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Israel seen cutting key rate by up to 0.5 pct.
By **Albert Robinson**
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TEL AVIV, Aug 21 (Reuters) - The Bank of Israel is expected to cut its key lending rate next week for the sixth consecutive month on the back of negative inflation in what some economists believe could be one of the last cuts this year.

With consumer prices in July falling a sharper than predicted 0.7 percent and negative inflation of 1.2 percent since the start of the year, economists agree the central bank has room for a cut of up 0.5 percentage points.

The central bank, due to announce its monetary policy for September on Monday at 1330 GMT, has cut interest rates by a cumulative 2.1 percentage points in the past six months, including a 0.5 percentage point cut a month ago to 7.0 percent.

Hit by the global slowdown, Israel has suffered its worst recession in half a century in the last two years, with sinking revenues pushing the deficit beyond its target rate and a rising defence budget due to a 34-month Palestinian uprising straining the budget.

Although he forecasts a cut of up to 0.5 percent in the key rate, Israel Discount Bank economist David Mann says another smaller cut next month will be the last for this year.

"I expected a 0.3 percentage point cut until the consumer price index for July fell more than expected," Mann said. "I now see a cut of 0.4-0.5 percentage point, and a smaller cut of 0.2-0.3 percentage points in September (for October)," Mann said, predicting a key rate of 6.4 percent at the end of 2003.

The central bank will end its interest cut policy with September's announcement since it sees inflationary expectations for the next 12 months close to the top end of the government's 1-3 percent target rate, Mann said.

In addition, the budget deficit is forecast to be twice the 3.0 percent of gross domestic product target rate and the shekel is starting to depreciate.

The shekel-dollar exchange rate plays a crucial role in Israeli inflation since housing, airfares, fuel and imported goods are mostly quoted in dollars. The strength of the shekel in the first seven months of the year has kept inflation in negative territory.

NEGATIVE CPI, RECESSION GIVE ROOM FOR CUTS

Other economists, citing the ongoing deep recession and negative inflation that is likely to produce annual inflation for the year close to zero or even, for the first time ever, a negative figure, say they see room for continuing cuts.

Professor Rafi Melnick of the Herzilya Inter-disciplinary Centre expects the central bank to cut rates by 0.4-0.5 percentage point on Monday and make further monthly cuts of 0.2-0.3 percentage points through the end of the year.

"The recession and high unemployment enable ongoing cuts," Melnick said. "We are living with rates that are far too high at 7.0 percent," he said, predicting a key rate of 5.9 percent by the end of 2003.