timely manner, in order to prevent to the extent possible a slowdown in economic activity. How will we do that? We have a range of tools, and they are all on the table. There are the standard tools, and we are refreshing the toolbox regarding tools that have not been tried here, or have not been used for a very long time.

And one more comment on monetary tools—in recent weeks the issue of the foreign exchange market has been in the headlines. Therefore, maybe this is the time to clarify—I did declare that in principle I would prefer that the exchange rate would be set by market equilibrium, and that was the also the Bank’s approach before I took office. Practically, there is a window of exchange rates that we view as consistent with price stability and economic activity, when we take into account all the factors and variables in the economy. The window is dynamic, and depends on parameters that change all the time, which naturally should not be disclosed.

From this perspective, the Bank of Israel policy on this issue could be called “constructive ambiguity", which is the appropriate policy for a small economy such as Israel; and therefore, if and when the Bank of Israel will assess that the exchange rate has materially deviated from the window that we defined, we may very well intervene in the market—and no one will receive a warning letter from us beforehand.

Thank you!