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Policy makers clash over strategy for strong shekel

Bank of Israel governor plays down shekel's impact, but former officials, trade groups call for exchange rate floor

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Bank of Israel Governor Karnit Flug downplayed the importance of the shekel-dollar exchange yesterday and said the rate has stabilized in recent months. But current and former central bank officials said they supported measures that would set a minimum rate against the dollar.

"The exchange rate is a very important data point that we look at," Flug told the Herzilya Conference, an annual gathering of policy makers, yesterday. "We look at the dollar because of its impact on inflation. In the past, this impact was very strong, while today it is moderate. It has also had an impact on employment and [economic] activity."

Flug said the shekel had experienced a sharp appreciation early last year but that the trend had moderated more recently.

Her remarks came amid growing concern that the strong shekel is undermining the price competitiveness of Israeli exports. The shekel strengthened 7.5% in 2013, but has weakened 0.4% since the beginning of this year and was set at 3.4610 to the dollar yesterday.

In a Knesset Finance Committee meeting yesterday, lawmakers called for the central bank to set a minimum exchange rate for the shekel.

"The Bank of Israel's current policy has failed," said MK Erel Margalit (Labor). "Market speculators are running circles around the Bank of Israel, making a lot of money, and we are not succeeding in defending the shekel."

Meanwhile, the Manufacturers Association, a trade group for the country's biggest industrial companies, reiterated a call to set a floor of 3.8 shekels to the dollar. Israeli high-tech leaders issued similar warnings on Sunday.

"The Bank of Israel chooses to do nothing, like dogs barking while the caravan moves on," the association said in a statement. "Instead of the bank buying as many dollars as necessary to raise the exchange rate to 3.8, the governor continues to ignore the situation and is leading the economy to doom."

But Andrew Abir, the head of the Bank of Israel's markets division, told the committee he had seen no signs of speculative trading recently

At the Herzilya Conference, Zvi Eckstein, a former

Karnit Flug *Erez Harudi*

deputy Bank of Israel governor who now serves as dean of the School of Economics at the Herzliya Interdisciplinary Center, said Israel needed to set a minimum shekel rate as well as cut the bank's base lending rate to zero.

The Bank of Israel's benchmark lending rate is 0.75%, close to its historic low, and economists are expecting the central bank to cut the rate another 0.25 percentage points in the next few months. Eckstein said he was confident an exchange rate floor would not attract speculative attacks.

The risk of lower interest rates is that it will encourage more people to take out home loans and boost housing prices.

"The Bank of Israel's main problem is the link between the interest rate and [the risk of] a housing bubble," he told the conference. "We have to break that link by requiring that mortgages be taken on fixed rates for five years."

Barry Topf, a member of the central bank's monetary committee until last year, said the strong shekel reflects the strength of the Israeli economy.

But economist Omer Maov suggested the government encourage more imports as a way of weakening the shekel.

"Exports are a means, not an end," he said. "Our goal in standard of living. The public shouldn't be subsidizing exporters."