RECENT ECONOMIC DEVELOPMENTS*

Main developments

In the first half of 2001 (the period reviewed), the slowdown in economic activity continued, as a result of the persistence of most of the shocks which had afflicted the economy in 2000:IV: security-related and political unrest, the crisis in the capital markets, particularly in the high-tech industries, and the global slowdown. The continuation and worsening of the shocks and the uncertainty they caused led to further contraction of demand in the period reviewed, a fall in the output of the principal industries, a rise in the number of job-seekers, a slowdown in tax revenues, and a significant diversion of resources to meet defense requirements, with an increase in the share of government expenses in GDP and the budget deficit. In contrast to all the above, the foreign-currency market remained stable, with a slight tendency towards depreciation, inflation expectations stayed low, and the real rate of interest declined.

The deceleration in activity was not confined to certain industries, but was evident in most sectors: companies in the hotel and catering industry and in trade had to lay off workers as a result of the steep decline in the number of incoming tourists; activity contracted in unskilled-labor-intensive industries, mainly agriculture and construction, due to the closure of the territories. The crisis in the capital market in Israel and abroad was felt mainly by high-tech firms which had previously been the objects of growing interest on the part of investors, and the easing in world trade and recession in the US caused a drastic fall in the output of export-oriented industries. Thus, following impressive rates of growth during most of 2000 which then became negative at the end of the year, the annual growth rate slowed to a moderate 1.7 percent in 2001:I, due mainly to the ongoing expansion of private consumption. Other uses—exports excluding start-ups, gross domestic investment, and general-government consumption—all declined.

The slowdown and its intensity are reflected in various indices of activity: the state-of-the-economy ("composite") index went down by 3 percent in the last three quarters, after rising constantly in the three previous quarters; the index of manufacturing production (excluding diamonds) declined by 4 percent in the first five months of 2001 from its level in the equivalent period in 2000, when it rose by 10 percent. The index of revenue in trade and services fell slightly in April–May, after declining more steeply in the two previous quarters. A similar picture emerges from the Survey of Companies for 2001:II conducted by the Research Department of the Bank of Israel: the hotel industry reported a sharp decline in tourists' bed-nights and in the average revenue per room; construction companies reported the continued contraction in the extent of implementation of building projects; and manufacturing and trading companies reported lower output, domestic sales and exports. Orders for the next quarter indicate that a further decline in activity is anticipated.

As world trade slowed down in the wake of the deceleration of activity in most of the industrialized countries, Israel's terms of trade deteriorated, contributing to a reduction in goods imports and exports. In 2001:I imports declined faster than did exports, so that the trade balance improved, but the trend reversed in the second quarter and the trade deficit worsened. This was mainly due to the sharp 8.1 percent reduction in industrial exports, especially in high-tech industries which were in the forefront of growth in 2000. The slowdown in economic activity is also clearly reflected in goods imports, which went down by 7.2 percent in the first half of 2001, a combination of the continued decline in the import of production inputs and the halt in the expansion of the import of capital goods.

In the area of fiscal policy, the net domestic budget deficit in the period reviewed came to half of the target for the year, in contrast to the surplus recorded in the equivalent period in the previous three years. The deficit, which reached about 2 percent of GDP by the end of the period reviewed, reflects an upward deviation in government expenses from the seasonal path calculated from planned expenses and the expected slowdown in tax revenues. The slowdown in revenues is due mainly to the deceleration of real economic activity offset by an underestimate of forecast tax revenues, and a lower-than-expected rise in prices. On the expenses side,

* *For diagrams (bilingual) please turn to Hebrew section.*

demands were made to increase the defense budget due to the deterioration in the security situation, and total expenses rose significantly by a 6 percent in real terms, with the share of government expenses in GDP increasing considerably. The deficit for 2001 is expected to exceed the target of 1.75 percent of GDP by up to one percentage point.

Despite the slowdown in economic activity due to the shocks mentioned above, the rate of unemployment in 2001:I dropped to 8.6 percent, below the average rate for the year 2000 (8.8 percent). This was the result of a sharp increase in the number of general-government employees (partly due to the elections), while the number of employees in the business sector fell marginally, especially in the hotel and catering industry, which depends heavily on tourism, and in the high-tech industries, which encountered difficulties due to the crisis in the capital markets. The real wage per employee post rose moderately in the first quarter, by 1.1 percent from the previous quarter (seasonally adjusted, in annual terms), after a steep rise of 6 percent in 2000.

The Consumer Price Index (CPI) rose by 2.2 percent in the period reviewed, slightly slower than the lower figure of the target inflation range for 2001, and consistent with the long-term target. Regarding price rises, the period can be divided into two: in 2001:I the CPI declined,

Table 1. Indicators of Business Activity, 1999–2001
(all data excluding construction are seasonally adjusted)

			2000			2001		Jan–June[a]		
	1999	2000	II	III	IV	I	II	2000	2001	*
Rates of change (annual averages, percent), compared with preceding quarter										
State-of-the-economy index	4.4	4.8	10.1	7.2	–3.2	–3.4	–5.5	6.3	1.5	6
Large-scale retail trade	4.3	10.1	19.8	6.2	10.6	–6	13.2	8.3	6.5	6
Manufacturing production (excl. diamonds)	1.3	9.9	17.9	1.9	–5.2	–0.6	–4.6	11.2	0.9	5
Business-sector consumption of electricity	2.7	7.4	–0.2	7.1	–6.3	11.8	9.7	11.2	3.1	4
Index of revenue in commerce	4.5	10.4	18.1	6.9	–6.1	2	7.2	11.2	4.7	4
Index of total revenue	6.6	10.8	13.4	10.9	–3.6	–7.2	–0.1	12.5	1.9	5
Rates of change (percent), compared with preceding quarter										
Tourist arrivals	8.8	4.5	–5.6	0.4	–44.7	0.7	–13.9	28	–49.5	6
Immigrant arrivals	35.5	–21.6	–3.6	22.8	–0.2	–32.3	–19.2	–5.2	–24.1	5
Residential starts	–14.4	20.7	–4.5	9.1	–14.3	–21.2		31.8	–29.6	3
of which: Government-initiated	–6.5	50.4	32.8	12.9	–30.3	–31.6		49.3	–28.6	3
Residential completions	–14.4	–8	–9	–6.3	–29.5	4.2		15	–37.4	3
of which: Government-initiated	–5.7	–39.5	15.8	–2.8	–17.3	–27.1		–50.4	–32.1	3
Survey of companies (percent)[b]										
Product of manufacturing firms (not adjusted)		9	11	25	27	–12	–6 [c]	–19		6
Product of manufacturing firms (adjusted)		9	11	24	16	–12	5 [c]	–21		6
Net sales by commercial firms (not adjusted)		12 [c]	5	19	20	–25	–11 [c]	–29		6
Net sales by commercial firms (adjusted)		12 [c]	5 [c]	26	7 [c]	–23	–6 [c]	–26		6

* Last month for which data available.
[a] Compared with same period in preceding year.
[b] Difference between the number of firms reporting a rise and those reporting a fall, as a percentage of all reporting firms.
[c] Denotes non-significant result at 5 percent level.

Table 2. National Accounts, 1999–2001
(seasonally adjusted)

	1999	2000	2000 II	2000 III	2000 IV	2001 I	2001 II	Jan–June[a] 2000	Jan–June[a] 2001	*
Rates of change (annual averages, percent, constant prices), compared with preceding quarter										
GDP	2.6	6.2	7.5	9	−9.8	1.7		6.3	1.8	3
Business-sector product	2.4	8.3	10.5	11.2	−16.2	2.5		8.5	1.4	3
Business-sector product excl. start–ups	2.0	5.5	5.8	4.3	−12.9	4.8		6.1	0.2	3
Private consumption	3.2	6.6	9.6	6.9	7.6	10		4.4	8.5	3
Gross domestic investment	9.5	−4.1	−2.2	−51.7	169.9	−11.1		0.4	3.2	3
Gross domestic investment excl. start-ups	6.8	−8.1	4.6	−10	47.6	−10.4		−10.8	5.6	3
Goods and services exports	11.6	23.9	9.7	86.8	−54.7	3.7		25.8	−0.9	3
Goods and services exports excl. start-ups	11.9	19.7	32.9	9	−23.1	−5.9		24	1.2	3
Goods and services imports	14.8	12.2	4.8	15.4	28.4	−10.1		16.1	8.7	3
General government consumption	3.1	1.1	−10.2	6	23.5	−2.4		6.4	3.5	3

** Last month for which data available.*
[a] Compared with same period in preceding year.

continuing the downward trend evident in the previous half year, and in 2001:II prices increased, but this was mainly seasonal, and does not necessarily indicate a change in the inflation environment. Headline inflation (excluding the seasonal items—housing, fruit and vegetables, clothing and footwear) changed in the same direction as the overall index, but was much less volatile.

In the area of monetary policy, in the light of the low rate of inflation, the slowdown in real economic activity, and stable inflation expectations at below the target level for the year 2001, the Bank of Israel's monetary policy in the period reviewed continued to gradually lower the rate of interest, with the intention of maintaining stability while attempting to achieve both the short- and long-term inflation targets. The lowering of the interest rate, together with the stability of inflation expectations for one year forward, resulted in the lowering of the expected short-term real rate of interest from 7.4 percent in December 2000 to 5 percent at the end of the first half of 2001. The cuts in nominal interest also contributed to a rapid expansion of the money supply, which increased by 13.7 percent in the period reviewed.

In the foreign-currency market the trend changed in the course of the period: In 2001:I the NIS weakened by 8.4 percent against the dollar and by 7.2 percent against the currency basket; in 2001:II stability of the NIS against the dollar while the dollar strengthened against the euro brought the NIS/currency basket exchange rate down to about 1 percent above the lower limit of the exchange-rate band. Data for July indicate that the NIS depreciated slightly against the currency basket, the outcome of a small depreciation of the NIS against the dollar and the dollar's weakness against the euro.

During the period reviewed, the public, in the light of the current rate of inflation and the internalization of the low-inflation environment, continued with the process of changing its assets portfolio, increasing the weight of unindexed local-currency assets as opposed to indexed assets (a trend noted also in mutual funds, whose assets are included in the monetary aggregates), while the weight of the shares component in the portfolio fell sharply with the decline in their prices and their lower demand. Trading turnover in the period was low, with steep share price reductions in most principal industries (mainly in 2001:I), against the background of developments in the US stock exchanges.

The principal industries

The unprecedented rates of growth in the first three quarters of 2000 halted suddenly in the fourth quarter with the outbreak of unrest in the territories and the cumulative effect of the world-wide slowdown. The lengthy closures of the territories led to a sharp reduction in the number Palestinian workers, and contributed to the recession in activity in traditional, unskilled-labor-intensive industries; the unstable situation regarding security considerably reduced the number of visitors to Israel, causing much harm to the hotel and catering industry, which depends heavily on incoming tourism; high-tech industries, which hitherto had provided the main impetus to growth, were obliged to cut back their activity in the light of the deepening crisis in the capital markets.

The composite index tells the tale of deceleration in activity: in the last three quarters the index fell by 3 percent (in annual terms), after rising by 7.6 percent in the previous three quarters. The index went down by 4.5 percent in the period reviewed, the outcome of a continuous reduction from January to April, a slight rise in May, followed by a further decline in June. Regarding the components of the index, the import index and the total revenue index both declined in January–May by 2.7 percent, and the index of manufacturing production (excluding diamonds) fell by 4 percent, seasonally adjusted, in annual terms.

Seasonally adjusted National Accounts data show that after the sharp reduction in the rate of growth of GDP in 2000:IV, there was a modest recovery, with a growth rate of 1.7 percent in 2001:I (compared to the previous quarter), mainly based on private consumption, which rose by 10 percent. The rise in consumption, which is not typical of periods of recession and uncertainty, consisted primarily of the purchase of household equipment, apparently due to reduced purchase taxes. Consumption of other durables, e.g., furniture and cars, as well as current consumption, showed signs of slowing down and even dipping, as the increase in the real wage moderated. Among other uses, general-government consumption contracted in 2001:I after rising considerably in the previous quarter because of the surge in defense imports; domestic gross investment dropped by 11 percent as a result of the steep decline in capital stock in principal industries and start-ups, while exports of goods and services, which had expanded exceptionally rapidly during most of 2000, grew only moderately, reflecting exports of start-ups alone after their decline in the previous quarter. On the sources side, the outstanding feature was the negative contribution of the start-ups to business-sector product in both 2001:I and 2000:IV, affecting the overall rate of growth considerably. Goods and services imports went down by 10.1 percent in 2001:I after rising sharply in 2000:IV due to the rise in defense imports mentioned above.

Various industry-related indices clearly indicate the reversal in economic activity: after negative rates of growth in 2000:IV, the index of manufacturing production continued its decline in the first two quarters of 2001, with falls of 0.6 percent and 4.6 percent respectively (Table 1). The number of employees also fell, as did their number of hours worked and their hourly output. In some traditional industries, such as the mining, non-metallic minerals, chemicals, and metal industries, output rose in 2001:I, after falling in the previous quarter, while in electronic equipment, which had hitherto expanded at an impressive rate, a fall in output was recorded, most notably in electronic components.

As activity in other industries eased, there was a slowdown also in residential construction, which had experienced a short-lived recovery in the first three quarters of 2000. This industry, activity in which had accelerated at the beginning of the 1990s with the great influx of immigrants, slowed when that impact had come to an end, and from 1997 till now has been on a downward trend, together with related industries (see Box 1). Various indicators show that the reduction in activity in the period reviewed was affected by both supply factors and demand factors. The demand side was affected by the continued fall in the rate of immigration, the security-related and political uncertainty, the fall in apartment prices and the expectation that this trend would continue. The persistent decline in mortgages taken up by those eligible because of their high real rate of interest also had an effect, while in May the number of mortgages taken up by those eligible rose as the real rate of interest came down, and people realized the benefits to which the Negev Law entitled them. On the supply side, the security-related incidents and the closure on the territories led to a sharp contraction in the number of those employed in the construction industry, and brought in its wake a steep reduction in the number of building starts and an even greater reduction in the number of completions. Building starts and completions initiated by both the ¿eneral government and the private sectors declined in 2001:I from their levels in 2000:IV, starts by 30 percent and completions by 37 percent. Investment in construction slumped by 16 percent in 2001:I compared with 2000:I, and accounted for 7.3 percent of GDP, a decline of 1.3 percentage points from its share in 2000.

The findings reported in the Bank of Israel Survey of Companies for the second quarter of 2001 also indicate that the reduction in construction industry activity continued, and that the main constraint is the low demand. Construction companies also reported that construction time had lengthened, that the extent of

Box 1
The State of the Construction Industry in Recent Years

After several years in which activity in the construction industry has been declining, it remained stable in the first three quarters of 2000, with a 21 percent rise in housing starts. This trend shifted in 2000:IV, as the security unrest began. The main reason for the decline in the demand for housing construction in recent years has been the slower growth rate of the population after the large influx of immigrants in the early 1990s.[1] In effect, the industry has been undergoing a period of adjustment, and its share of GDP is returning to its level in 1989 and 1990. Since 1998 housing prices have declined in real terms, falling by 5.8 percent in 2000.

Apart from the demographic change, there appear to be additional long-term reasons for the falling demand for housing. One of these may be the lower inflation environment, causing a rise in the relative risk embodied in real-estate assets.[2] In addition, many more investment alternatives are available today, including real-estate abroad and a more efficient capital market. The long-term reasons for the fall in demand were supplemented by short-term ones, such as the effect of the business cycle, the high mortgage interest rate (which has been declining consistently since January 2001), and the security unrest which has brought housing sales in certain areas to a virtual standstill.

The security unrest also had an adverse effect on *construction supply*. Before the unrest erupted, some 63,000 workers from the Territories were employed in the industry,[3] accounting for a quarter of all employment in it. Since the security unrest the majority of these workers cannot get to work, and certainly not on a regular basis. The number of work permits dropped to 8,000 in April 2001, and since June this year a total closure has been imposed on the Territories. The impact on supply was partly offset by replacing workers from the Territories with foreign and Israeli workers.[4] Despite the adverse effect on the supply of work in the industry, according to the Companies Survey, the main restriction on the expansion of activity in it at present derives from demand.

The fall in demand and the rise in the number of building starts in 2000 led to an ongoing increase in the supply of new apartments. The stock of privately-constructed housing reached a peak at the beginning of 2001—over 19,000 apartments.[5] In order to help contractors sell their stocks, the Ministry of Housing has prepared a 4-month plan intended to increase demand in various ways,[6] but it does not seem to have had the desired effect of turning the demand trend for construction around.

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[1] At the beginning of 2001 immigration to Israel was significantly lower than in the last few years (Table 1).

[2] Yona Rubinstein (2001). "Housing Prices in Israel, 1974–96; a Financial Bubble?" in Leo Leidermann (ed.) *Inflation and Disinflation in Israel*, Bank of Israel.

[3] In 2000:III, including illegal employees. Most workers from the Territories were employed illegally; during this period only 21,500 work permits were issued.

[4] The Labor Force Survey for 2001:I indicates a 3.6 percent rise in employment (seasonally adjusted), and it is reasonable to assume that this rise would be steeper were it not for the fact that the number of foreign workers rose concurrently.

[5] Since January the stock has been declining, due to the rise in the number of units sold and a fall in building starts. The stock of apartments was 16,768 at the end of April (private construction, preliminary figures).

[6] At the beginning of June the socio-economic cabinet approved parts of the plan: an additional mortgage of NIS 100,000, half of it a grant for eligible persons, in two designated areas (Har Homa, Pisgat Ze'ev), and mortgages increased by NIS 50,000, half of it a grant for homeless and eligible persons, in 16 localities.

building starts and completions had fallen, and that they had low expectations that these projects would be implemented in the following quarter. Contraction in the construction industry greatly affects industries which supply it with inputs, such as mining and quarrying, and building materials, and those companies reported a fall in domestic sales and in the number of employees. The Survey also reports lower output in nearly all industries, from the traditional ones to the most advanced, a fall in exports and domestic sales with an increase in the stock of finished goods, and a decline in orders received, which serve as an indicator of future activity. A similar picture emerged regarding trade, transport, business services, and hotels; hotels, hard hit by the security situation, reported a sharp drop in the bed-nights of foreign tourists for the third quarter in succession, with expectations of further reductions, based on reservations received for the following quarter. The findings of the Survey of Companies are supported by data of the Central Bureau of Statistics (CBS): in the first five months of 2001 total bed-nights in tourist-grade hotels totaled 5.84 million, 26 percent lower than in the same months in 2000.[1] The reduction in the number of bed-nights in 2001 is the result of a 57 percent reduction in tourists' hotel bed-nights, offset in part by a rise of almost 22 percent increase in bed-nights of Israelis, apparently due to cuts in hotel rates.

The revenue index of hotels and catering is consistent with the drop in demand for the industry, and it was 3.3 percent lower (up to April) than in the equivalent period in 2000. The revenue index of business services declined even more drastically, by 4.5 percent. The revenue index of trading industries rose by 4.7 percent from its level in the equivalent period in 2000, having risen in the second and third quarters of 2000, fallen in 2000:IV, and risen moderately in the period reviewed.

The labor market

Data relating to 2001:I show that the number of employees increased faster than did the civilian labor force, so that the rate of unemployment went down to 8.6 percent (seasonally adjusted).[2] The rise in the number of employees was particularly notable in the general-government sector (partly due to the elections), while the business sector was affected by the slowdown in economic activity. The adverse effects can be traced to three main causes: first, the deterioration in the security situation deterred tourist, and caused much damage to trade, and hotels and catering. Second, the slump in the number of Palestinian workers, which reached about 70 percent, affected primarily those industries employing unskilled labor, such as agriculture. Third, the collapse of the capital markets in Israel and abroad saw many employees being laid off in computers, R&D, and banking and financial services. Calculations performed by the Research Department of the Bank of Israel show that the business sector made a positive contribution of 0.6 percentage points to unemployment. In contrast, the general government sector absorbed workers faster than the rate of increase in the labor force, thereby contributing 0.9 percentage points to the reduction in the rate of unemployment.[3]

In 2001:I the rate of unemployment went down to 8.6 percent (seasonally adjusted), the same rate as in 2000:I. The economic slowdown and the sense of uncertainty among employers regarding its future path affect the structure of employment. Since the outbreak of the *intifada*, utilization has fallen, in other words, the number of employees in full-time positions has gone down, and at the same time the number in part-time positions, and the number of those temporarily absent from their jobs, have risen. It is reasonable to assume that if the slowdown persists for a long time, employers will have to lay off more workers, and the number of those in part-time jobs may fall.

The security events affected employment in two directions: the slump in the number of tourist entries since October 2000 depressed activity in hotels and catering and trade, and led to a steep fall in the number of employees in those industries. On the other hand, the fact that Palestinian workers could not leave the territories caused a substitution effect, increasing the number of employees in construction, textiles, rubber and plastic goods, etc. Moreover, as the security situation deteriorated, the number of employees in guarding and security rose. The number of employees in high-tech industries, which were also hit by external shocks, and the number of degree-holders seeking

[1] In the equivalent period in 2000, however, bed-nights of foreign tourists were exceptionally high due to the Pope's visit to Israel in March.

[2] According to CBS trend data, the percent of unemployed persons in April and May did not change.

[3] The contribution to the number of unemployed is calculated as the difference between the number of workers who would have been employed if employment would have increased at the same rate as did the civilian labor force, on the one hand, and its actual increase, on the other.

Table 3. Indicators of Labor Market Developments, 1999–2001
(seasonally adjusted)

			2000			2001		Jan–June[a]		
	1999	2000	II	III	IV	I	II	2000	2001	*
			('000s)							
Civilian labor force	2,344	2,436	2,436	2,452	2,458	2,477		3.6	3.3	3
Israelis employed	2,136	2,223	2,227	2,233	2,240	2,263		3.8	3.3	3
Business sector	1,491	1,559	1,560	1,570	1,568	1,566		4.2	1.9	3
General government	646	662	673	661	666	693		2	6.7	3
Average hours worked per employee	37	38	38	38	38	37		1.9	–1.1	3
Business sector	40	41	40	41	40	40		3.3	–1.9	3
General government	31	31	31	32	31	31		1.2	–1.1	3
Labor input of Israelis employed	79,564	83,987	84,538	84,628	84,168	83,958		5.8	1.6	3
Business sector	59,398	63,415	63,597	64,070	63,444	62,613		7.5	0.1	3
General government	20,167	20,573	20,941	20,558	20,724	21,345		0.9	6.4	3
Claims for unemployment benefit	108	106	102	103	106	109	111	–1.4	3.2	6
Work seekers	158	165	163	168	167	174	179	2.2	8.9	6
Real wage[b] per employee post (NIS)	4,304	4,564	4,489	4,578	4,687	4,700	4,712	6.9	4.7	4
of which: Business sector	4,410	4,690	4,626	4,685	4,837	4,857	4,697	7.3	4.6	4
Unemployment rate (%)	8.9	8.8	8.6	8.9	8.9	8.6				3

* Last month for which data available.

[a] Percent change compared with same period in preceding year.

[b] At 1994 prices.

employment increased (according to data from the Employment Service). The number of employees in the general government sector expanded mainly in public administration, the health and welfare services, but a significant part of the increase was of a one-time nature, resulting from the elections.

The rate of increase of the real wage in the period reviewed was lower than that in 2000. The real wage per employee post, which rose by 6 percent in 2000, largely due to the rise of the share of positions in high-tech and the lower-than-expected rate of price increases, slackened, rising from 2000:IV to 2001:I by only 1.1 percent (seasonally adjusted, in annual terms). The slowdown was evident in both the general-government sector and the business sector, and was due to the slowdown in economic activity, and the internalization of the low-inflation environment. The reductions occurred mainly in construction, agriculture, hotels and catering, and banking, while in transport and communications and business services the real wage rose.

The rapid rise of the business-sector wage, the elections for Prime Minister, and the fact that no wage agreements for 1999 and 2000 were signed, resulted in the General Federation of Labour (the New Histadrut) declaring a general labor dispute in the general-government sector, including government offices, the government corporations, the local authorities, etc. On 22 January 2001, as no real progress had been made in negotiations, employees instituted sanctions, and it was eventually agreed that they would receive a wage rise of 3.6 percent for 2001 as well as a one-time additional payment. The agreement, which did not satisfy all the demands of the workers, ensured industrial peace until July 2001, with a government commitment to renew negotiations at that time regarding the outstanding claims. On 1 April 2001 the minimum wage and the wage of the most senior general-government personnel was raised by 10.2 percent, similar to the rise in the average wage. It was decided, however, that henceforth, the wage of new senior general-government personnel will be linked to the CPI, and not as hitherto to the average wage.

According to the aspects of unemployment usually used as indicators of hard-core unemployment, there was some slight improvement in 2001:I: the proportion of young people in the unemployed rose from what it was in 2000:I, and the share of married persons declined. The length of time spent job-hunting and the period of unemployment were shortened (seasonally adjusted data).

The balance of payments

The trend of a slackening in world trade, essentially led by the recession in the US economy, was reflected in Israel's foreign trade too. Since the beginning of the year, exports have fallen by 8.7 percent, and imports by 7.1 percent (monthly averages, seasonally adjusted). The two quarters differed, however: in the first, imports declined by more than did exports, so that the trade deficit improved slightly; in the second quarter the opposite was the case, and the trade deficit increased. The turnaround in 2001:II derived essentially from the rapid decline, 8.1 percent, in industrial exports, especially in high-tech industries, which went down faster. This reduction encompassed most industries, but the most marked occurred in electronic components, whose exports plunged by almost 30 percent in the period reviewed. Exports of electrical equipment, motors, and textiles rose in the period. Imports of production inputs, which provide an indication of current activity and which account for more than half of total goods imports, declined in the last three quarters, with an even faster drop in the period reviewed. With regard to the composition of goods imports by principal use, imports of consumer goods rose by 8.1 percent in 2001:I (from the previous quarter), but fell at an even faster rate in 2001:II, due in part to a sharp drop in the import of vehicles; imports of capital goods, which point to the level of future activity, slowed in 2001:II, after rising constantly in the previous three quarters.

The share of exports to the EU increased in the period reviewed, at the expense of those to Asia and the US went down. In imports, however, the share from the US increased.

Table 4. Balance of Payments, Foreign Trade,[a] and the Reserves, 1999–2001
($ million, current prices)

			2000			2001		Jan–June		
	1999	2000	II	III	IV	I	II	2000	2001	*
Monthly averages										
Trade deficit	434	310	251	312	310	301	318	308	310	6
Goods imports	1,852	2,092	2,057	2,158	2,166	2,128	2,012	2,021	2,070	6
Consumer goods	328	375	363	386	389	421	366	363	394	6
Capital goods	446	494	481	499	510	518	518	483	518	6
Intermediates	1,077	1,221	1,212	1,272	1,264	1,187	1,126	1,173	1,157	6
Goods exports	1,419	1,782	1,806	1,846	1,856	1,827	1,694	1,713	1,760	6
Manufacturing	1,352	1,721	1,743	1,783	1,799	1,774	1,631	1,652	1,702	6
Quarterly averages										
Net current account	–761	–354	–738	–147	–159			–555		12
Financial account (excl. foreign-currency balances)	633	588	544	477	564			655		12
Nonresidents' direct and portfolio investments	1,119	1,926	1,952	2,324	843			2,269		12
Israeli residents' direct and portfolio investments	267	1,178	1,701	1,934	946			916		12
Net foreign debt (% of GNP)	9.82	6.48	7.66	7.07	6.31			7.7		12
End-period Bank of Israel reserves	22,515	23,164	22,187	22,076	23,164	23,840	23,072	22,187	23,072	6

* Last month for which data available.
[a] Foreign trade data are seasonally adjusted monthly averages (excluding ships, aircraft, diamonds, and fuel).

Some of the trends in the trade balance can be explained by the deterioration in Israel's terms of trade, after their continuous improvement in 2000. The rise in prices of imports and fall in prices of exports in 2001:I (excluding diamonds, airplanes and ships) resulted in a 0.7 percent lowering of Israel's terms of trade (compared with 2000:I). The rise in import prices came from higher prices of consumer durables and of imported production inputs. On the export side, the 1.2 percent fall in prices of industrial exports was marked, most notable being the 2.8 percent drop in prices of electronic components and computers, and the 1.6 percent reduction in export prices of communication equipment and medical control equipment.

Despite the domestic and external shocks which Israel experienced in the first half of 2001, the NIS remained relatively stable, mainly due to the fact that opposing forces were exerted in the foreign-exchange market, offsetting each other. The considerable reduction in nonresidents' investments in Israeli securities—which started at the end of 2000:IV with the collapse of prices on the US stock exchanges and continued in the period reviewed—exerted upward pressure on the exchange rate. The increase in foreign-currency credit, which according to data from the Foreign Exchange Control Department was $ 1.1 billion higher than in the equivalent period in 2000, acted in the opposite direction, putting downward pressure on the exchange rate. The increase in credit was caused by the difficulty which companies face in trying to raise capital via stock exchanges in Israel or abroad, and by the widening of the effective interest-rate differential resulting from the faster reduction in the dollar interest rate than that in the NIS interest rate and from the decrease in Israel's risk premium.[4]

The NIS/currency-basket exchange rate continued to move within the band in the period reviewed, without Bank of Israel intervention in the foreign-currency market, despite the fact that towards the end of the period the strengthening of the dollar against the euro and the stability of the euro against the NIS brought the currency-basket exchange rate to only 1 percent above the lower limit of the band. The Bank of Israel's foreign-exchange reserves totaled $ 23.085 billion at the end of June 2001, slightly below their level at the end of 2000. This level of the reserves after offsetting the whole of Bank of Israel's profits was reached due to the strengthening of the dollar against other currencies in which the reserves are held, and due to a reduction in the government's foreign-currency deposits.

[4] Israel's risk premium taken into account by markets abroad was assessed at 1.2 percent in December 2000, and 0.7 percent in June 2001. The long-term (10-year) risk premium went down in the same period from 2.1 percent to 1.6 percent.

World economic developments and their implications for Israel

After impressive growth rates at the end of 1999 and the beginning of 2000 in both the advanced and the developing countries, there was a marked slowing of global growth. This slowdown, whose intensity far exceeded expectations, was led primarily by the slump in the US economy, but also derived from the cessation of Japan's economic recovery and the moderate growth rate displayed by the members of the EU and several emerging economies. Before the slowdown which, according to IMF and OECD estimates, was evident in most advanced economies, the growth rate exceeded that of potential GDP, was accompanied by soaring oil prices, and created inflationary pressures that impelled central banks to raise interest rates. The acceleration of inflation and the subsequent interest-rate hikes, against the backdrop of share prices that exceeded their real value contributed to the decline in share prices (especially those of high-tech companies) on world stock markets, and the slowdown that affected many economies. The slowing of growth rates was less marked in the developing countries and more notable in the advanced ones, where high-tech industry has contributed significantly to economic activity.

Quantitative indices of foreign trade in the advanced economies rose in 2001 by half their 2000 growth rate (Table 5), primarily expressing the damage incurred by countries with close trading ties with the US. Israel, whose 1999 growth rate was impressive due to the rapid expansion of exports in general, and high-tech exports in particular, was among them. According to estimates, inflation in most of the advanced countries is expected to fall in the next two years, stabilizing at the levels that characterized it before it rose in 2000. The expected deceleration of inflation is based on the assumption that world oil prices will decline, and this depends to a great extent on Opec's decision on oil production quotas. The moderation of oil prices in 2001 and the intensification of the economic slowdown impelled the Federal Reserve to cut interest rates rapidly by 2.5 percentage points in the first half of 2001, after they had risen during 2000. The reduction of the interest rate, which was intended to help the manufacturing sector finance its activities, on the one hand, and increase demand, on the other, could bring the

Table 5. Indicators of Economic Development in Advanced and Developing Countries,[a] and Forecast for 2002

	1999	2000	Estimate 2001	Forecast 2002
Annual rate of change[b]				
World GDP				
Total	3.5	4.8	3.2	3.9
Advanced countries	3.4	4.1	1.9	2.7
Developing countries	3.8	5.8	5.0	5.6
World trade				
Total	5.3	12.4	6.7	6.5
Advanced countries				
Imports	7.9	11.4	6.7	6.5
Exports	5.0	11.4	6.2	6.2
Developing countries				
Imports	1.6	16.9	8.8	7.9
Exports	4.1	15.7	7.1	7.0
Inflation (CPI)				
Advanced countries	1.4	2.3	2.1	1.8
OECD (excl. Turkey)	1.4	1.7	2.1	1.9
Developing countries	6.7	6.1	5.7	4.8
Prices of unprocessed goods (US$)				
Oil	37.5	56.9	–9.6	–11.8
Other	–7.1	1.8	0.5	4.5
Short-term interest[c] (%)				
Dollar deposits	5.5	6.5	4.6	4.4
Yen deposits	0.2	0.2	0.3	0.2
DM deposits	3.0	4.4	4.4	4.3
Unemployment rate				
OECD countries	6.8	6.3	6.3	6.3

[a] According to “World Economic Outlook,” Israel is classified as an advanced country.
[b] Apart from interest and unemployment rates, which are shown as percentages.
[c] 3-month rate.
SOURCE: “World Economic Outlook” (IMF), May 2001, and OECD “Economic Outlook,” May 2001.

process of emergence from recession forward to the second half of 2001—but given an environment of slack capital markets, tight credit, and investors’ risk-aversion, the process might take a long time.

The rapid pace of interest-rate reduction by the Federal Reserve in the first half of 2001 served to widen the interest-rate spread, making it easier to administer monetary policy. Nonetheless, the period reviewed was characterized by local-currency depreciation against the currency basket and the dollar, by 0.6 and 3.5 percent respectively, in the context of relatively sparse capital inflow as well as increased demand for foreign currency—apparently due to the political and security uncertainty.

The public sector

The 2001 budget, which was prepared in 2000 (before the security unrest) and approved in March 2001, encountered unforeseen developments on both the expenditure and the income sides. On the expenditure side, additional budgetary demands were made, primarily due to increased defense requirements, the need to finance the February elections, the wage agreements signed at the beginning of the year, and the introduction of private legislation such as the Large Family Law. On the income side, revenues dipped as a

Table 6. The Budget and its Financing, 1999–2001
(cash flows, as percent of GDP)

	1999	2000	2000 II	2000 III	2000 IV	2001 I	2001 II	Jan–June[a] 2000	Jan–June[a] 2001	*
1. Government domestic expenditure	36.7	36.4	35.2	34.2	38.2	33.9	41	36.6	37.5	6
2. Government receipts	33.8	35.9	35.8	34.6	33.6	35.3	35.6	37.7	35.5	6
3. Domestic budget deficit (1 – 2)	2.9	0.5	-0.6	-0.4	4.6	-1.4	5.4	-1.1	2.0	6
4. Government and Jewish Agency domestic deficit[b] (5 + 6)	3.0	-0.4	-2.9	0.3	4.4	-2.6	3.8	-3.4	0.7	6
5. Government net borrowing from the public	2.0	0.2	2.0	-2.6	-0.4	1.0	4.9	2.0	2.9	6
6. Public-sector injection (9 – 8 – 7)	1.0	-0.6	-4.9	2.9	4.9	-3.5	-1.0	-5.4	-2.3	6
7. Bank of Israel injection	-0.1	0.6	6.1	-2.9	-5.2	5.5	2.1	5.6	3.8	6
8. Private-sector foreign-currency conversions	-0.1	-0.1	-0.1	-0.1	0.0	-0.5	-0.2	-0.2	-0.4	6
9. Change in monetary base	0.9	0.1	1.3	0.3	-0.4	2.0	1.1	0.2	1.6	6

* Last month for which data available.
[a] Compared with same period in preceding year.
[b] Including non-budgetary injection.

result of the moderation of economic activity, lower than forecast price levels (i.e., a fall in nominal tax receipts), and tax concessions extended to residents of the Negev region. In addition, there was uncertainty regarding aid from the US in the wake of the election of a new President there. Hence, if the nominal expenditure ceiling is maintained the 2001 deficit is expected to deviate from the target (1.75 percent of GDP) by NIS 3 billion– NIS 5 billion (0.7–1.0 percent of GDP).

The government's net domestic deficit (excluding credit extended) was NIS 4.3 billion in the period reviewed, due to a surplus of NIS 1.5 billion in 2001:I and a deficit of NIS 5.8 billion in 2001:II. This deficit accounts for half the annual deficit target—NIS 8.4 billion—compared with a surplus in the same period in the last three years. To date, the estimated departure from the seasonal path (which is consistent with the deficit target of 1.75 percent of GDP) has amounted to NIS 3.8 billion.[5] This departure is due in part to the assymetric effects of the slowing of price increases on the income and expenditure sides. Whereas revenues moderated by NIS 2.5 billion due to the slower rise in prices than was assumed when the budget was prepared, expenditure deviated from the budget's nominal framework. To date, government spending has exceeded the seasonal path by some NIS 900 million, rising by 6 percent in real terms, due to an 8 percent drop in 2001:I and a 17 percent rise in 2001:II (relative to the same period in 2000).

After a steep rise in the government's tax receipts in 2000, these have begun to dip, largely due to the growing economic slowdown, especially in the high-tech industry. In the first half of 2001 the share of taxes in GDP remained unchanged, and total receipts amounted to NIS 75 billion—up by 2.5 percent over the first half of 2000. This rate of increase constitutes a markedly slower rise in receipts, as in the first half of 2000 these went up by 19.7 percent over the equivalent period in 1999. The slowing of tax receipts can be explained by the moderation in income-tax revenues, reduction of purchase taxes in August 2000, sharp fall in imports of consumer goods—which are tax-intensive—and the lower than expected level of prices.

As a result of the increasing rise in defense needs, alongside the fall in tax receipts, it was decided in May to divert budgetary resources from the various government ministries to the Ministry of Defense and

[5] Although at present the deviation is NIS 6 billion, NIS 2.2 billion of the shortfall in revenues of is explained by a technical change in the seasonal funding path of the National Insurance Institute, which was obliged to invest all its surplus income in government bonds. This year the Institute chose to delay the purchase of the bonds, after encountering cash-flow problems due to a delay in the government transfer of finance for part of its activities. This delay influences the timing with which income is recorded in the budget but is not expected to affect total income for 2001 as a whole.

the Ministry for Public Security, in order to minimize the deviation from the annual deficit target. It was also decided that the amount required would be obtained by deducting 4 percent from the purchasing budget of each ministry as well as by altering specific budget items.

To date, most deficit financing has come from domestic borrowing, while privatization receipts have been relatively slight (NIS 144 million). The government's foreign deficit was NIS 0.7 billion lower in the first half of 2001 than in the equivalent period in 2000, and amounted to NIS1.8 billion, in spite of an NIS0.8 billion increase in expenditure abroad.

Transfers to households via the National Insurance Institute were up by 13.7 percent over the equivalent period in 2000 (until May). The rise encompassed most categories, the steepest increase being in income support, which soared by 23.3 percent. Old-age and survivors' pensions, which constitute a third of all national insurance payments, were up by 12.4 percent over the same period in 2000.

Prices, and the money and capital markets

An examination of the development of the CPI since the beginning of the year shows that after a cumulative 1.9 percent decline in 2001:I, the inflation rate accelerated and in the period reviewed it amounted to 2.2 percent (in annual terms). This rise is explained mainly by seasonal price increases that characterize Q2, as well as by the rise in energy prices. On the basis of the inflation rate in the last 12 months, expectations for a year ahead, and forecasts by various economic entities, inflation in 2001 will be in the region of the lower limit of the target for the calendar year (2.5–3.5 percent), and within the long-term range (1–3 percent).

The direction of change of the basic CPI, adjusted for housing and fruit and vegetables, resembled that of the unadjusted CPI. The rise in 2001:II, after a decline in 2001:I, was largely due to the shift in the price of fuel and oils, primarily via the transport and communications, and housing services items, which together make up 40 percent of the CPI. The index of housing prices grew continuously during the period reviewed, rising by an overall **(**4.4 percent (in annual terms).

Inflation expectations in 2001, calculated from the gap between the yields on nominal and CPI-indexed bonds, declined in the first half of 2001, and averaged 1.6 percent. An examination of their trend during the period reviewed reveals that they maintained a low level of volatility, varying by not more than one percent, reaching their lowest level—1.3 percent—in April. The decline in expected inflation and its entrenchment at a level below the target is particularly noteworthy in view of the fall in share prices on the Nasdaq, the elections for the prime minister, and the deteriorating security situation. It appears to be the result of both the intensification of the economic slowdown and the cautious monetary policy adopted. The fall in inflation expectations is expressed not only in the framework of the coming year, but also for the longer term, as reflected in the shift in the composition of the public's asset portfolio, with a rise in long-term local-currency deposits alongside departure from CPI-indexed savings

Table 7. Selected Price Indices, 1999–2001
(annual rates of change during period, percent)

			2000			2001		Jan–June		
	1999	2000	II	III	IV	I	II	2000	2001	*
CPI	1.3	0	6.6	–3.3	1.9	–1.9	6.6	0.8	2.2	6
CPI excl. housing, fruit and vegetables	1.7	0.9	6.5	–3.6	1.5	–3.5	6.6	3	1.4	6
CPI excl. housing, fruit and vegetables, controlled goods, clothing and footwear	2.4	0.6	4.6	–1.3	–2.2	–1.6	5.9	3.1	2.1	6
Index of housing prices	–0.9	–2.4	12.3	–5.8	3.2	7.4	1.6	–3.4	4.4	6
Wholesale price index	3.5	2	9.7	–1.6	1.4	–4.2	5	4.1	0.3	6
NIS/$ exchange rate	0.4	–2.7	10.7	–6.5	4.3	8.4	–0.2	–4.1	4.0	6
NIS/currency-basket rate	–2.5	–6.3	8.2	–14.6	6.2	7.2	–6.3	–7.8	0.2	6

** Last month for which data available.*

Table 8. Monetary Indicators and Nondirected Bank Credit, 1999–2001
(percent change, annual terms)

	1999	2000	2000 II	2000 III	2000 IV	2001 I	2001 II	Jan–June 2000	Jan–June 2001	*
Rates of change	(average)		(compared with preceding quarter)					(during period)		
M1[a]	9.6	11.0	10.6	13.9	6.5	11.2	22.1	1.6	13.7	6
M2[b]	21.0	20.7	12.8	19.7	22.6	21.0	11.6	17.1	14.2	6
M3[c]	21.8	19.7	12.4	16.9	18.6	23.0	10.9	17.0	14.4	6
Nondirected bank credit	16.7	13.1	10.2	11.3	10.9	11.5	9.5	10.9	10.0	6
Unindexed local-currency	18.2	25.2	25.9	14.9	15.8	22.0	11.2	33	15.3	6
CPI-indexed	15.4	6.9	2.1	13.5	–2.7	0.3	5.5	3.3	4.1	6
Foreign-currency-indexed and denominated	17.3	9.5	5.3	3.1	30.6	17.1	13.5	–0.4	12.8	6

* Last month for which data available. Some data for the last quarter are based on preliminary data.
[a] Narrow money supply (cash in the hands of the public and demand deposits).
[b] M1 plus short-term local-currency deposits.
[c] M2 plus foreign-currency-indexed and denominated deposits.

schemes. This trend attests to the public's perception of the decline in inflation as not being ephemeral, and to its belief in the ability of current policy to attain the long-term inflation target (see Box 2).

As a result of the low inflation environment and the moderation of real economic activity (as reflected in the widening output gap), the Bank of Israel continued to reduce the interest on banks' deposits during the period reviewed by a total of 1.4 percentage points, to stand at 6.8 percent (and by another 0.3 percentage points in July). As a result of this and the relative stability of expectations, expected real short-term interest declined from 7.4 percent in December 2000 to 5 percent during the period reviewed. Real long-term interest rates—such as the yield to maturity on 5- and 10-year government bonds and mortgage interest—also fell.

Total nondirected bank credit grew by 10 percent (in annual terms) during the period reviewed, more slowly than in 2000. The expansion of credit was accompanied by a rise in the share of credit denominated in and indexed to foreign currency as well as in that of unindexed local-currency credit, while that of CPI-indexed credit fell. Alongside the increased exposure on the foreign-currency liabilities side, there was stability in foreign-currency assets: total deposits denominated in and indexed to foreign currency (primarily of corporations) rose in the first half of 2001 at a similar rate to that evident in the preceding two years.

M1 expanded by 13.7 percent (in annual terms) in the period reviewed, exceeding its 2000 rate. This is significantly above the current growth rate and constitutes an aberrant development, but in a situation with a growing output gap it is reasonable to expect that upward pressure on prices will ease. An examination of the public's asset portfolio shows a slowing in the accrual of short-term local-currency deposits (up to a year) compared with 2001: during the period reviewed the gap between the growth rates of M1 and M2 was 0.5 percent compared with 15.5 percent in the equivalent period in 2000. By contrast, accrual of unindexed long-term local-currency deposits accelerated, and in the first half of 2001 they rose by an annual rate of 50.4 percent. Concurrently, there was ongoing withdrawal from savings schemes and departure from long-term CPI-indexed deposits.

The transition to unindexed local-currency assets was also characteristic of mutual funds. The total sources of mutual funds based on local currency and specializing in unindexed local-currency assets rose significantly in the period reviewed——from a monthly average of NIS830 million in 2000 to NIS2.1 billion in January–May 2001. Concurrently, redemptions from mutual funds specializing in and based on shares persisted. Preference for the local-currency channel is evident in the development of the composition of the funds' asset portfolio over time: unindexed local-currency assets accounted for 75.2 percent of the funds' total assets in May 2001, compared with 52 percent at the beginning of 2000. By contrast, the proportion of shares and convertible securities fell from 31 to 12 percent in this period.

Table 9. Interest Rates, Yields, and the Share-Price Index, 1999–2001

			2000			2001		Jan–June		
	1999	2000	II	III	IV	I	II	2000	2001	*
Nominal interest										
Nondirected local-currency credit	16.4	12.9	13.0	12.6	11.8	11.1	10.5	13.7	10.8	5
Average monetary loan	12.4	9.3	9.5	9.1	8.4	7.7	7.0	9.9	7.3	6
SRO deposits	10.7	8.0	8.1	7.7	7.0	6.5	6.0	8.6	6.3	5
3-month Eurodollar	5.3	6.4	6.5	6.6	6.6	5.2	4.1	6.2	4.6	6
Yield to maturity on Treasury bills	11.4	8.8	9.0	8.8	8.3	7.3	6.6	9.1	6.9	6
10-year bonds	5.2	5.5	5.2	5.7	5.7	5.4	4.9	5.2	5.2	5
5-year bonds	5.6	6.0	5.7	6.2	6.2	5.7	5.0	5.8	5.4	6
General Share-Price Index (points)	181.4	248.6	251.0	262.4	226.4	202.5	196.5	252.9	199.5	6
Expected inflation (gross)	5.3	2.5	3.4	2.4	1.6	1.8	1.4	3.0	1.6	6
Interest derived from expected inflation (gross)	5.7	6.0	5.5	6.2	6.5	5.3	4.9	5.8	5.1	6

** Last month for which data available.*

Domestic and external shocks hit the Tel Aviv Stock Exchange (TASE), and it suffered from falling share prices for most of the period, with a modest level of involvement by the public, expressed in low turnover. The General Share-Price Index, which fell by a total of 13.2 percent in the period reviewed, with the steepest drop occurring in 2001:I, reflected declining share prices in most industries, chief among them manufacturing, electricity and electronics, as well as in those of holding companies. The Nasdaq, which plummeted by 39.3 percent in 2000, did not rally in the period reviewed, continuing to fall by a total of 12.2 percent. Most of the decline occurred in 2001:I due to the publication of a series of profit warnings, while there seemed to be some recovery in 2001:II, primarily in view of the Fed's interest-rate policy and the publication of some encouraging figures regarding economic activity.

Box 2
Inflation Expectations for 12 Months. and the Probability Index for Attaining the Inflation Target, Based on Data from the Companies Survey, 1987:I to 2001

In the framework of the Bank of Israel's Companies Survey, some 550 participating business-sector firms submit quarterly reports of their inflation expectations for the next twelve months. An examination of their replies makes it possible to construct the distribution of inflation expectations for twelve months ahead. Note that there are two other sources: expectations derived from the capital market and the inflation forecasts of private forecasters; these are received more frequently, but do not present a distribution, unlike the reported expectations in the Companies Survey.

An analysis of the inflation expectations data from the Companies Survey from 1997:I to 2001:II shows that the distribution of expectations has shifted downwards (see Figure 2.1 in Hebrew Box 2) over time, alongside a decline in its variance. This smaller variance indicates that throughout the period sampled the public's assessment of the probability of an aberrant development in inflation has declined.

The distribution of inflation expectations for twelve months derived from the Companies Survey has also made it possible to construct a probability index for remaining within the upper limit of the inflation target. This index examines the proportion of respondents envisaging that inflation in the next twelve months will be above the upper limit of the target. This index (Figure 2.2, see Hebrew Box 2) shows a decline in the probability of an upward deviation from the inflation target,[1] which reversed in 1998:IV in the wake of the depreciation occasioned by the world-wide exchange-rate crisis, gradually reviving during 1999 and until the beginning of 2001. In 2001:I only 10 percent of firms estimated that inflation would deviate above the upper limit of the target—indicating that the inflation target regime has become entrenched in Israel.

The *gradual nature* of the decline in the probability of an upward deviation from the inflation target in 1999 is the result of two factors:

a. The adaptive nature of inflation expectations, reflected in the close correlation between inflation in the last twelve months and the probability of an upward deviation from the inflation target. Note in this context that in 2001:II there was a deviation, and the probability of an upward deviation from the inflation target rose; however, it is still too soon to tell whether this is a passing phenomenon or a lasting one.

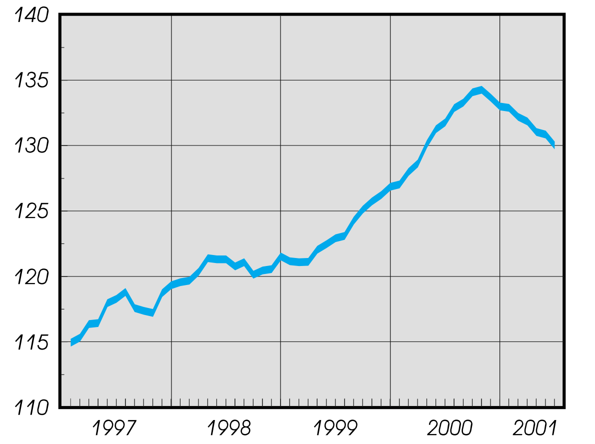
b. The sharp reduction of the upper limit of the inflation target, from 10 percent in 1998 to 4 percent in 1999.

[1] The limit of the inflation target changed in the period sampled, in line with the government's decision regarding the inflation target.

Figure 1 דיאגרמה

המדד המשולב למצב המשק* (ממוצע 1994=100)

State-of-the-economy index* (average 1994=100)



* Until June.

* עד יוני.

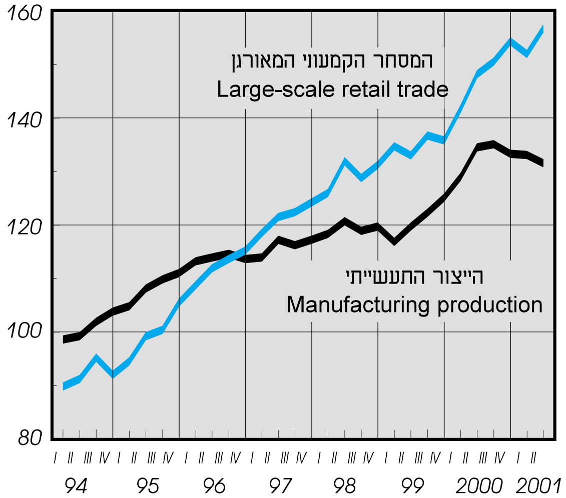
Figure 2 דיאגרמה

הייצור התעשייתי* והמסחר הקמעוני המאורגן

(ממוצע 1994=100)

Manufacturing production and large-scale retail trade*

(average 1994=100)



* Until May.

* עד מאי.

Figure 3 דיאגרמה

הריבית וסביבת האינפלציה

Interest and the inflation environment

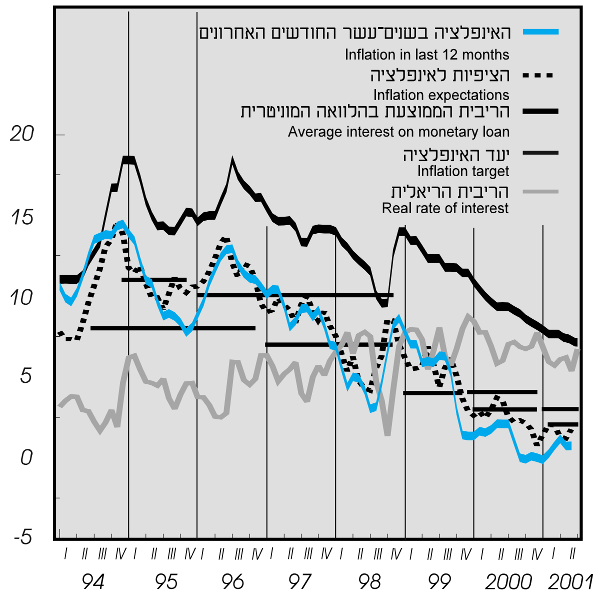
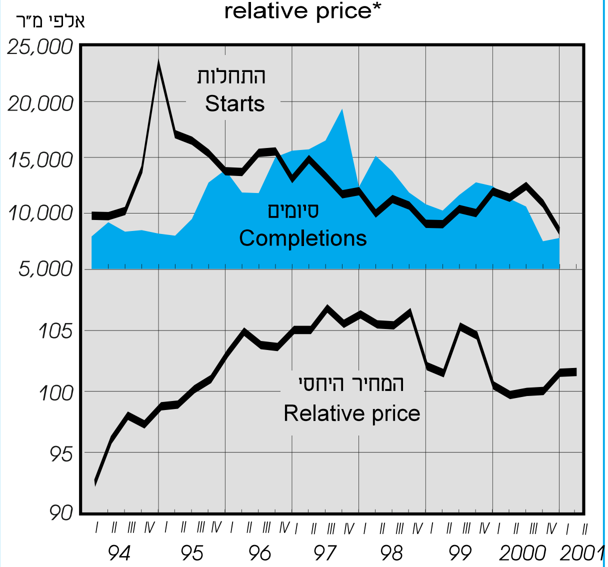


Figure 4 דיאגרמה

מספר ההתחלות והסיומים של יחידות דיור והמחיר היחסי של הדיור*

Housing units: starts and completions, and relative price*



* Relative to CPI.

* במונחי מדד המחירים לצרכן.

Figure 1.1 דיאגרמה ת'-1-1

ההשקעה בבנייה כאחוז מהתוצר
Construction investment as share of GDP

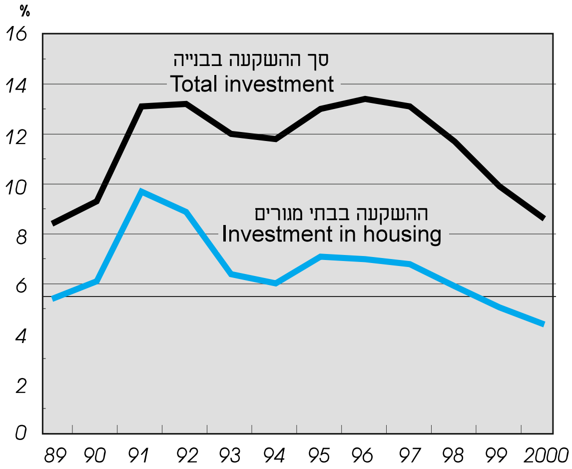
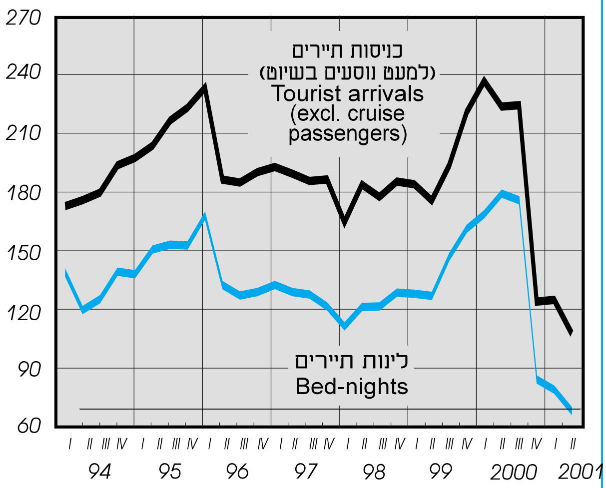


Figure 5 דיאגרמה

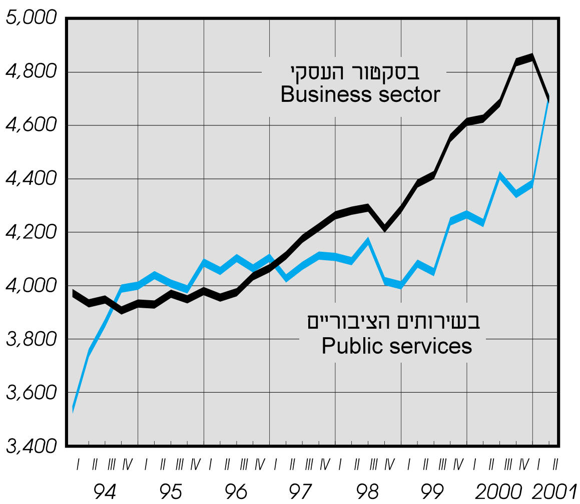
התיירות (מדד, ממוצע 1989=100)
Tourism (index, average 1989=100)



* Until June.
* עד יוני.

Figure 7 דיאגרמה

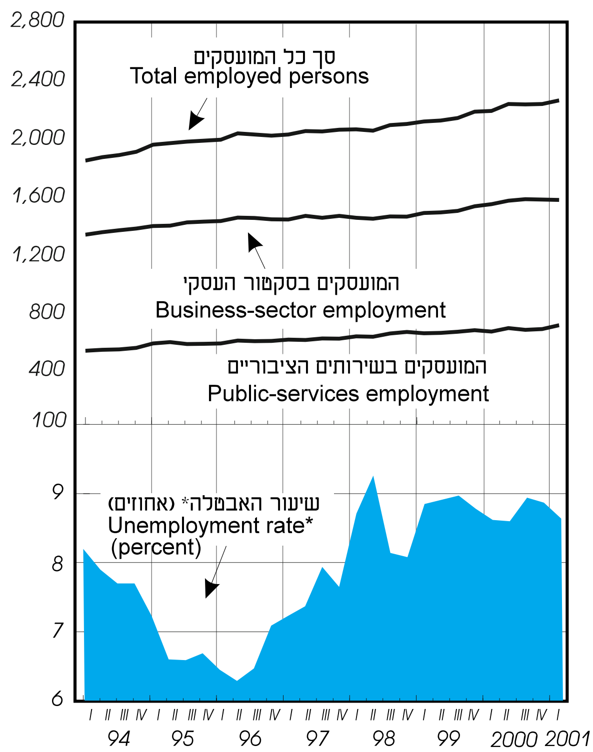
השכר הריאלי למשרת שכיר (ש"ח, במחירי 1995)*
Real wage per employee post (NIS,1995 prices)*



* Until April.
* עד אפריל.

Figure 6 דיאגרמה

שוק העבודה* (אלפים)
The labor market* (thousands)

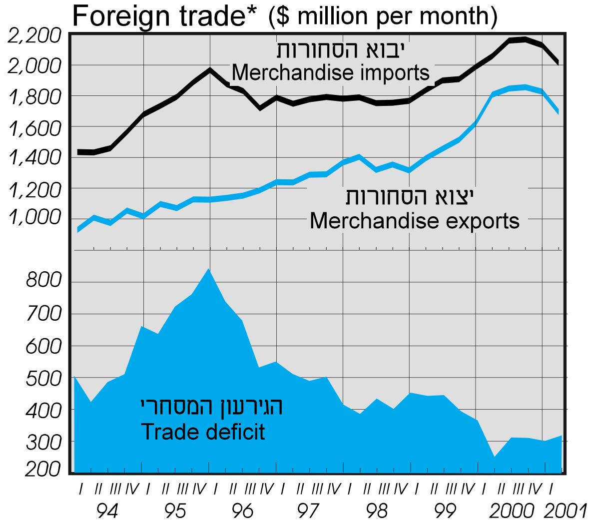


* Seasonally adjusted.
* נתונים מנוכי עונתיות.
* Until March.
* עד מארס.

Figure 8 דיאגרמה

סחר החוץ* (מיליוני דולרים לחודש)

Foreign trade* ($ million per month)



* Excluding ships, aircraft, diamonds, and fuel.

Seasonally adjusted.

* ללא אניות ומטוסים, יהלומים ודלק.

נתונים מנוכי עונתיות.

Figure 9 דיאגרמה

זרמי הכספים של הממשלה

(מיליוני ש"ח, ממוצע חודשי לרביע*)

Government cash flows

(NIS million, monthly average per quarter*)

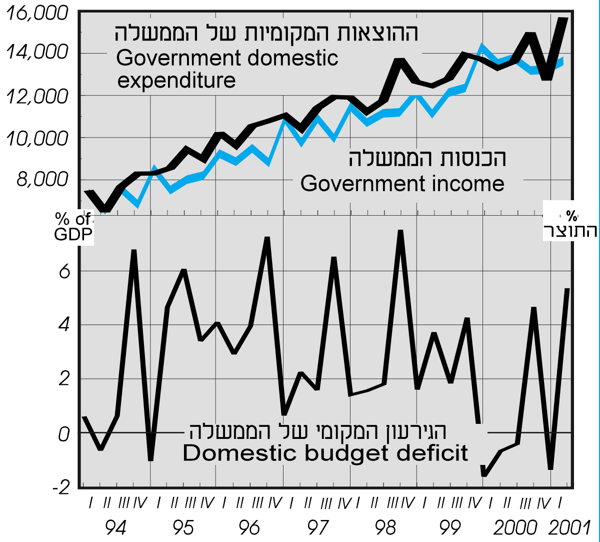


Figure 10 דיאגרמה

המצרפים הכספיים והאשראי (השינוי ב־12 החודשים האחרונים)

Monetary aggregates and credit (change in last 12 months)

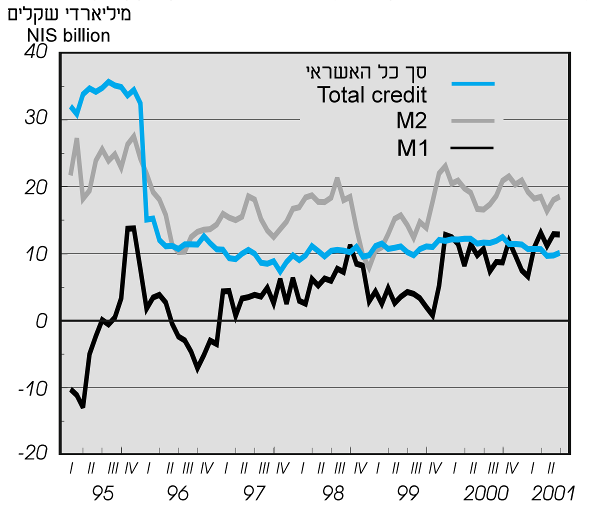
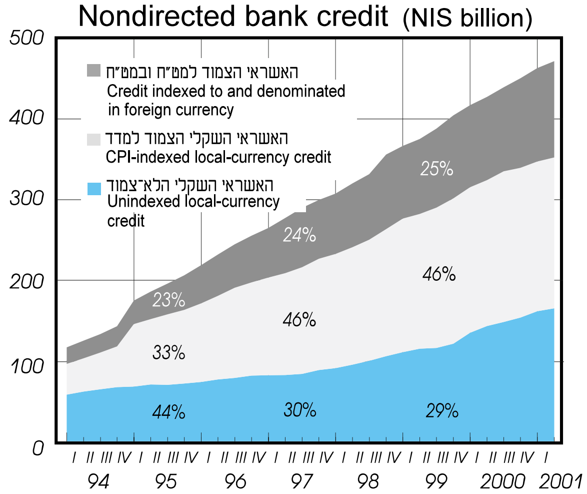


Figure 11 דיאגרמה

האשראי הבנקאי החופשי (מיליארדי שקלים)

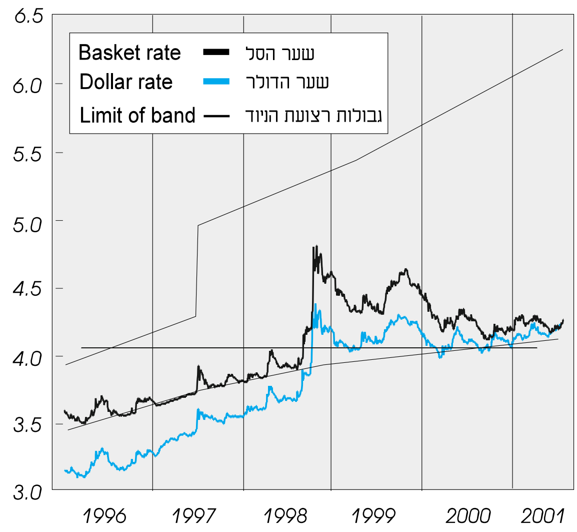
Nondirected bank credit (NIS billion)



דיאגרמה 12 Figure 12

שער החליפין של השקל לעומת סל המטבעות (ש"ח)

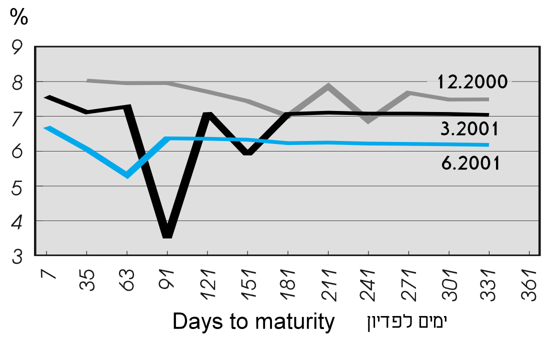
NIS/currency-basket exchange rate



דיאגרמה 13 Figure 13

עקום תשואות המק"ם (נתונים לסוף תקופה)

Yield on Treasury bills (end-period figures)

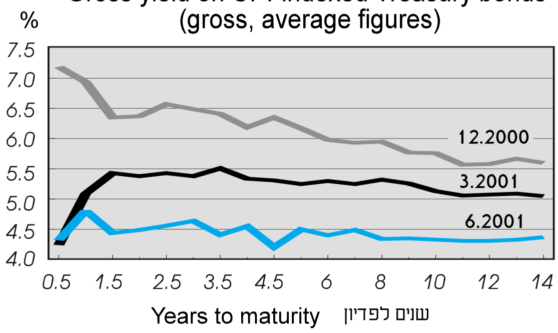


עקום התשואות של איגרות החוב הצמודות למדד

(ברוטו, נתונים ממוצעים)

Gross yield on CPI-indexed Treasury bonds

(gross, average figures)

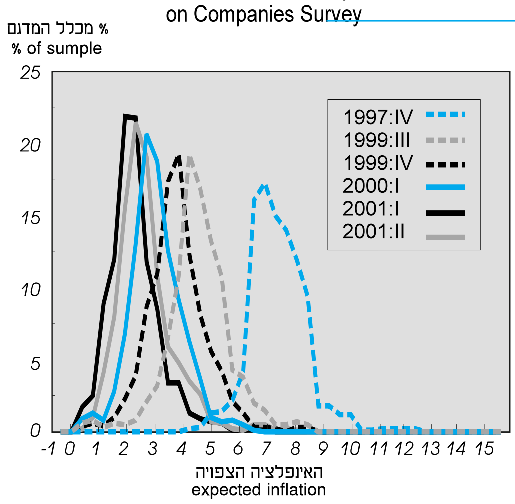


דיאגרמה ת'-2-1 Figure 2.1

התפלגות הציפיות לאינפלציה ל-12 חודשים

על פי סקר החברות

Distribution of 12-month inflation expectations, based on Companies Survey



דיאגרמה ת'-2-2 Figure 2.2

מדד להסתברות לחריגת האינפלציה מעל לגבול העליון של היעד, על פי סקר החברות, 1997 עד 2001

Probability index of overshooting inflation target, based on Companies Survey, 1997-2001