

# **Recent Economic Developments**

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## Part 1: Review of Recent Economic Developments, January to April 2008<sup>1</sup>

### Main Developments

According to economic data for the period reviewed—January to April 2008—Israel’s economy is doing well and its economic activity continues to expand at a rapid pace: GDP continued to grow quickly due to the marked expansion of private consumption; the surplus on the current account grew; exports and imports of goods and services rose steeply; unemployment fell significantly and for all education levels alongside an increase in both the participation rate and employment; the nominal wage per employee post rose. However, these developments occurred alongside sharp price increases in Israel and elsewhere, particularly those of food and fuel, amid growing apprehensions that inflation would exceed the upper limit of the target rate and a rise in inflation expectations; the trade deficit widened; the dollar continued to weaken; the US economic growth rate slowed, and this is expected to have repercussions on the global economy and on Israel; and there was a decline in share prices in Israel and elsewhere—all of which give rise to concern regarding the continuation of rapid economic growth in Israel.<sup>2</sup>

In 2008:Q1 GDP expanded by 5.4 percent and business-sector product by 6.1 percent (in annual terms), slightly below the growth rate of the preceding quarters. Private consumption, which rose by a steep 14.1 percent, was particularly noteworthy.

The surplus in the current account grew in the first quarter of 2008 as a result of the rise in the surplus in the services account, which was partly offset by the widening of the deficit in the goods account, the effect of the deterioration in the terms of trade.

The level of imports went up sharply in 2008:Q1, encompassing imports of goods and in particular those of services. Despite the economic slowdown in the US, which was accompanied by expectations that demand would moderate, in the period reviewed the growth rate of exports of goods and services, excluding diamonds, ships, and airplanes, continued to rise.

<sup>1</sup> The frequency of this publication has changed, and starting with this issue will review a four-month period.

<sup>2</sup> For further clarification regarding continued economic growth in Israel, see Part 2—macroeconomic forecast for 2008 and 2009.

The ongoing improvement in the labor market reflected the rapid economic growth and the further entrenchment of expanded production capacity. The participation and employment rates rose, and the unemployment rate fell to 6.3 percent, its lowest level since 1995. In spite of the entry of new workers into the labor market, the rise in the nominal wage per employee post accelerated.

The Consumer Price Index (CPI) has risen by 1.6 percent since the beginning of the year, and in the twelve months up to the end of the period reviewed it has increased by a cumulative 4.7 percent, despite the marked local-currency appreciation vis-à-vis the dollar which was expected to cause price increases to moderate. In March and April the interest rate was lowered in view of the persistent local-currency appreciation against the dollar—and expectations that it would intensify in the wake of sharp interest-rate reductions by the Fed—and apprehensions that economic activity would suffer in view of the impending economic slowdown in the US. In May, against the background of a relatively sharp deviation from the inflation target in April, the Bank of Israel raised the interest rate for June by 0.25 percentage points, a step intended to return inflation to the price stability range, and thus strengthen the basis essential for continued growth.

In the context of the credit crisis, which began in the US, Israel’s capital market was affected by the tremors in global financial markets. During the period reviewed the general share-price index declined, and high-tech and real-estate shares in particular plummeted.

The discussion in Part 2 of this review focuses on four subjects: updating the economic forecast, long hours of work, reducing the incentives for private vehicle ownership given by the government, and the link between economic expansion and employment.

### Aggregate and by-industry real activity

National Accounts data indicate that economic growth persisted in 2008:Q1, too, albeit at a slightly slower rate than in the previous quarters (Table 1.1). GDP rose by 5.4 percent in that quarter, while business-sector product grew by 6.1 percent (in annual terms), due largely to the rise in the tax component on imports of consumer durables, particularly cars.

Private consumption soared by 14.1 percent (in annual terms) in 2008:Q1, above its growth rate in 2006 and 2007. The expansion of purchases of consumer durables, which was particularly notable, was due to the rise in car purchases.<sup>3</sup> Current consumption also rose markedly in comparison with 2007:Q4. The accelerated increase in private consumption stemmed from the rise in disposable income as a result of the reduction of direct taxation at the beginning of the year as well as from the increase in the employment rate and wages, and occurred despite the decline in the indices of share prices and consumer confidence.

Irrespective of the slowdown in the US, which was accompanied by expectations of the moderation of demand, and despite the steep local-currency appreciation, the growth rate of exports of both goods and services, excluding diamonds, ships, and airplanes, rose significantly in 2008:Q1. This was due primarily to the increase in services exports, while the rise in manufactured goods exports slowed during this quarter. According to foreign trade data for January to April, the slowdown in the growth rate of exports of manufactured goods stemmed from the slower growth rate of high-tech exports, most of which go to the US. On the

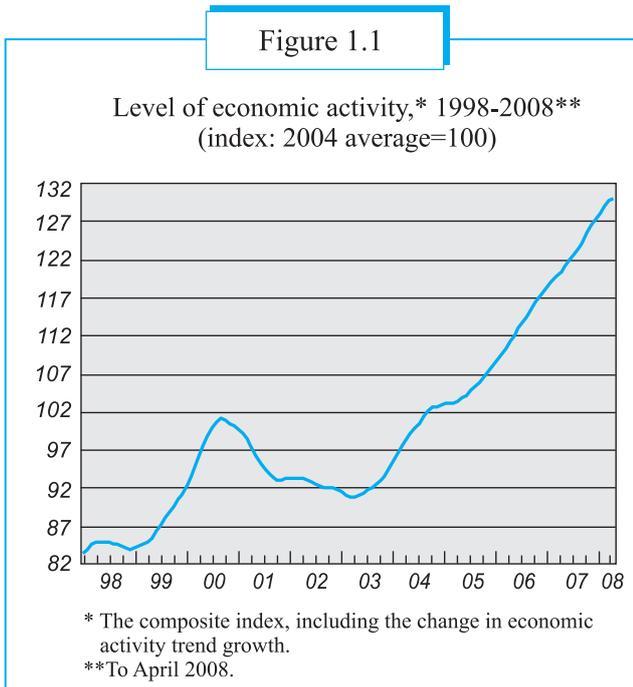
other hand, the exports of the medium-low-tech industries expanded significantly, encompassing all their components.

The growth rate of fixed investment was high in 2008:Q1, after declining in 2007:Q4. Most of the acceleration growth of investment relative to 2007:Q4 focused on the principal industries and transport vehicles. However, investment in machinery and equipment dropped in 2008:Q1, attesting to continued apprehensions regarding an economic slowdown. Gross domestic investment was lower in 2008:Q1 than in 2007:Q4 due to the reduction of stocks.

Public consumption rose by a relatively steep 5.1 percent in 2008:Q1 as a result of the expansion of defense imports. Domestic consumption expenditure fell by 2.9 percent due to the sharp drop in defense consumption and the 3.3 percent rise in civilian consumption.

There was a precipitous rise in the level of imports, encompassing both goods and in particular, services. In line with the National Accounts figures, foreign trade data attest to a rise in all categories of goods imports. Imports of consumer goods rose notably—inter alia because of the steep increase in car imports. The rise in imports of capital goods was due mainly to investment in items other than machinery and equipment. Imports of machinery and equipment in the period reviewed were up only slightly compared with past increases—despite the local-currency appreciation—and

Figure 1.1



<sup>3</sup> The increase in purchases of cars was due to the 6 percentage-point reduction of the purchase tax on them, as planned, and the lower than expected rise in the valuation for tax purposes of the use of company cars.

Figure 1.2

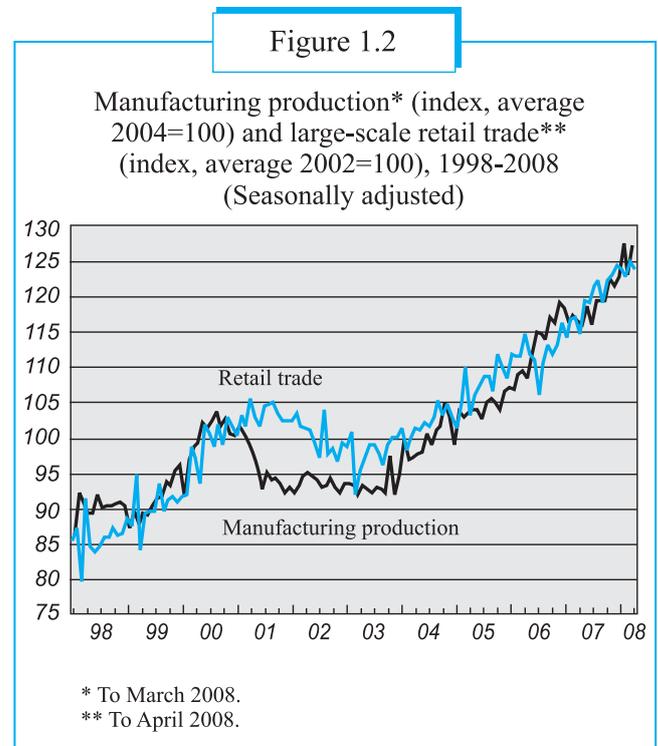
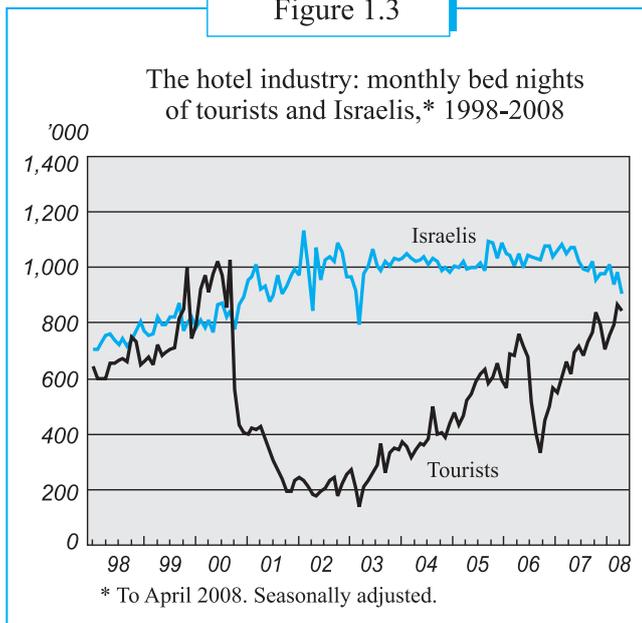


Figure 1.3



In commerce the upward trend in sales persisted, and the index of revenue in the industry rose markedly (Table 1.2). The increase in commerce and the services encompassed all industries with the exception of personal services, while revenue in the business services industry rose notably. This is borne out by the Companies Survey, attesting to commercial firms' expectations that the expansion of sales will persist in 2008:Q2. In the business services industry firms reported an increase in revenue due to the rapid rise in sales abroad alongside stability in domestic sales. According to the survey, business services firms expect export orders to expand in 2008:Q2.

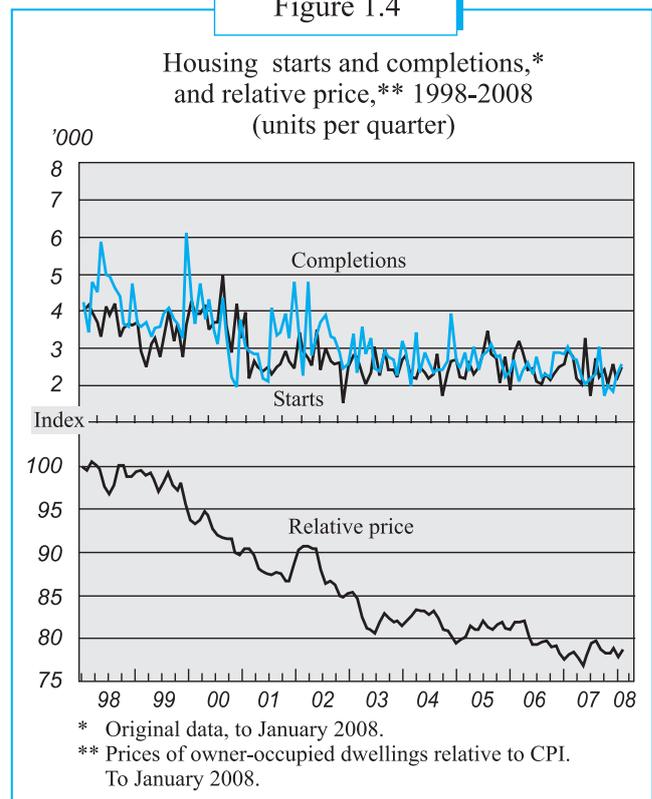
As a result of the relatively tranquil security situation the tourist industry recovered completely from the slump at the end of 2006. In 2008:Q1 there was a significant rise in tourist entries, and from January to April the number of tourist bed-nights rose markedly. In comparison with the equivalent period in 2007, the occupancy rate rose steeply in all parts of Israel, especially in the Jerusalem and Tel Aviv areas (Figure 1.3, seasonally adjusted figures). Taking a global perspective, the World Economic Forum<sup>4</sup> ranked Israel in 35th place in the world tourist industry—the highest ranking

even remained unchanged in April. These figures could indicate pessimistic expectations regarding future economic growth. However, imports of machinery and equipment are still higher than they were in the second half of 2007.

The relative prices in the National Accounts attest to sharp real local-currency appreciation—with a cumulative real appreciation of 10 percent in 2007:Q4 and 2008:Q1. The relative price of exports (relative to the GDP deflator) fell by 7 percent. Export prices fell by 6.2 percent, and import prices by 4.8 percent, despite the global rise in prices of raw materials. The steep drop in prices is the result of the sharp nominal local-currency appreciation against the dollar. Consequently, the gap between import and export prices attests to a 1.5 percent deterioration in the external terms of trade.

The index of manufacturing production rose markedly in 2008:Q1, further to its increase in 2007:Q4 (trend data). Manufacturing production expanded due to an increase in all the principal industries with the exception of the low-tech industries. The expansionary trend continued in the high-tech and medium-low-tech industries in particular, due to the steep rise in investment (Figure 1.2). Although the Bank of Israel's Companies Survey indicates a slowdown in firms' performance, when the findings are weighted by firm size this slowdown is seen to be more moderate. The composite state-of-the-economy index and D&B's Purchasing Managers Index both indicated a certain slowdown in economic activity in April (Figure 1.1).

Figure 1.4



<sup>4</sup> The World Economic Forum (WEF) meets once a year at Davos, Switzerland, to discuss matters of the moment. Heads of state and CEOs of large companies participate in the meeting.

in the Middle East. This was a result of the high ranking accorded to the quality of the infrastructure and workers in this industry, as well as of the activity undertaken by the Ministry of Tourism to improve the situation in many spheres.<sup>5</sup> The Bank of Israel's Companies Survey attests to the expectations of the hotel companies, on average, that the increase in bookings will continue to accelerate. At the same time, the number of hotel bed-nights of Israelis continued to decline in 2008:Q1, continuing the downward trend that has been in evidence since the end of 2005. This may be due to the steep local-currency appreciation, which makes vacations abroad more attractive. This explanation is supported by National Accounts data regarding the marked rise in consumption abroad by Israelis.

Despite Israel's rapid economic growth rate, the creation of the appropriate conditions for the purchase of an apartment (the reduction of the mortgage interest rate and VAT), and a rise in purchasing power, activity in the construction industry is still low relative to recent years, alongside the widening of the gap between sales of new units and the stock of new apartments for sale. The slowdown in the industry's activity is expressed in the low level of building starts, the continued steep decline in the number of new units for sale (30 percent lower in April 2008 than in April 2007), and the number of supply months.<sup>6</sup> In the period reviewed the average number of months was 9, compared with 12 in the equivalent period in 2007. The crisis in the industry's activity is particularly apparent in the peripheral areas: whereas prices of dwellings (especially luxury apartments) in the central region are rising, prices throughout the peripheral areas (e.g., Beersheba, Haifa, and Galilee) are stagnant. There is continual negative migration from these regions, and apartment prices are continuing to fall.<sup>7</sup> According to reports by firms participating in the Bank of Israel's Companies Survey, the slowdown in construction activity is expected to persist in 2008:Q2.

### The labor market

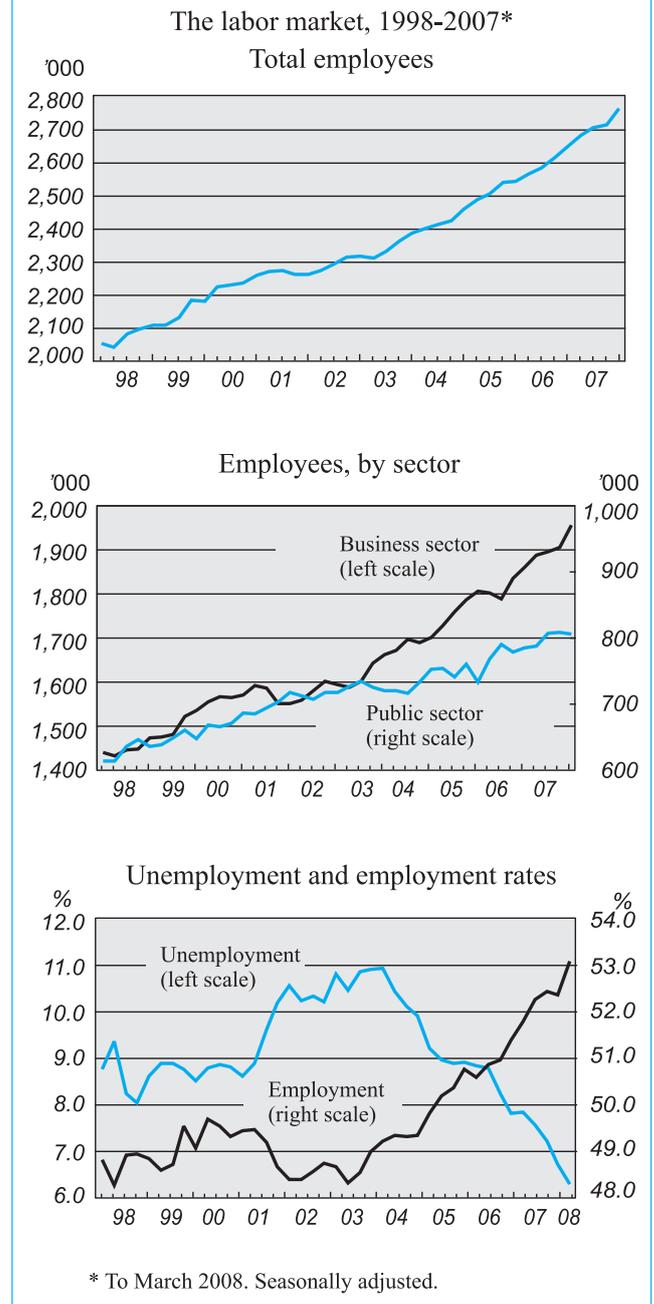
The persistence of the high economic growth rate was also expressed in the marked improvement in the labor market: according to the CBS's Labor Force Survey for 2008:Q1, the unemployment rate continued to fall significantly this quarter, too, to reach 6.3 percent, its lowest level since 1995.

<sup>5</sup> Examples of activities undertaken by the Ministry of Tourism: it holds courses to train tourist guides in various languages, it has set up a fund to finance the renovation of hotels, and it shows movies about Israel all over the world.

<sup>6</sup> The number of months remaining until the stock of apartments finishes, according to the extent of sales in that month.

<sup>7</sup> See Ministry of Construction and Housing, Department of Information and Economic Analysis, Monthly Information Sheet, April 2008.

Figure 1.5



There was also a steep increase in the participation rate and in employment (Table 1.3 and Figure 1.5). According to Employment Service data, both the number of work-seekers and claims for unemployment benefit fell in the period reviewed, further to their decline in 2007. The combination of the decline in unemployment and the rise in the participation rate attests to the fact that the rise in the demand for workers has exceeded their supply—an indicator of continued economic growth.

According to the survey, employment expanded greatly in 2008:Q1, expressing a rise in the number of persons in full-time employment alongside a decline in those working part-time. At the same time, there has been a marked increase (9.3 percent) in the number of persons working part-time involuntarily, a feature which mainly characterizes women. The improvement in the labor market in 2008:Q1 found expression at almost all levels of education. The unemployment rate was down in this quarter from 2007:Q4 (seasonally adjusted data) for all education levels except for persons with 13 to 15 years of education. The participation rate was higher than in 2007:Q4 except for persons with 9 to 10 years of schooling. In comparison with 2007:Q1 the unemployment rate has fallen at all levels. The participation and employment rates rose at all education levels in this period, except for persons with 9 to 10 years of schooling. The improvement in 2008:Q1 over 2007:Q1 is particularly apparent for persons with 11 to 12 years of schooling, whose unemployment rate plummeted and whose employment rate soared.

Although the participation rate rose markedly in 2008:Q1 it is still low relative to the OECD and other developed countries,<sup>8</sup> so that per capita GDP in Israel is still relatively low; the relatively few labor-force participants affects the country's production capacity. An international comparison of labor productivity shows that Israel is in a good position, its level being higher than that of many developed countries. Consequently, taking steps to increase the participation rate, especially among those segments of the population with a particularly low participation rate—ultra-orthodox men and Arab women—could increase Israel's production capacity (despite the expected decline in labor productivity<sup>9</sup>), thereby bolstering the continuation of economic growth.

Low participation rates are also expressed in the employment of non-Israelis (foreign workers and Palestinians). Their share in the total number of employees increased again this quarter, extending the trend that started in the second half of 2007. The high supply of non-Israeli workers reduces the possibilities of employment and the wage of Israelis with low levels of education.<sup>10</sup>

The quarterly rate of increase in the average nominal wage per employee post from 2007:Q4 to 2008:Q1 was greater than the average quarterly rise in 2007, despite the entry of

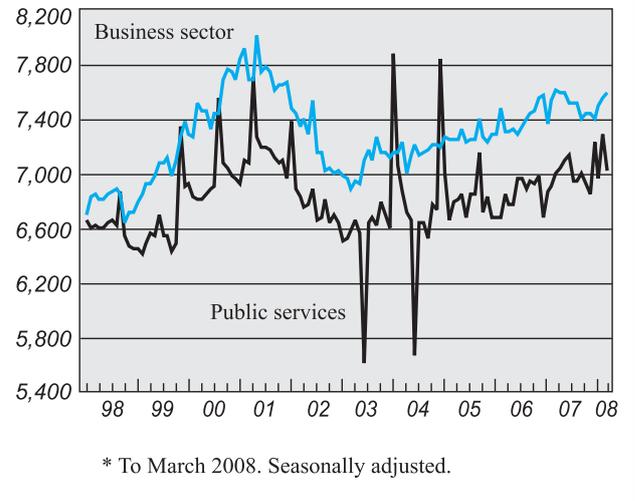
<sup>8</sup> For further clarification, see Recent Economic Developments, no. 119, Bank of Israel, Research Department, November 2007.

<sup>9</sup> N. Sussman and A. Friedmann (2008), "The Quality of the Labor Force in Israel," Discussion Paper, Bank of Israel.

<sup>10</sup> For a more detailed discussion, see Box 5.2 in the Bank of Israel 2007 Annual Report.

Figure 1.6

Real wage per employee post, 1998-2008\*  
(NIS, 2004 prices)



many new employees. Over the previous twelve months too (January to March 2008 compared with January to March 2007) the nominal wage increased relatively rapidly, by 4.9 percent, with rises in both the business sector wage and the public sector wage.

The rise in the nominal wage in the public services during the period reviewed apparently derived from the return to work of the teachers and the university lecturers after a lengthy strike, since wages soared in education.<sup>11</sup> The average real wage per Israeli employee post rose more moderately in 2007, by 2.0 percent in January and February relative to the equivalent period in 2006—even more moderately than the growth rate of labor productivity. The moderate increase apparently stemmed from the steep rise in the CPI which eroded much of the rise in the nominal wage (Figure 1.6).

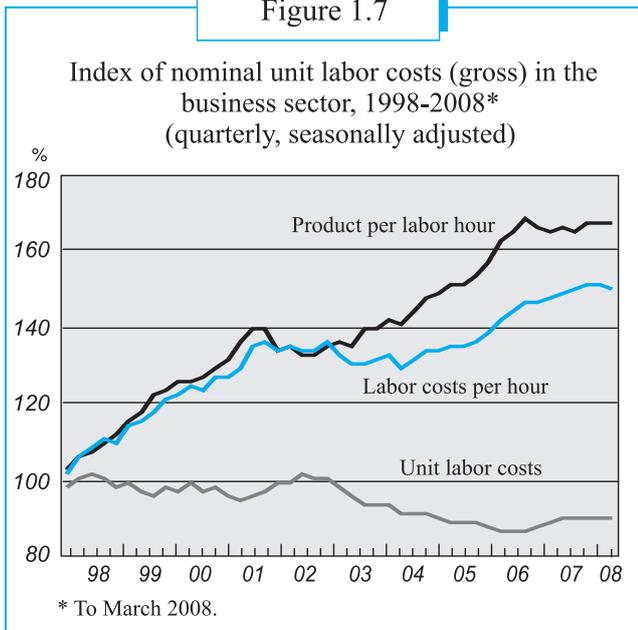
Despite the continued rapid growth rate for the fourth year in succession, with a steep rise in uses, unit labor costs remained steady in the first quarter of 2008, as they did in the previous four quarters. This was the outcome of a small drop in output per labor/hour and in labor costs per hour (Figure 1.7). The stability of unit labor costs indicates that demand pressures have not been felt yet in the labor market:

<sup>11</sup> The teachers' strike lasted over two months and ended in mid-December 2007 with an agreement between the Ministries of Education and Finance and the representatives of the teachers. The strike of the university lecturers lasted for almost an entire semester and ended in mid-January with an agreement between the Ministry of Finance and the lecturers.

labor supply has risen in line with the increase in potential output, so that the output gap has not contracted.

The continued decline in the unemployment rate, particularly among graduates, could lead to demand pressures by workers and a rise in the average wage in the coming months. If the steep price increases persist, upward pressure on the eroded wages may be created in the business sector. Last April a wage agreement was signed between the Federation of Labor (Histadrut) and the Ministry of Finance,<sup>12</sup> so that the wage for May (and at the latest for June) will include the first installment of the increment, which will be paid retroactively from the beginning of 2008, amounting to 16.5 percent.<sup>13</sup> The framework agreement also included a section regarding the establishment of a committee to examine the structure of employment in the business sector. The wage agreement is included in the 2008 budget, and is not expected to give rise to any deviations from it.

Figure 1.7



<sup>12</sup> The agreement includes all employees of the government, the municipalities, the regional authorities, some government corporations, the Airports Authority, Yad Vashem and the National Insurance Institution, career military personnel, employees of the Prison Service, the Police Force, as well as employees of the universities and Hadassah Hospital.

<sup>13</sup> Similar to the old framework agreement: 1.5 percent in January 2008, 1.5 percent in December 2008, and 2.0 percent in December 2009.

## The government

An analysis of the performance of the government budget during the period reviewed shows that the budget surplus, without credit, was NIS 5.6 billion. At present it would appear that in 2008 the government will meet the deficit limit it has set—1.6 percent of GDP.<sup>14</sup> From the beginning of the year until April the surplus amounted to NIS 6.4 billion—above the seasonal path. This finding reflects the continued increase in tax receipts, albeit at a more moderate rate than in 2007, and a level of expenditure which is higher than the seasonal path.

According to data for government tax receipts, the downward trend in revenues from direct taxes, which began in the second half of 2007, continued, while revenues from indirect taxes rose at a moderate and consistent rate. During the period reviewed a large part of revenues from direct taxes contracted, inter alia because of statutory changes.<sup>15, 16</sup> Adjusting for legislative changes and non-recurring income, revenues from direct taxes fell more steeply in real terms as a result of the real drop in revenues from the capital market—due to the decline in share prices in the financial markets—as well as of the decline in income tax receipts, primarily in manufacturing and banking. By contrast, revenues from indirect taxes rose by 8.9 percent in real terms, due mainly to the marked increase in tax receipts from imports, especially cars, which also rose as a result of the reduction of purchase tax on vehicles and the cancellation of the system whereby a car's year of production is determined in April.<sup>17</sup> This increase is consistent with National Accounts figures regarding the marked rise in private consumption.

The government's expenditure during the period reviewed was above the level which is in accordance with full budgetary performance, with expenditure by the Ministry of Defense being particularly high. It would appear, therefore, that there is an upward trend in the rate of government

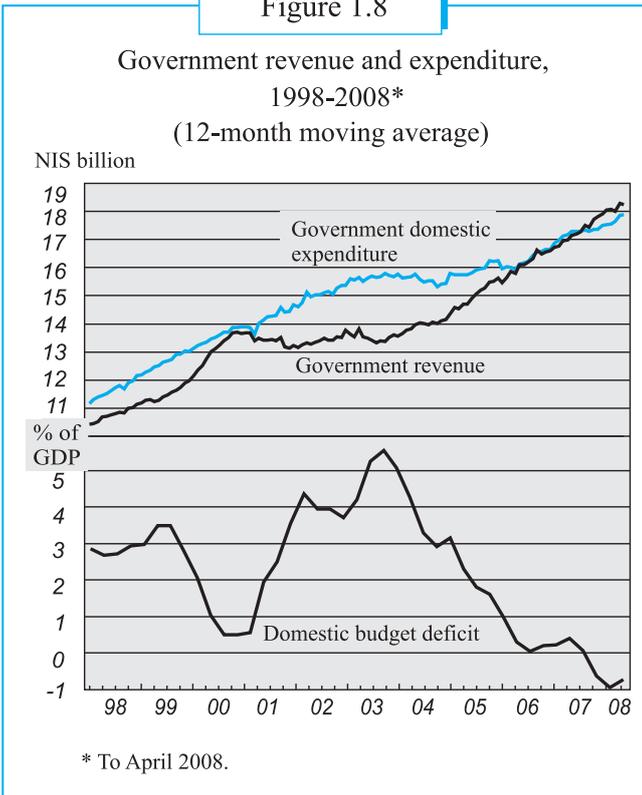
<sup>14</sup> There is uncertainty with regard to the expected deficit at the end of the year, since the reference is only to the first third of the year.

<sup>15</sup> On 1 January, according to the amendment to the Income Tax Law (no. 160 and the Provisional Directive), 5768-2007, the tax rate was reduced: the tax brackets were widened and the value of credit points rose.

<sup>16</sup> Especially since in February 2007 the government's tax receipts were higher than usual because of the Bachar Reform and the sale of the Oil Refineries.

<sup>17</sup> On 1st April 2008 the traditional system whereby the year in which a car was considered to have been manufactured began on 1st May each year was cancelled—and since then the year of production is represented by the tenth character of the 17-character VIN (vehicle identification number) stamped on every vehicle.

Figure 1.8



expenditure performance, with the exception of January, when expenditure was especially low.

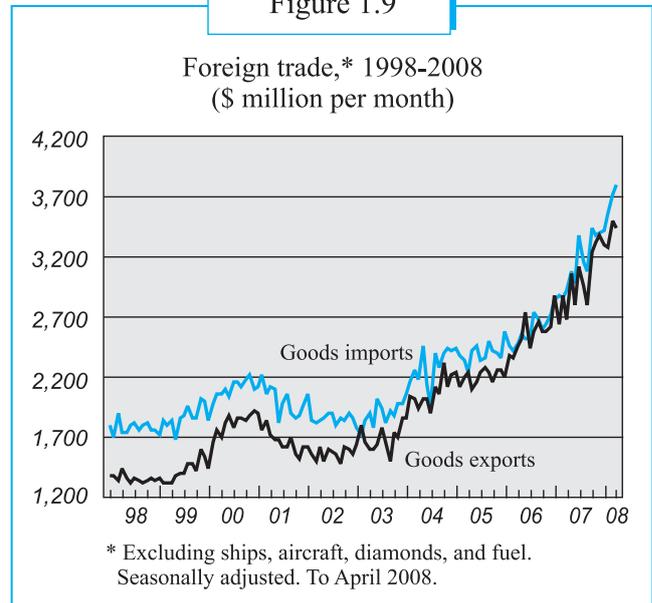
In the first four months of the year there were no notable divergences in the government's financing activity, and it is difficult to determine whether its revenues this year will be higher than budgeted or whether there will be a shortfall. One of the decisions made with regard to the 2008 budget was to raise NIS 4 billion through privatization. To date no significant privatization has been undertaken, and the government is still dealing with the privatization of Bank Leumi and the Bezeq phone company, which could bring in considerable capital. According to stock exchange figures, the total net amount raised by the government on the stock market since the beginning of the year was more than 50 percent above the amount raised in the whole of 2007.

### The balance of payments

In line with the data on real economic activity quoted above, the surplus in the current account also rose in first quarter of 2008, following its increase in the second half of 2007 (Figure 1.5). The rise was due to the increase in the surplus

in the services account,<sup>18</sup> partly offset by the widening of the deficit in the goods account. The deficit on the income account was higher than in the previous quarter.

Figure 1.9



### Global developments

The global economy is currently facing three main causes of uncertainty: the continued deterioration of the financial sector, the slowdown in growth, and the acceleration of inflation. After a protracted decline in the financial sector some stability has been attained there, but it would seem that the credit crisis is not yet over and will continue to affect the financial sectors of developed countries. The last International Monetary Fund (IMF) forecast of global growth made in April 2008 has been revised downwards, and the IMF now expects a global growth rate of 3.7 percent in 2008 and 3.8 percent in 2009, compared with 4.9 percent in 2007 (Table 1.6). The IMF expects that the GDP growth rate in the advanced countries will decline to 1.3 percent in 2008. On the other hand, it expects that the emerging markets will continue to grow at a very rapid rate, albeit more slowly than in 2007. Concurrently, the global acceleration of inflation constitutes a substantial problem worldwide, which is particularly severe in emerging markets, where the rise in food prices threatens stability.

<sup>18</sup> The increase in the surplus in the services account was affected by the rise in services exports, the result of the sale of start-ups to nonresidents.

### Rates of GDP Growth in Selected Countries (rates of change in annual terms)

|          | 2007 | 2007:Q4 | 2008:Q1 | Forecast<br>2008 | Forecast<br>2009 |
|----------|------|---------|---------|------------------|------------------|
| US       | 2.2  | 0.6     | 0.9     | 0.5              | 0.6              |
| Eurozone | 3.1  | 1.4     | 3       | 1.8              | 1.7              |
| UK       | 3.1  | 2.5     | 1.6     | 1.6              | 1.6              |
| Japan    | 2.1  | 3.7     | 3.3     | 1.4              | 1.5              |
| China    | 11.4 | 11.2    | 10.6    | 9.3              | 9.5              |
| India    | 9.2  | 8.4     | 8.8     | 7.9              | 8                |

SOURCE: OECD, India Economy Watch, China Economy Watch.

In 2008:Q1 GDP grew very slowly in the US, for the fourth successive quarter. The low rate of GDP growth is due to the steep decline in investment, especially in real estate, equipment, and software. Private consumption—which accounts for two-thirds of GDP—rose very slightly in 2008:Q1, and there are apprehensions that this could persist, as it is adversely affected not only by the decline in the financial markets, the contraction of credit, and the slump in the housing market, but also by the steep rise in food and fuel prices. Hence, the US Federal Reserve has introduced several measures in order to help the financial institutions to stabilize, and these include increasing the extent of the loans it extends to them. Further to the reduction of the nominal interest rate, which began in September 2007, it also slashed the interest rate in the period reviewed. During January it cut interest twice, bringing it down from 4.25 percent to 3.0 percent, and at the end of April it stood at only 2.0 percent. The object of these sharp reductions was to moderate the steep fall in share prices and prevent the US economy from going into recession. However, the reduction of the nominal interest rate weakened the US dollar considerably vis-à-vis other currencies. The low real interest rate (the result of the reduction of the nominal interest rate) could give rise to inflation pressures and further price increases. The US labor market also showed signs of a slowdown in the period reviewed: the number of vacant positions and the participation rate have both continued to fall, and the inflation rate has risen.

The effects of the crisis in the US have not been in evidence in the growth data for the eurozone, and domestic demand, exports, and manufacturing production have continued to rise despite the sharp increase in food and fuel prices, the greater inflexibility of credit terms, and the failure to reduce the nominal interest rate. On the other hand, the downward trend in the index of consumer confidence and retail sales persisted, increasing the possibility that it will affect private

consumption. Against this backdrop, the IMF reduced its growth forecast for the eurozone for 2008 to 1.8 percent.

The emerging economies, which constitute the main engine of global economic growth, continue to perform well. To date the financial crisis has not affected their economic data, and they have benefited from the rise in commodity prices, although persistent increases could lead to their instability.

Fuel prices continued to soar during the period reviewed and attained new heights. During the period as a whole the price of a barrel of oil rose by 18.2 percent. Note that part of the steep increase in oil prices stemmed from the considerable weakening of the dollar. The price of a barrel of oil in NIS terms rose by only 5 percent.

### Prices, monetary policy, and the money and capital markets<sup>19</sup>

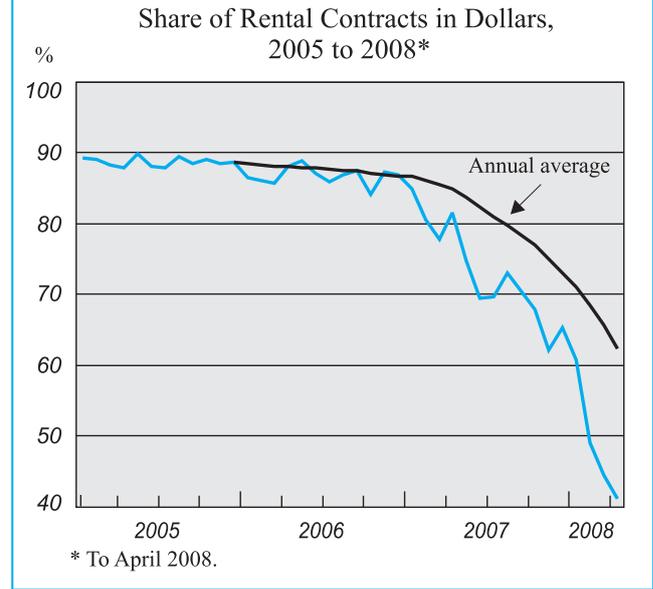
The Consumer Price Index (CPI) rose by 1.6 percent from January to April, completing a cumulative 4.7 percent increase in the 12 months to the end of the period reviewed and exceeding the upper limit of the inflation target (Table 1.7 and Figure 1.11). At the beginning of the period reviewed (in January and February) the CPI dipped moderately, in accordance with its seasonal path, but later on rose steeply, surpassing the forecast by far. This indicated that the inflation target as measured over the last 12 months would be overshot. At the beginning of the period reviewed the moderate rise, and even decline, in the CPI was affected by the sharp local-currency appreciation, enabling the Bank of Israel to reduce the nominal interest rate. But the steep increase in the CPI in the latter half of the period reviewed attested to the acceleration of inflation, due primarily to the rise in prices of imported consumer goods and raw materials, such as food and fuel. There was a particularly steep increase in April; a rise in prices at this time of the year is expected and acceptable because of the Passover festival, but this year the increase in the CPI deviated significantly from that of the last four years: 1.5 percent in April 2008 compared with an average of 0.8 percent in the four previous years. Price increases were particularly in evidence in the price of food, which rose substantially throughout the period reviewed, with a cumulative 5.8 percent increase since the beginning of the year. Because of the sharp rise in food prices, the source of the acceleration of inflation would appear to lie abroad, although the CPI adjusting for food also rose considerably due to an increase in domestic prices in the context of rapid economic growth and the contraction of the output gap.

<sup>19</sup> For further clarification, see Inflation Report 22, Bank of Israel, May 2008.

Figure 1.10



Figure 1.11



Housing prices rose during the period reviewed despite the local-currency appreciation against the dollar, because since mid-2007, as a result of the cumulative local-currency appreciation and the continued stagnation of the dollar worldwide, a trend has emerged whereby housing prices are no longer quoted in dollar terms. An increasing number of contracts are drawn up in local-currency terms (Figure 1.11).<sup>20</sup>

The development of the nominal interest rate was not uniform during the period reviewed: at first it was raised by 0.25 percentage points, and later reduced by a cumulative 1 percentage point. At the beginning of 2007 there were apprehensions regarding a continuous rise in prices as a result of increased demand in the developing countries. In order to help inflation to return gradually to within the target range, while maintaining financial stability, the nominal interest rate was raised to 4.25 percent in January.

The picture changed later in the period reviewed: because of misgivings concerning the repercussions of the crisis in the US on Israel's economy, as a result of the sharp interest rate cuts there, as well as expectations of local-currency appreciation—together with the moderation of growth—it was assessed that Israel's economic growth rate could slow in 2008. Consequently, the interest rate was reduced by a relatively steep 0.5 percentage points both in March and in April. These measures were introduced in order to bolster

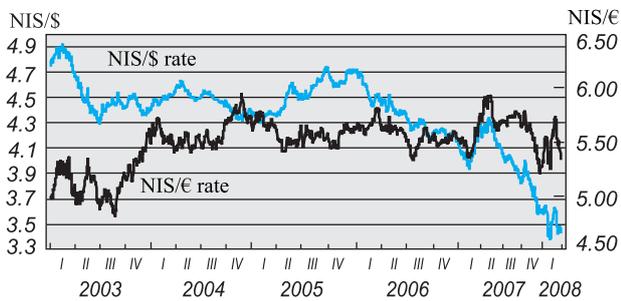
real economic activity, primarily in view of the assessment that the disinflationary effects of the slowdown, as well as the cumulative strengthening of the local currency, would return the inflation rate to within the target range by the end of the year. In retrospect, the fears of a significant slowing of Israel's growth rate were unfounded, or at least have been to date, and domestic demand continued to rise, resulting in a high inflation environment with a low interest rate. The Bank of Israel consequently acted to attain the secondary target of maintaining economic prosperity against the backdrop of a flexible target of price stability, while expecting the slowdown and local-currency appreciation to act to restore inflation to within the range in a reasonable period of time. In May, in view of the significant deviation from the inflation target in April, the Bank of Israel raised the interest rate for June by 0.25 percentage points. This was intended to return inflation to the target range of price stability, and thereby to strengthen the basis essential for sustained growth.

During the entire period reviewed there was local-currency appreciation against the dollar, with the exchange rate rising from NIS 3.85 at the beginning of January to 3.43 at the end of April; against the euro the exchange rate rose from NIS 5.67 at the beginning of January to NIS 5.33 at the end of April (Figure 1.13). The strengthening of the shekel was affected by the excess supply of foreign currency as a result of the surplus on Israel's current account and the realization of assets abroad by Israelis. This improvement stemmed from a consistent and rapid decline in the debt/GDP ratio to an unprecedented level, alongside adherence to fiscal

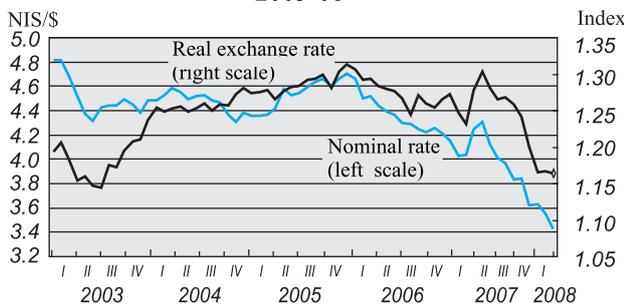
<sup>20</sup> For further clarification, see Box 3.2 in Bank of Israel, Annual Report, 2007.

Figure 1.12

The nominal NIS/\$ and NIS/€ exchange rates, 2003-08\*



The real\*\* and nominal NIS/\$ exchange rates, 2003-08\*

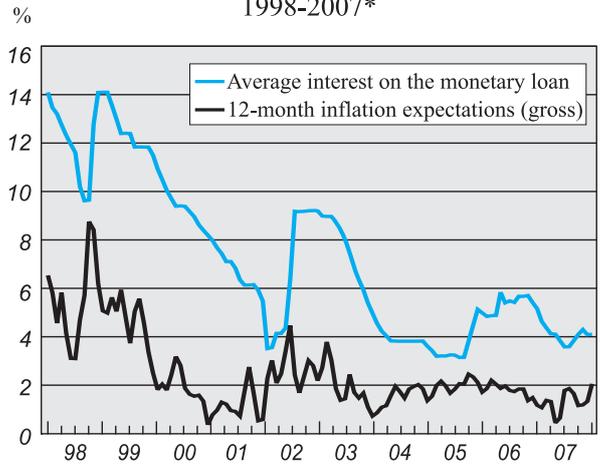


\* To April 2008.

\*\* The real exchange rate is calculated on a monthly basis.

Figure 1.13

Interest and inflation expectations, 1998-2007\*



\* 12-month inflation expectations as calculated by the Bank of Israel Monetary Department. To December 2007.

discipline; these trends also helped Israel to gain acceptance as a member of the OECD Development Center and to become a candidate for membership of the organization. The local-currency appreciation vis-à-vis the dollar was also due to the weakening of the dollar worldwide, in the wake of the sharp US interest rate cuts. During the period reviewed the passthrough from the exchange rate to prices appeared to continue to weaken, and the exchange rate stabilized at a low level. In view of the needs of the economy, against the backdrop of rapid GDP growth in recent years and Israel's growing integration into the global economy and financial system, in March the Bank of Israel decided to increase the foreign reserves by purchasing dollars in the course of trading.

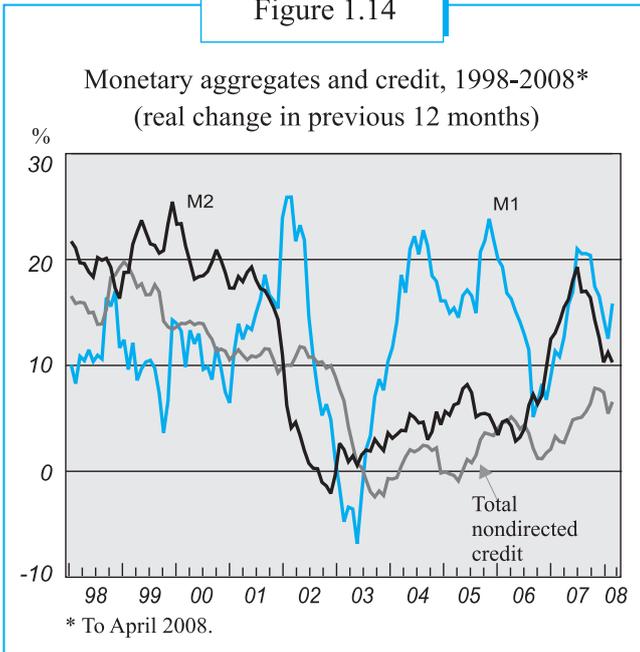
In contrast with the past, developments in the NIS-dollar exchange rate were not expressed in inflation expectations for the next 12 months. Further to their increase since mid-2007, these continued to rise towards the upper limit of the inflation target. The upward trend also derived from the increased cost of imports in NIS terms, as well as from the decline in indexation. Inflation expectations for the next 12

months derived from the capital market averaged 2.6 percent in the period reviewed—near the upper limit of the target range (Table 1.9 and Figure 1.12). According to predictions by domestic forecasters, at the end of 2008 the annual inflation rate will average 3.9 percent, slowing in 2009 to return to the target range.

The rate of expansion of the narrow money supply (M1) and the monetary aggregates increased markedly in the last 12 months, exceeding by far the total expected growth rate and the inflation rate (Table 1.8 and Figure 1.14). An examination of the composition of the assets comprising the M2 aggregate indicates that in the last year short- and fixed-term deposits of up to a year grew appreciably. The rate of expansion of nondirected bank credit has also slowed to some extent since the beginning of the year. An analysis of its components points to an increase in CPI-indexed local-currency credit and a decline in unindexed local-currency and foreign-currency-indexed credit; this change in composition attests to a rise in the exposure of the credit market to inflation risks.

During the period reviewed business-sector activity in the primary bond market declined markedly, and this was accentuated in April, reaching the lowest rate of purchases in the last two years. This follows an extremely high level of bond purchases in 2007. The expansion of total nonbank credit in the business sector was checked in 2008:Q1, against the backdrop of the fall in prices in the financial markets. These findings indicate that there has been some contraction

Figure 1.14



in firms' activity, in expectation of a slowdown in Israel's economy or of a credit crunch.

The value of the public's asset portfolio contracted during the period reviewed, mainly as a result of the fall in the component of shares in Israel. The weight of these shares in the asset portfolio, which peaked in 2007, began to decline at the beginning of 2008, and reached 20 percent in March as a result of the fall in share prices.

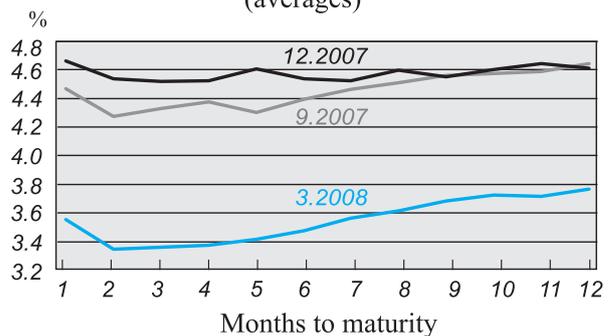
The *makam* (short-term bills) yield curve (Table 1.9 and Figure 1.15) responded to the interest-rate shifts: in January the short-term curve (up to six months) declined, though the long-term curve rose. As a result, its slope became steeper. In February the entire curve flattened, albeit more moderately for longer terms. In March and April the curve continued to decline, in the wake of the reduction of the nominal interest rate by the Bank of Israel. In these months the slope became steeper, attesting to expectations of a rise in the interest rate. According to forecasters' predictions, too, the Bank of Israel's key interest rate is expected to rise and average 3.73 percent by the end of 2008.

During the period reviewed the index of 100 leading shares in the Tel Aviv Stock Exchange fell by about 14 percent,

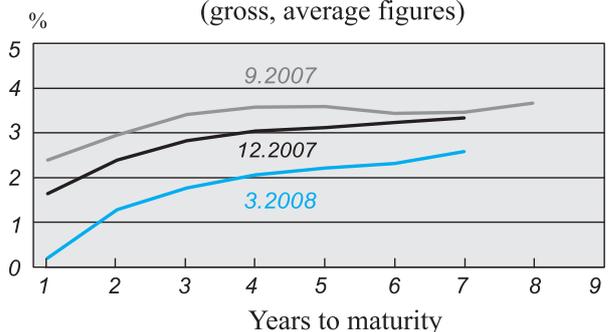
and share prices fell throughout most of the period reviewed. This was due to increased apprehensions of a recession in the US and a slowdown in the global economy, as well as steep interest-rate cuts by the Fed, the Bank of Israel's intervention on the foreign-currency market by buying dollars, and its cutting the nominal interest rate to as little as 3.25 percent. There was a moderate rise in share prices in February and at the beginning of March, following the stabilization of the dollar and expectations of an interest-rate cut, despite the decline in share prices abroad and the soaring price of oil. High-tech and real-estate shares fell most steeply (by 30 and 27 percent respectively). Bank shares also fell sharply during the period reviewed—due inter alia to the huge losses incurred by Bank Hapoalim because of the sub-prime crisis and the reduced rating accorded to Israeli banks by the Merrill-Lynch investment bank in March.

Figure 1.15

*Makam* yield curve, September 2007 to March 2008 (averages)



Yield curve of CPI-indexed Treasury bonds,\*  
September 2007 to March 2008  
(gross, average figures)



\* Excluding the yield on CPI-indexed 10-year bonds.

Table 1. National Accounts,<sup>a</sup> 2007-08

|                                                    | 2007              |                              |      |      |       | 2008/I                       |                                    |
|----------------------------------------------------|-------------------|------------------------------|------|------|-------|------------------------------|------------------------------------|
|                                                    | 2007 <sup>b</sup> | Change from previous quarter |      |      |       | Change from previous quarter | Year on year change <sup>b,c</sup> |
| I                                                  |                   | II                           | III  | IV   |       |                              |                                    |
| GDP                                                | 5.3               | 5.2                          | 6.1  | 5.9  | 5.8   | 5.4                          | 5.8                                |
| Business-sector product                            | 6.1               | 5.6                          | 7.1  | 7.3  | 7.6   | 6.1                          | 7.0                                |
| Private consumption                                | 6.6               | 8.4                          | 3.9  | 7.9  | 3.0   | 14.1                         | 7.1                                |
| Gross domestic investment                          | 13.8              | -19.9                        | 59.8 | 0.6  | 12.1  | -10.2                        | 12.8                               |
| Fixed investment                                   | 14.2              | 8.6                          | 15.4 | 42.9 | -11.8 | 9.6                          | 12.4                               |
| Goods and services exports                         |                   |                              |      |      |       |                              |                                    |
| excl. diamonds                                     | 9.3               | 8.3                          | 11.3 | 12.0 | 10.9  | 16.5                         | 12.7                               |
| Goods exports <sup>d</sup>                         | 8.9               | 12.7                         | 3.8  | 10.1 | 23.7  | 2.0                          | 9.6                                |
| Services exports <sup>d</sup>                      | 7.3               | -2.5                         | 19.4 | 7.5  | 4.9   | 41.8                         | 17.5                               |
| Goods and services imports                         |                   |                              |      |      |       |                              |                                    |
| excl. diamonds                                     | 14.0              | 16.6                         | 21.5 | 9.2  | 14.3  | 20.0                         | 16.1                               |
| Goods imports <sup>e</sup>                         | 11.4              | -5.3                         | 23.9 | 27.3 | 0.2   | 11.0                         | 15.1                               |
| Services imports <sup>e</sup>                      | 17.8              | 33.7                         | 20.4 | -7.0 | 0.8   | 39.5                         | 12.0                               |
| Public sector consumption                          | 2.6               | -0.7                         | 5.8  | 2.0  | -3.6  | 5.1                          | 2.3                                |
| Public sector consumption<br>excl. defense imports | 3.2               | 6.5                          | 1.8  | 4.4  | 1.1   | -2.9                         | 1.1                                |
| Domestic use of resources                          | 6.7               | 2.8                          | 12.4 | 3.4  | 7.5   | 4.4                          | 6.9                                |

<sup>a</sup> Percentage change in annual terms, at constant prices, seasonally adjusted.

<sup>b</sup> Unadjusted data.

<sup>c</sup> In quarterly terms

<sup>d</sup> New calculation - excluding subsidies.

<sup>e</sup> New calculation - excluding taxes.

SOURCE: Central Bureau of Statistics.

Table 2. Indicators of Business Activity,<sup>a</sup> 2007-08

|                                                         | 2007 <sup>b</sup> | 2007  |       |       |       | Change from previous period | Jan - Apr 08                       |                                      |
|---------------------------------------------------------|-------------------|-------|-------|-------|-------|-----------------------------|------------------------------------|--------------------------------------|
|                                                         |                   | I     | II    | III   | IV    |                             | Year on year change <sup>b,c</sup> | Last month for which data available* |
| Change from previous quarter                            |                   |       |       |       |       |                             |                                    |                                      |
| Composite state-of-the-economy index                    | 4.5               | 7.7   | 6.9   | 7.6   | 9.7   | 8.0                         | 8.0                                | Apr                                  |
| Large-scale retail trade                                | 6.7               | 7.9   | 6.4   | 11.5  | 7.6   | 4.1                         | 7.1                                | Apr                                  |
| Manufacturing production                                |                   |       |       |       |       |                             |                                    |                                      |
| (excl. diamonds)                                        | 4.9               | -4.3  | 1.0   | 8.8   | 9.8   | 12.8                        | 8.0                                | Mar                                  |
| Index of trade revenue                                  | 7.6               | 13.2  | 5.5   | 6.0   | 0.9   | 11.8                        | 6.0                                | Mar                                  |
| Index of trade and services revenue                     | 9.0               | 16.6  | 4.6   | 6.6   | 2.8   | 6.2                         | 5.0                                | Mar                                  |
| Index of services exports                               | 9.0               | 10.8  | 15.1  | -0.3  | 21.7  | 28.2                        | 16.0                               | Apr                                  |
| Tourist arrivals                                        | 24.4              | 121.0 | 2.2   | 61.5  | 95.4  | 28.5                        | 43.0                               | Apr                                  |
| Residential construction <sup>b</sup>                   |                   |       |       |       |       |                             |                                    |                                      |
| Starts                                                  | -3.0              | -12.2 | -0.2  | 13.1  | -8.6  |                             | -15.0                              | Jan                                  |
| Completions                                             | -7.0              | 17.7  | -15.3 | 4.6   | -29.3 |                             | -14.3                              | Jan                                  |
| Nonresidential construction <sup>b</sup>                |                   |       |       |       |       |                             |                                    |                                      |
| Area of starts                                          |                   | -48.0 | -25.0 | -21.0 | -3.0  | -4.0                        | -4.0                               | Mar                                  |
| Survey of companies (net balance, percent) <sup>d</sup> |                   |       |       |       |       |                             |                                    |                                      |
| Weighted balance of the business sector                 | 33.0              | 26.0  | 30.0  | 40.0  | 34.0  |                             |                                    | Mar                                  |
| Output of manufacturing firms                           | 27                | 27.0  | 24.0  | 34.0  | 23.0  |                             |                                    | Mar                                  |
| Sales by trading firms                                  | 37                | 31.0  | 36.0  | 46.0  | 36.0  |                             |                                    | Mar                                  |

\* When the last month is April, the comparisons are of four-month periods; when the last month is March, the comparisons are quarterly; and when the last month is January, the comparisons are monthly.

<sup>a</sup> Percentage change, in annual terms, seasonally adjusted.

<sup>b</sup> Unadjusted data.

<sup>c</sup> In quarterly terms.

<sup>d</sup> The net balance is defined as the difference between the number of firms reporting a rise and those reporting a decline, as a proportion of all reporting firms.

SOURCE: Based on Central Bureau of Statistics and Ministry of Construction and Housing data.

Table 3. Indicators of Labor Market Developments,<sup>a</sup> 2007-08

|                                                                               | 2008     | 2007                                 |      |      |      | Change from previous period | Jan - Apr 08                     |                                      |
|-------------------------------------------------------------------------------|----------|--------------------------------------|------|------|------|-----------------------------|----------------------------------|--------------------------------------|
|                                                                               | I        | I                                    | II   | III  | IV   |                             | Year on year change <sup>b</sup> | Last month for which data available* |
|                                                                               | ('000s)  | percent change from previous quarter |      |      |      |                             |                                  |                                      |
| Civilian labor force                                                          | 2,944.0  | 1.2                                  | 1.0  | 0.5  | -0.3 | 1.0                         | 3.0                              | Mar                                  |
| Israeli employees                                                             | 2,760.0  | 1.2                                  | 1.3  | 0.8  | 0.3  | 2.0                         | 4.0                              | Mar                                  |
| <i>of which:</i> in general government                                        | 806.0    | 0.7                                  | 0.4  | 2.5  | 0.1  | 0.0                         | 3.0                              | Mar                                  |
| in business sector                                                            | 1,955.0  | 1.3                                  | 1.5  | 0.4  | 0.5  | 3.0                         | 5.0                              | Mar                                  |
| Foreign workers and Palestinians<br>(unadjusted)                              | 392.0    | -2.8                                 | -0.9 | 5.0  | 5.3  | 4.0                         | 14.0                             | Mar                                  |
| Average hours worked weekly per employee                                      | 36.6     | 0.0                                  | -0.8 | 0.5  | 0.5  | -0.5                        | 0.0                              | Mar                                  |
| Labor input in business sector<br>(incl. foreign workers and<br>Palestinians) | 95,670.0 | 0.1                                  | 0.7  | 1.5  | 1.7  | 2.0                         | 6.0                              | Mar                                  |
| <i>of which:</i> Israelis                                                     | 83,832.0 | 0.2                                  | 1.0  | 1.1  | 1.4  | 1.0                         | 5.0                              | Mar                                  |
| Labor input in general government (Israelis)                                  | 17,368.0 | 4.0                                  | -3.4 | 3.0  | -0.7 | 3.0                         | 1.0                              | Mar                                  |
| Unemployed                                                                    | 185.0    | 1.4                                  | -2.5 | -3.9 | -7.4 | -5.0                        | -17.0                            | Mar                                  |
| Work seekers                                                                  | 187.0    | -1.2                                 | -1.4 | -2.8 | -3.2 | -9.0                        | -8.0                             | Mar                                  |
| Claims for unemployment benefit                                               | 56.0     | -2.0                                 | -1.8 | -3.2 | -7.5 | -15.0                       | -16.0                            | Apr                                  |
| Real wage per employee post <sup>c</sup>                                      | 7,459.0  | -0.3                                 | 1.1  | -1.4 | 0.4  | 8.0                         | 1.0                              | Mar                                  |
| In general government                                                         | 6,973.0  | 0.9                                  | 2.3  | -1.8 | 0.6  | 5.0                         | 2.0                              | Mar                                  |
| In business sector                                                            | 7,691.0  | -0.3                                 | 0.8  | -1.1 | -0.7 | 6.0                         | 1.0                              | Mar                                  |
| Nominal wage per employee post <sup>c</sup>                                   | 7,910.0  | -0.2                                 | 1.4  | -0.1 | 1.5  | 12.0                        | 5.0                              | Mar                                  |
| In general government                                                         | 7,394.0  | 1.4                                  | 2.4  | -0.6 | 1.6  | 11.0                        | 6.0                              | Mar                                  |
| In business sector                                                            | 8,156.0  | 0.1                                  | 0.7  | 0.2  | 0.4  | 12.0                        | 4.0                              | Mar                                  |
| Participation rate                                                            | 56.6     | 56.2                                 | 56.5 | 56.5 | 56.1 |                             |                                  | Mar                                  |
| Employment rate                                                               | 53.1     | 51.8                                 | 52.2 | 52.4 | 52.4 |                             |                                  | Mar                                  |
| Unemployment rate                                                             | 6.3      | 7.8                                  | 7.5  | 7.2  | 6.7  |                             |                                  | Mar                                  |
| Depth of unemployment <sup>d</sup>                                            | 34.0     | 35.1                                 | 32.0 | 30.4 | 30.1 |                             |                                  | Mar                                  |

\* When the last month is April, the comparisons are of four-month periods; and when the last month is March, the comparisons are quarterly.

<sup>a</sup> Percent change, seasonally adjusted.

<sup>b</sup> Unadjusted data.

<sup>c</sup> Including foreign workers and Palestinians.

<sup>d</sup> Percent of unemployed seeking work for more than six months (unadjusted).

SOURCE: Central Bureau of Statistics, Labor Force Survey, except for data on Israelis, non-Israelis, and labor input in the business sector, and total Israelis employed, which are the Central Bureau of Statistics' National Accounts estimates.

Table 4. Government Budget Performance, 2007-08

|                                                                         | 2007  |                                          |      |      |       | Jan - Apr 08                |                     |                                      |
|-------------------------------------------------------------------------|-------|------------------------------------------|------|------|-------|-----------------------------|---------------------|--------------------------------------|
|                                                                         | 2007  | I                                        | II   | III  | IV    | Change from previous period | Year on year change | Last month for which data available* |
| Domestic deficit as percent of GDP                                      | 1.5   | 5.1                                      | 1.1  | 2.2  | -2.6  | 4.7**                       |                     | Mar                                  |
| Deviation from domestic budget path, excl. credit extended <sup>a</sup> |       | NIS billion, <sup>b</sup> nominal prices |      |      |       |                             |                     |                                      |
| Revenue                                                                 |       | 4.1                                      | 3.6  | 4.1  | 3.2   | -1.5                        | -3.9                | Apr                                  |
| Expenditure                                                             |       | -2.2                                     | -2.1 | -0.7 | -0.6  | 1.5                         | 1.3                 | Apr                                  |
| Deficit                                                                 |       | -6.3                                     | -5.7 | -4.8 | -3.8  | -3.0                        | -5.2                | Apr                                  |
| Total deficit (excluding credit)                                        |       | 6.4                                      | -0.8 | 2.2  | -7.9  | 13.3                        | -1.6                | Apr                                  |
|                                                                         |       | Real percentage change, year on year     |      |      |       |                             |                     |                                      |
| Government tax revenue                                                  | 5.9   | 7.7                                      | 5.5  | 6.7  | 3.4   | 12.6                        | -1.9                | Mar                                  |
| <i>of which:</i> income tax, net                                        | 3.0   | 11.5                                     | 4.0  | -3.2 | -0.8  | 18.8                        | -11.6               | Mar                                  |
| VAT, gross                                                              | 5.7   | 0.5                                      | 2.3  | 10.5 | 9.6   | 5.5                         | 7.8                 | Apr                                  |
| Government expenditure                                                  | 3.4   | 9.0                                      | 3.8  | 0.8  | 1.0   | -7.2                        | 2.3                 | Apr                                  |
| National insurance allowances                                           | 2.8   | 4.8                                      | 4.5  | 1.5  | 0.4   | 1.9                         | 2.9                 | Mar                                  |
| <i>of which:</i> Unemployment benefit                                   | -10.6 | -7.4                                     | -7.9 | -8.5 | -18.9 | 6.1                         | -12.1               | Mar                                  |
| Income support                                                          | -8.0  | -6.6                                     | -5.8 | -9.3 | -10.6 | 4.2                         | -6.5                | Mar                                  |
| National insurance contributions received from the public               | 4.7   | 2.9                                      | 6.1  | 7.7  | 2.1   | -1.1                        | 5.9                 | Mar                                  |

\* When the last month is April, the comparisons are of four-month periods; and when the last month is March, the comparisons are quarterly.

\*\* The deficit in 2008:I.

<sup>a</sup> The path was determined on the basis of a deficit of 3.0 percent of GDP.

<sup>b</sup> Year on year change. Does not refer to the seasonal path.

SOURCE: Based on Ministry of Finance and National Insurance Institute data.

Table 5. Foreign Trade, Balance of Payments, and the Reserves, 2007-08  
(seasonally adjusted)

|                                                                  | 2007 <sup>a</sup>                                 | 2007       |        |        |        | 2008   | Jan - Apr 08                |                                  |                                      |  |
|------------------------------------------------------------------|---------------------------------------------------|------------|--------|--------|--------|--------|-----------------------------|----------------------------------|--------------------------------------|--|
|                                                                  |                                                   | I          | II     | III    | IV     | I      | Change from previous period | Year on year change <sup>a</sup> | Last month for which data available* |  |
|                                                                  | percent change from previous quarter <sup>b</sup> |            |        |        |        |        |                             |                                  |                                      |  |
| <b>Trade in goods<sup>c</sup></b>                                |                                                   |            |        |        |        |        |                             |                                  |                                      |  |
| Goods imports                                                    | 20.8                                              | 7.4        | 4.7    | 7.1    | 6.2    |        | 9.1                         | 26.1                             | Apr                                  |  |
| <i>of which:</i> Consumer goods                                  | 29.0                                              | 17.9       | 3.6    | 6.3    | 4.6    |        | 19.8                        | 36.1                             | Apr                                  |  |
| Capital goods                                                    | 23.9                                              | 6.6        | 7.1    | 12.1   | 6.4    |        | 13.6                        | 41.2                             | Apr                                  |  |
| Intermediates                                                    | 17.0                                              | 4.4        | 4.3    | 5.6    | 6.7    |        | 3.5                         | 17.3                             | Apr                                  |  |
| Goods exports                                                    | 18.5                                              | 7.8        | 1.5    | 3.9    | 12.2   |        | 6.1                         | 22.0                             | Apr                                  |  |
| <i>of which:</i> Manufacturing                                   | 18.2                                              | 7.0        | 2.1    | 4.4    | 11.9   |        | 6.5                         | 23.4                             | Apr                                  |  |
| <i>of which:</i> High-tech                                       | 12.8                                              | 5.1        | 2.3    | -0.5   | 11.9   |        | 0.6                         | 11.7                             | Apr                                  |  |
| <b>Balance of payments</b>                                       |                                                   |            |        |        |        |        |                             |                                  |                                      |  |
|                                                                  |                                                   | \$ million |        |        |        |        |                             |                                  |                                      |  |
| Goods and services exports                                       | 71,498                                            | 16,581     | 17,276 | 18,015 | 19,311 | 20,900 |                             |                                  | Mar                                  |  |
| Goods and services imports                                       | 73,634                                            | 16,603     | 17,737 | 19,260 | 20,107 | 21,444 |                             |                                  | Mar                                  |  |
| Balance of trade in goods and services                           | -2,136                                            | -22        | -461   | -1,246 | -795   | -543   |                             |                                  | Mar                                  |  |
| Current account surplus                                          | 5,197                                             | 1,518      | 1,578  | 791    | 946    | 1,092  |                             |                                  | Mar                                  |  |
| Financial account (excl. foreign exchange reserves) <sup>a</sup> | -1,600                                            | -1,329     | -2,331 | 25     | -2,764 |        | -2,798.0                    | -1,329.0                         | Mar                                  |  |
| <i>of which:</i> Nonresidents' direct investment <sup>a</sup>    | 2,644                                             | 2,869      | 2,074  | 3,251  | 2,083  |        | 2,918.0                     | 2,869.0                          | Mar                                  |  |
| Nonresidents' portfolio investment <sup>c</sup>                  | 67                                                | 1,033      | 845    | -801   | -808   |        | -2,315.0                    | 1,033.0                          | Mar                                  |  |
| Residents' direct and portfolio investment abroad <sup>a</sup>   | 3,131                                             | 3,880      | 4,429  | 1,910  | 2,304  |        | 1,617.0                     | 3,880.0                          | Mar                                  |  |
| Net foreign debt (percent of GDP) <sup>a</sup>                   | -23.6                                             | -23.4      | -24.1  | -23.0  | -23.4  |        | -23.9                       | -23.4                            | Mar                                  |  |
| Bank of Israel reserves, end-period <sup>a</sup>                 | 28,460                                            | 30,504     | 28,969 | 29,130 | 28,460 |        |                             |                                  | Apr                                  |  |

\* When the last month is April, the comparisons are of four-month periods; and when the last month is March, the comparisons are quarterly.

<sup>a</sup> Unadjusted data.

<sup>b</sup> The change relates to the dollar values of imports and exports.

<sup>c</sup> Not including ships, aircraft, diamonds, and fuel.

SOURCE: Central Bureau of Statistics.

Table 6. Indicators of Economic Development in Advanced and Developing Countries<sup>a</sup>  
(annual rate of change, percent)<sup>b</sup>

|                                         | 2005 | 2006 | 2007 | Projection | Projection |
|-----------------------------------------|------|------|------|------------|------------|
|                                         |      |      |      | 2008       | 2009       |
| World GDP                               | 4.4  | 5.0  | 4.9  | 3.7        | 3.8        |
| Advanced countries                      | 2.5  | 3.0  | 2.7  | 1.3        | 1.3        |
| Developing countries                    | 7.0  | 7.8  | 7.9  | 6.7        | 6.6        |
| World trade                             | 7.5  | 9.2  | 6.8  | 5.6        | 5.8        |
| Advanced countries                      |      |      |      |            |            |
| Imports                                 | 6.1  | 7.4  | 4.2  | 3.1        | 3.7        |
| Exports                                 | 5.8  | 8.2  | 5.8  | 4.5        | 4.2        |
| Developing countries                    |      |      |      |            |            |
| Imports                                 | 12.1 | 14.4 | 12.8 | 11.8       | 10.7       |
| Exports                                 | 11.1 | 10.9 | 8.9  | 7.1        | 8.7        |
| Commodity prices (US\$)                 |      |      |      |            |            |
| Oil <sup>c</sup>                        | 41.3 | 20.5 | 10.7 | 34.3       | -1.0       |
| Nonfuel                                 | 10.3 | 23.2 | 14.0 | 7.0        | -4.9       |
| Inflation (CPI) in advanced countries   | 2.3  | 2.4  | 2.2  | 2.6        | 2.0        |
| Short-term interest <sup>d</sup> (%)    |      |      |      |            |            |
| Dollar deposits                         | 3.8  | 5.3  | 5.3  | 3.1        | 3.4        |
| Euro deposits                           | 2.2  | 3.1  | 4.3  | 4.0        | 3.6        |
| Unemployment rate in advanced countries | 6.0  | 5.7  | 5.4  | 5.6        | 5.9        |

<sup>a</sup> According to World Economic Outlook, Israel is classified as an advanced country. The advanced countries include the industrialized countries and some emerging markets.

<sup>b</sup> Except for unemployment and interest rates.

<sup>c</sup> Average price per barrel in 2006 was \$64.27

<sup>d</sup> Six-month Libor rate for US dollar deposits, and three-month Libor rate on euro deposits.

SOURCE: World Economic Outlook (IMF), April 2008.

Table 7. Selected Price Indices, 2007-08  
(percent change)

|                                                                                            | 2007 | 2007                                       |      |      |      | Jan - Apr 08                             |                     |  |
|--------------------------------------------------------------------------------------------|------|--------------------------------------------|------|------|------|------------------------------------------|---------------------|--|
|                                                                                            |      | I                                          | II   | III  | IV   | Change from previous period <sup>a</sup> | Year on year change |  |
|                                                                                            |      | Change during the quarter <sup>b</sup>     |      |      |      |                                          |                     |  |
| CPI                                                                                        | 3.4  | -0.2                                       | 1.2  | 1.3  | 1.1  | 1.6                                      | 4.7                 |  |
| CPI excl. housing, fruit and vegetables                                                    | 3.7  | -0.1                                       | 1.7  | 0.1  | 2.0  | 1.7                                      | 4.8                 |  |
| CPI excl. housing, fruit and vegetables, price-controlled goods, clothing and footwear     | 3.8  | 0.6                                        | 1.2  | 0.6  | 1.3  | 2.4                                      | 5.0                 |  |
| Index of housing prices                                                                    | 1.9  | -0.3                                       | -0.1 | 4.7  | -2.3 | -1.2                                     | 1.1                 |  |
| Wholesale price index                                                                      | 11.4 | 1.6                                        | 2.5  | 1.9  | 5.0  | 2.8                                      | 11.7                |  |
| NIS/\$ exchange rate                                                                       | -7.1 | 0.0                                        | -0.4 | -2.3 | -4.5 | -9.8                                     | -13.5               |  |
| NIS/currency-basket rate                                                                   | 2.4  | 0.2                                        | 0.9  | 1.0  | 0.3  | -2.4                                     | 0.8                 |  |
|                                                                                            |      | During previous twelve months <sup>c</sup> |      |      |      |                                          |                     |  |
| CPI                                                                                        | 0.5  | -0.6                                       | -1.1 | 0.9  | 2.8  |                                          | 3.9                 |  |
| CPI excluding housing, fruit and vegetables, price controlled goods, clothing and footwear | 1.1  | 0.5                                        | 0.0  | 0.7  | 3.1  |                                          | 4.4                 |  |

<sup>a</sup> April 2008 compared with December 2007.

<sup>b</sup> Last month of each quarter compared with last month of previous quarter.

<sup>c</sup> Year on year change, average of quarter (or four months).

SOURCE: Central Bureau of Statistics.

**Table 8. Monetary Aggregates and Nondirected Bank Credit, 2007-08**  
(annual terms, percent)

|                                              | 2007                         |       |      |      |       | Jan - Apr 08<br>Change during period                           |                        |
|----------------------------------------------|------------------------------|-------|------|------|-------|----------------------------------------------------------------|------------------------|
|                                              | 2007                         | I     | II   | III  | IV    | Compared with<br>change during<br>previous period <sup>a</sup> | Year on year<br>change |
| Rates of change                              | change from previous quarter |       |      |      |       |                                                                |                        |
| M1 <sup>a</sup>                              | 15.3                         | 21.0  | 23.3 | 38.4 | -1.5  | 5.4                                                            | 15.1                   |
| M2 <sup>b</sup>                              | 15.3                         | 22.8  | 19.3 | 21.1 | 1.6   | 6.0                                                            | 11.2                   |
| M3 <sup>c</sup>                              | 12.9                         | 19.8  | 13.7 | 22.2 | 4.0   | 4.3                                                            | 10.3                   |
| Nondirected bank credit                      | 4.3                          | 3.8   | 7.0  | 10.1 | 5.8   | 5.5                                                            | 6.9                    |
| Unindexed local-currency credit              | 15.7                         | 20.0  | 17.3 | 3.3  | 16.9  | 21.5                                                           | 14.5                   |
| CPI-indexed credit                           | -0.9                         | -6.3  | 1.4  | 14.0 | 5.1   | 1.9                                                            | 5.6                    |
| Credit in and indexed to foreign<br>currency | -10.9                        | -13.0 | -7.7 | 22.3 | -18.6 | -26.5                                                          | -10.3                  |

<sup>a</sup> September to December 2007.

<sup>a</sup> Narrow money supply (demand deposits and cash in the hands of the public).

<sup>b</sup> M1 plus short-term local-currency unindexed deposits.

<sup>c</sup> M2 plus short-term CPI-indexed demand deposits.

SOURCE: Bank of Israel.

**Table 9. Interest Rates, Yields, and the Share-Price Index, 2007-08**  
(quarterly average, percent)

|                                                            | 2007 | 2007 |      |      |     | Jan - Apr 08                                |                        |
|------------------------------------------------------------|------|------|------|------|-----|---------------------------------------------|------------------------|
|                                                            |      | I    | II   | III  | IV  | Change from<br>previous period <sup>a</sup> | Year on year<br>change |
| Nominal interest                                           |      |      |      |      |     |                                             |                        |
| SRO deposits                                               | 3.0  | 3.3  | 2.8  | 2.8  | 3.0 | 2.8 <sup>b</sup>                            | 3.2                    |
| Nondirected local-currency credit                          | 7.5  | 7.8  | 6.9  | 7.9  | 7.4 | 8.0                                         | 7.8                    |
| Effective interest on daily deposit auctions               | 3.9  | 0.0  | 0.0  | 3.7  | 4.1 | 4.1                                         | 4.0                    |
| LIBID 3-month dollar interest                              | 5.2  | 5.2  | 5.2  | 5.3  | 4.9 | 3.0                                         | 5.2                    |
| Yield to maturity on:                                      |      |      |      |      |     |                                             |                        |
| <i>Makam</i> (short-term Bank of Israel bills)             |      |      |      |      |     |                                             |                        |
| Yield on 5-year bonds                                      | 4.3  | 4.5  | 3.8  | 4.5  | 4.5 | 4.1                                         | 4.3                    |
| Risk premium <sup>c</sup>                                  | 3.2  | 3.2  | 2.9  | 3.4  | 3.3 | 2.7                                         | 3.2                    |
| Expected inflation, twelve months forward <sup>d</sup>     | 0.0  | 0.2  | 0.2  | 0.2  | 0.3 | 2.4                                         | 3.5                    |
| General Share-Price Index (change from previous<br>period) | 1.3  | 1.3  | 1.0  | 1.6  | 1.5 | 2.6                                         | 1.1                    |
| General Share-Price Index (change)                         | 23.3 | 10.1 | 11.0 | -0.7 | 1.7 | -11.3                                       | 16.9                   |

<sup>a</sup> September to December 2007.

<sup>b</sup> 2008:I compared with 2007:IV.

<sup>c</sup> As measured by the 5-year credit-default-swap (CDS) market

<sup>d</sup> Derived from the yield gap between indexed and unindexed bonds held by tax exempt institutional investors, minus the x-day effect on the price of the bond.

SOURCE: Bank of Israel.

## Part 2: Broader Review of Selected Issues

### Working Long Hours

A workaholic is defined as someone who is addicted to work<sup>1</sup> and devotes most of his time and effort to it even though there is no economic necessity for him to do so.<sup>2</sup> He is under the illusion that the way to deal with the challenges of life and work is by working hard. This phenomenon has been investigated extensively in psychological and sociological contexts but has received little attention from economists. This is partly due to the difficulty in differentiating between a high preference for work (and a low preference for leisure) and workaholism.

The addiction to work has spread during recent decades due to a number of processes: increased individualism—accompanied by, among other things, competitiveness, the desire to develop one’s career and materialism—has led to a decrease in the allocation of time to leisure and in general to the family; far-reaching structural changes, including an increase in the proportion of corporations, many of them multinationals, that operate around-the-clock in a globally competitive environment, especially in the hi-tech industries, and the increase in the share of the service industries, in which long hours are often the norm; a decline in the level of unionization which reduces the negotiating power of workers, particularly with respect to work hours;<sup>3</sup> technological improvements and institutional arrangements that make housework and childrearing easier; and increased income inequality that increases the benefit from hard work that can enhance one’s chances of achieving a high-paying position.

Furthermore, employers encourage addiction to work by blurring the boundaries between work and leisure. This is

accomplished by providing workers with modern means of communication (cellular phones, laptop computers, Internet connections, etc.) and a car, which enables them to work from home and to easily get to work at any time of day. Employers also “bring the home to work” (by providing a fitness room, daycare centers and the like) and organize social activity in order to increase the feeling of home at work. In addition, close supervision and monitoring of workers is common (for example, monitoring computer user; tracking the location of company cars and cellular telephones and the use of smart cards).<sup>4</sup> All this provides the employer with information on the work patterns of each and every one of his workers. Finally, employers create a work environment in which the workaholic receives encouragement and promotion while other workers are likely to get the cold shoulder.

Addiction to work has wide-ranging effects on the worker and on the economy. The phenomenon is liable to increase a worker’s level of tension and anxiety, damage his health (fatigue, high blood pressure, etc.) and in exceptional cases can even lead to death (in Japan, this phenomenon is called *karoshi*).<sup>5</sup> It is also liable to affect social relationships in general and family relationships in particular, even to the point of divorce. The presence of a workaholic in a place of work induces his fellow workers to also increase their work hours. In view of these negative externalities and the overrepresentation of high-income earners among workaholics, there are those who recommend raising the progressivity of direct taxation.<sup>6</sup> From the viewpoint of the economy as a whole, labor costs are indeed declining but the employment of others is liable to be affected and in the long run, with the continued burnout of employees in the workplace, productivity per hour of labor will decline and as a result labor cost per unit of output may in fact increase.

<sup>1</sup> The term workaholic was coined by W. Oates (1971). *Confessions of a Workaholic*, World Press, NY.

<sup>2</sup> It is important to stress that accepted conventions among employers and the demands of the job, which require long work hours, do not necessarily remove a worker from the category of workaholic since, at least in the long run, he is able to choose a less demanding position or type of work. Furthermore, in most cases, a workaholic could have chosen from the beginning not to work in a position that requires long work hours.

<sup>3</sup> Thus, for example, a link was found between the level of unionization in Europe and work hours. See: A. Alesina, E. Glaeser and B. Sacerdote (2005). *Work and Leisure in the U.S. and Europe: Why so Different?* NBER Working Paper 11278.

The unions are interested in a large number of members and therefore a shorter work week, rather than layoffs. In many cases, a shorter work week is a way to get around opposition to a wage increase.

<sup>4</sup> For more details, see F. Petrar-Alon et al. (2008). “The Multi-Annual Survey of the Center for the Study of Organizations and Human Resource Management – Haifa University,” *Human Resources*, 242, 38-44 (Hebrew).

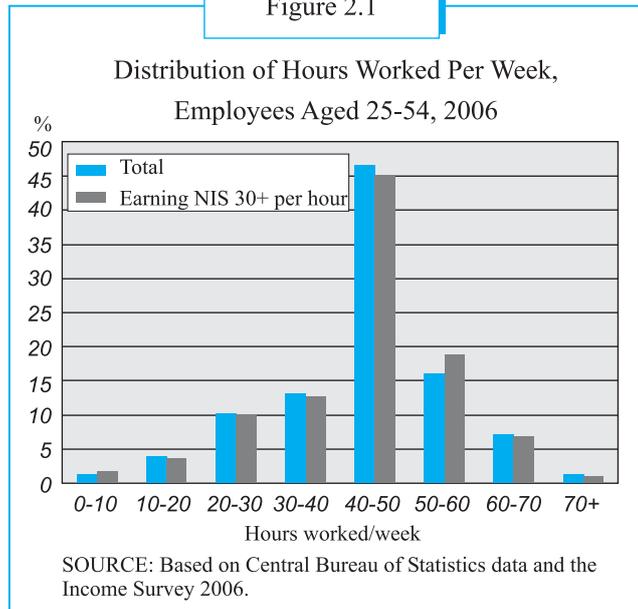
<sup>5</sup> Employees who work long hours and are also high-income earners tend to be under great stress. For details, see: D.S. Hamermesh and J. Lee (2007). “Stressed Out on Four Continents: Time Crunch or Yuppie Kvetch?” *The Review of Economics and Statistics*, 89(2), 374-383.

<sup>6</sup> D.S. Hamermesh and J.B. Slemrod (2008). “The Economics of Workaholism: We Should Not Have Worked on This Paper,” *The B.E. Journal of Economic Analysis & Policy*, 8(1).

Notice that while high taxes imposed on addictive and harmful products (such as cigarettes and alcohol) are regressive, in this case they are progressive.

Due to the difficulty in identifying workaholics, we will discuss employees (within the civilian labor force) who work at least 60 hours per week<sup>7</sup> and whose wage per hour is greater than NIS 30.<sup>8</sup> These will be defined as workers who “work long hours at a high wage” (though not in all cases due to workaholism). Not included in the definition are workers who work long hours but earn less than NIS 30 per hour since, in many cases, they are forced to do so in order to make a living. The focus will be on all employees of working age (25–54) earning more than NIS 30 per hour serving as the reference groups.

Figure 2.1



The proportion of employees working long hours at a high wage within the employees population was 4.9 percent in 2006 (5.4 percent among Jews)<sup>9</sup> and they constitute 7.9 percent of the total employees earning over NIS 30 per hour (see Figure 2.1). It should be mentioned that more than 9 percent of those earning less than NIS 30 work 60 hours or more per week, which provides evidence that many workers are forced to work long hours in order just to make a living.

<sup>7</sup> There is a high correlation between long work hours and workers defining themselves as workaholics. Thus, for example, the Canadian Social Survey for 2005 showed that more than half of those who work more than 60 hours per week reported that they are addicted to work.

<sup>8</sup> A similar fundamental approach, which defines workaholics according to work hours, given the financial needs of the household, was adopted in the following study: I. Harpaz and R. Snir (2003). “Workaholism: Its Definition and Nature”, *Human Relation*, 56(3), 292-320.

<sup>9</sup> 3.4 percent of employees work at least 60 hours per week at a wage that exceeds NIS 40 per hour (3.8 percent among Jews).

Among employees working long hours at a high wage, there is a relatively high proportion of Jewish educated men aged 35–44<sup>10</sup> who are married to a working spouse (Table 2.1).<sup>11,12</sup> They work on average close to 64 hours per week, as compared to 42 hours among the total population of employees who earn over NIS 30 per hour. Their average monthly wage is NIS 15.9 thousand, which is about one-third higher than that of employees in the reference group but, due to their long work hours, their wage per hour is similar at NIS 60.

The main occupations in which employees working long hours at a high wage can be found are managers (18 percent), academics (23 percent) and engineers and technicians (21 percent) (see Figure 2.2.a). Their proportion of these occupations is also high relative to the reference groups. Thus, for example, the proportion of managers working long hours at a high wage is double that of managers in the general population of employees earning over NIS 30 per hour. A similar situation can be found in other countries.<sup>13</sup>

Many of these employees are in the civil service (18 percent) and in the advanced branches of the economy – hi-tech and computer services and R&D (16 percent) (see Figure 2.2b) and their proportion of total workers in these branches is also high in relative terms.

In order to evaluate the attitudes of employees who work long hours at a high wage to their place of work and the effects of long work hours on the balance between home and office, use was made of social surveys carried out by the Central Bureau of Statistics in 2003 and 2005, which contain relevant questions (Table 2.2).

Job satisfaction among employees who work long hours at a high wage was similar to that among the total population of employees who earn NIS 30 or more per hour. Satisfaction

<sup>10</sup> Some of the employees who are starting out in the labor market are likely to work long hours for a relatively short period of time due to the demands of the job (for example, interns training to become lawyers, accountants or physicians).

<sup>11</sup> Leisure is in part consumed jointly with a spouse and therefore if one spouse works long hours the other is likely to react by increasing his/her hours of work as well.

<sup>12</sup> Other socioeconomic characteristics of employees who work long hours can be found in: K. Levi (2006). *Who are the Employees Working More than 50 Hours a Week?* Central Bureau of Statistics, Working Paper Series, No. 23 (Hebrew). The logistic estimations presented there show that the characteristics which contribute to a work week of over 50 hours are similar to those common to employees who work long hours at a high wage, as presented here.

<sup>13</sup> C. Fagan (2004). “Gender and Working Time in Industrialized Countries”, In: J.C. Messenger (ed.), *Working Time and Workers’ Preferences in Industrialized Countries*, ILO.

**Table 2.1: Socioeconomic characteristics of employees aged 25–54: Employees working long hours relative to the rest, 2006 (percent)**

|                                                  | Total       | Employees earning over NIS 30 per hour | Employees working long hours at a high wage |
|--------------------------------------------------|-------------|----------------------------------------|---------------------------------------------|
| Total (thousands)                                | 1,620       | 920                                    | 79                                          |
| Proportion of the population                     | 100         | 56.8                                   | 4.9                                         |
| Men                                              | 52.4        | 55                                     | 87.9                                        |
| Age distribution:                                |             |                                        |                                             |
| 25–34                                            | 41.3        | 36.3                                   | 32.8                                        |
| 35–44                                            | 31.4        | 33.6                                   | 37.5                                        |
| 45–54                                            | 27.4        | 30.1                                   | 29.7                                        |
| Jews                                             | 88.8        | 93.4                                   | 98.2                                        |
| Married                                          | 72.6        | 78.6                                   | 85.3                                        |
| <i>of those:</i> to a working spouse (employees) | 56.7        | 63.9                                   | 73.8                                        |
| Distribution by education:                       |             |                                        |                                             |
| No academic degree                               | 65.8        | 52.4                                   | 49.2                                        |
| First degree                                     | 21.8        | 29.4                                   | 26                                          |
| Second or third degree                           | 12.4        | 18.2                                   | 24.8                                        |
| Average (median) work week (hours)               | 41.6 (43.0) | 41.5 (43.0)                            | 63.7 (60.0)                                 |
| Average (median) hourly wage (NIS)               | 44.5 (33.5) | 61.4 (49.8)                            | 58.9 (49.4)                                 |
| Average (median) monthly wage (NIS '000)         | 7.6 (5.8)   | 10.5 (8.6)                             | 15.9 (13.8)                                 |

Source: Based on Central Bureau of Statistics, Income Survey 2006.

with their income from work was higher, which is not surprising since their monthly income is much higher. The importance of a working environment “without too much pressure” and convenient working hours for these employees was lower than among the reference group but they report greater difficulty in handling their workload.<sup>14</sup>

With regard to substitution between work and leisure, employees who work long hours at a high wage are less willing to give up work hours because of family commitments, find it more difficult to find time for household chores and are more willing not to utilize vacation time. These findings are in agreement with those in the literature which show that the family is a less important factor in their lives.

<sup>14</sup> The finding that convenient working hours are less important to employees who work long hours at a high wage than to others is probably an indicator of a low preference for leisure though it contradicts findings in The 1998 Employment Options Survey which found that four-fifths of employees who work 50 hours or more per week would prefer to reduce their work hours (with more than half of them wishing to reduce by 15 hours or more).

It is interesting that no major difference was found between employees who work long hours at a high wage and others with regard to whether they would allow themselves not to work at all if it was possible financially. This contrasts with the conventional wisdom that among the former there is a higher proportion of believers in the work ethic. Finally, satisfaction with life among employees who work long hours at a high wage is no different than among other employees who make NIS 30 or more per hour. However, it was found that employees working long hours would prefer to work less.<sup>15</sup>

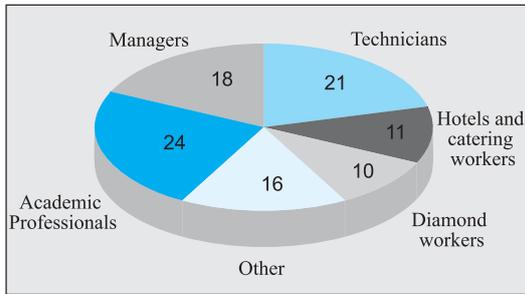
An international comparison of workaholism is difficult since there is no uniform definition of the phenomenon and there is a shortage of comparable data. Snir and Harpaz (2006) found—based on an international survey of the meaning of work carried out in the early 1980s—the following descending order for the incidence of workaholism by country: Japan,

<sup>15</sup> N. Zussman and D. Romanov (2005) “Life Satisfaction among Israelis,” *Israel Economic Review*, 77, 105–137 (Hebrew).

Figure 2.2

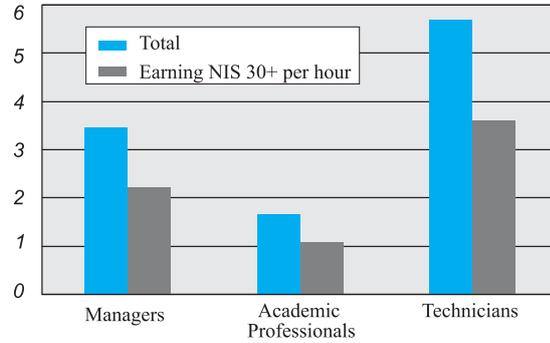
Occupation of employees aged 25-54 who work long hours at a high wage, and the industries in which they work, 2006

a. Distribution (percent)

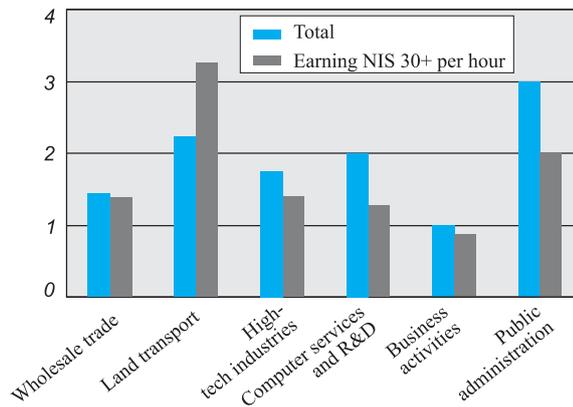
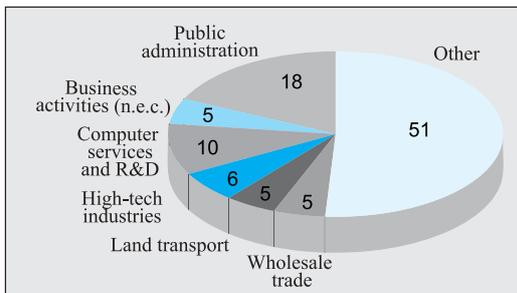


b. Proportion in selected occupations and industries relative to the reference groups

Occupations



Industries



SOURCE: Based on Central Bureau of Statistics data and Income Survey 2006.

Belgium, the US, Israel and Holland. However, during the last two decades, there has been a decline in the number of work hours in Japan. This is also true of Western Europe though this trend came to an end in the late 1990s, partly due to the weakening of the unions and the greater flexibility in the labor market (such as the dilution of the Aubry law in France which was passed in the late 1990s and which reduced the standard workweek from 39 to 35 hours).

According to a publication of the International Labor Organization,<sup>16</sup> it appears that the proportion of employees working 60 hours or more in Israel exceeds that in most of the OECD countries—among both men and women—and is only higher in South Korea, Japan and Mexico (and among women in the US) (Figure 2.3). The countries with a relatively high rate of workaholism are characterized by a relatively flexible labor market and a low level of unionization.

<sup>16</sup> S. Lee, D. McCann and J.C. Messenger (2007). *Working Time Around the World – Trends in Working Hours, Laws and Policies in a Global Comparative Perspective*, ILO and Routledge, London and New York.

Table 2.2: Attitudes to work—employees who work long hours at a high wage in comparison to others: Jewish employees aged 25–54 in 2005<sup>a</sup> (percent)

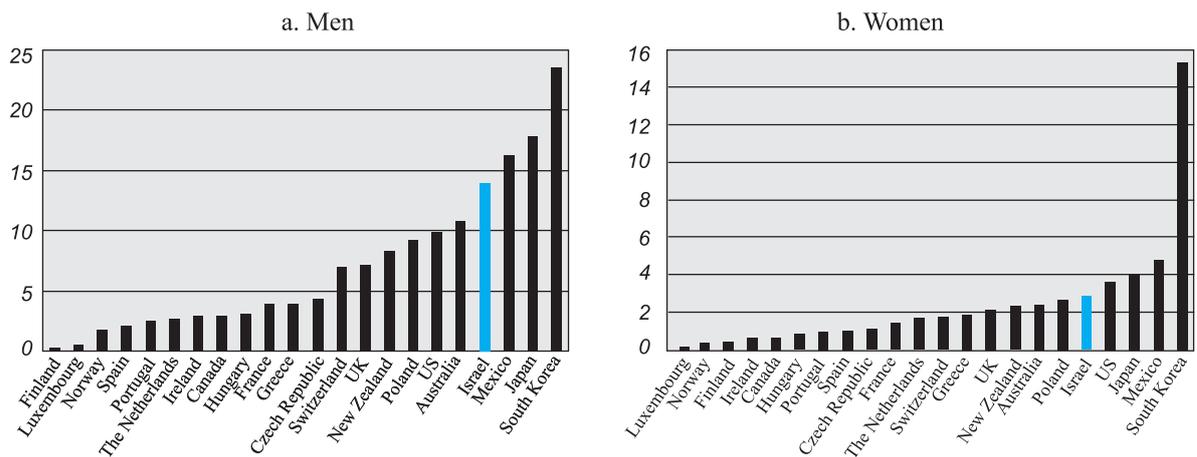
|                                                                  | Total | Employees earning over NIS 30 per hour | Employees working long hours at a high wage |
|------------------------------------------------------------------|-------|----------------------------------------|---------------------------------------------|
| Job satisfaction                                                 | 83    | 88                                     | 89                                          |
| Satisfaction from work income                                    | 50    | 62                                     | 71                                          |
| Important reasons for going to work:                             |       |                                        |                                             |
| Career development                                               | 71    | 75                                     | 77                                          |
| Pleasure from working                                            | 66    | 68                                     | 67                                          |
| Importance of the work environment:                              |       |                                        |                                             |
| Reasonable number of work hours                                  | 72    | 69                                     | 64                                          |
| Convenient work hours                                            | 88    | 84                                     | 73                                          |
| Difficulty in handling the workload (2003)                       | 25    | 25                                     | 41                                          |
| Substitution between home and work (2003):                       |       |                                        |                                             |
| Less work hours due to family commitments                        | 16    | 17                                     | 10                                          |
| Difficulty in doing household chores because of work commitments | 35    | 35                                     | 54                                          |
| Giving up vacation time due to work commitments                  | 39    | 41                                     | 69                                          |
| Will continue to work even if there is no economic necessity     | 76    | 77                                     | 79                                          |
| Satisfaction with life                                           | 86    | 91                                     | 91                                          |

<sup>a</sup> Unless stated that the figures are for 2003.

Source: Based on Central Bureau of Statistics, Social Survey 2003 and 2005.

Figure 2.3

The proportion of employees<sup>a</sup> who work 60 hours or more per week, Israel and OECD countries,<sup>b</sup> 2004<sup>c</sup> (percent)



<sup>a</sup> In most of the countries, the figures are for over 25-year olds. In Holland, Japan, Luxembourg, New Zealand, Poland, Portugal and Canada, over 15-year olds; in the US and Norway, over 16-year olds.

<sup>b</sup> There are no available data for some of the OECD countries.

<sup>c</sup> The figure for Britain is for 2003; the figure for Greece is for 2005.

SOURCE: Based on Lee, McCann and Messenger (2007).

## The Relation Between Growth and Unemployment, and its Estimation in Israel

Decades ago economists were aware of the existence of a negative relation between GDP and unemployment in the course of cyclical changes. This is well explained by supply and demand factors: an increase in GDP in periods of growth, in the absence of changes in productivity, requires the employment of more workers, at least some of whom were previously unemployed. In contrast, in recessions, as demand declines and GDP falls, fewer workers are needed, and some are fired and rejoin the ranks of the unemployed. This process was first described as an empirical law and estimated by the American economist Arthur Okun, and the relation he discovered is known as Okun's Law. The relation between growth and unemployment plays an important role in the formulation of macroeconomic policy, as the absolute value of the estimated coefficient can be used as a measure of the cost of a high rate of unemployment, in terms of its adverse impact on GDP.

To present the link between GDP and unemployment we will denote the log of actual GDP by  $y_t$ , log of potential GDP (GDP at full employment) by  $y_t^n$ , the actual rate of unemployment by  $u_t$ , and the Non-Accelerating Inflation Rate of Unemployment, NAIRU, by  $u_t^n$ . The equation which Okun estimated may be shown as

$$(1) \quad u_t - u_t^n = \beta_1(y_t - y_t^n) + \varepsilon_t$$

where

$\varepsilon_t$  is a random white-noise-type disturbance,  $t = 1, 2, \dots, T$  and  $\beta_1 < 0$ .

This is known as the 'gap' model, as it is based on the output gap, which is the difference between actual and potential GDP, and the unemployment gap, which is the difference between actual unemployment and NAIRU. The problem that arises with the gap approach is in the use of unobserved variables—potential GDP and NAIRU—meaning that it cannot be estimated simply. Okun therefore proposed an alternative method of estimation, using a difference model, which uses only observable variables, actual GDP and the actual unemployment rate. This model can also ease the econometric difficulty: the estimation is performed via stationary difference series, as the original series are likely to have a unit root. The difference model describes the relation between the first order difference of the GDP and that of unemployment:

$$(2) \quad \Delta u_t = \beta_0 - \beta_1 \Delta y_t + \varepsilon_t$$

Okun (1962) used both models, and based on US data from the years 1947–60 concluded that every percentage point

difference between actual unemployment and NAIRU reduces GDP, according to this estimate, by about 3 percent<sup>17,18</sup> (i.e., the estimate of  $\beta_1$  is about  $-0.3$ ).

It is reasonable to assume that this ratio does not remain constant over time, as the link between GDP and unemployment is a dynamic one, and is the result of many changes in the labor market—such as a rise in the participation rate of women in the labor force, changes in productivity and wages, structural changes in the economy reflected in changes in its composition by industry, changes in the labor market institutions, and globalization. Blanchard (1999) claims that the impact of changes in GDP on the rate of unemployment has strengthened over time, as a result of increased international competition and greater flexibility of the labor market, expressed by the reduced cost of changing manpower (following the relaxation of the employment security laws and the reduced cost of laying off workers); these made it easier for companies to adjust their workforce according to changes in the economic environment. In contrast, the estimates obtained by Abel and Bernanke (2005) indicate a weakening of the link between GDP and unemployment over time.

Studies of whether Okun's Law applies outside the US found a negative correlation between GDP and unemployment in most of the economies examined, but its strength varied from one country to another, and changed over time in all of them, indicating some reservations about the applicability of Okun's Law in these cases. Perman and Tavera (2005) found that in twelve of the seventeen countries they studied the effect of changes in GDP on unemployment intensified with time; Moosa (1997) found that the Okun coefficient declined significantly in two of the seven countries in his study; and Lee (2000), based on data of sixteen OECD countries, concluded that in most of them the negative impact of a rise in unemployment on GDP has weakened over the last few decades.

<sup>17</sup> The finding that the change in GDP is faster and stronger than that in unemployment may be explained in several ways: as the rate of unemployment rises, some of the unemployed leave the labor force (i.e., they stop actively looking for jobs, the discouraged worker effect), and disappear from the statistics; also, some of the employed may work fewer hours. In addition, employers who avoid laying off workers cause labor productivity to fall.

<sup>18</sup> This interpretation of the coefficient is not strictly accurate (see Plosser and Schwert, 1979). The correct interpretation is that a rise of one percent in GDP corresponds with a decline of about 0.3 percentage points in the rate of unemployment.

## Estimating Okun's Law in Israel

Okun's Law can be estimated in its original form in Israel's case, i.e., using the gap model based on potential GDP and NAIRU, as in the study by Suchoy and Friedman (2002). In accordance with the models used to estimate these two unobserved variables, Okun's Law was estimated for two periods, 1987–2001 and 1995–2007. For the first period the value obtained for  $\beta_1$  in Equation (1) was  $-0.6$ , after correcting for the period of large scale immigration into Israel, when unemployment surged markedly as a result of exogenous factors (before the correction the coefficient was  $-0.65$ ). This means that a 1 percent rise in GDP relative to potential GDP is matched by a 0.6 percentage point decline in the rate of unemployment relative to the NAIRU, an effect double that found by Okun.

In the second period the estimation is more complex, because the two gap series are not stationary, so that the estimate is carried out with series of gap differences, as a result of which the estimate obtained is not comparable with the estimate of  $\beta_1$  in the previous case, although the relation between GDP and unemployment is still negative.

### The relation between growth and employment in Israel

The weakness of Okun's Law lies in the fact that it does not take into account other factors that could affect GDP, such as changes in labor productivity. In addition, measuring the relation between GDP and unemployment is problematic because changes in the rate of unemployment result from the combination of changes in the labor force (on the supply side) and changes in employment (on the demand side). The supply of labor depends on growth for two main reasons: first, in a period of growth wages rise, and motivate those with a higher wage threshold than existed prior to the growth to join the labor force. Second, in a period of growth it is less difficult to find employment, and some discouraged workers may return to the labor force. At the same time, but acting in the opposite direction, is the added worker effect: in a period of growth, as the income of the main earner improves, some of the secondary workers in the household (mainly women and teenagers) may leave the labor force. Over and above these effects, the labor market may be affected by labor migration: growth leads to an inflow of migrants or labor migrants into the economy, and exogenously increases the labor force. A rise in labor productivity, particularly when accompanied by a rise in the labor force, can increase real GDP without reducing unemployment, an effect known as 'jobless growth.' It is thus worthwhile to examine the relation between growth and employment.

Figure 2.4

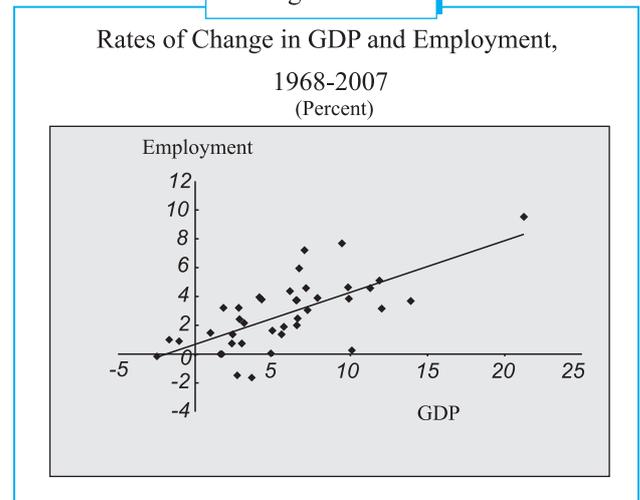


Figure 2.4 shows the strong relation between the rate of change in GDP and that in employment in the business sector in the years 1968–2007 (the coefficient of correlation between the two series is about 0.6).

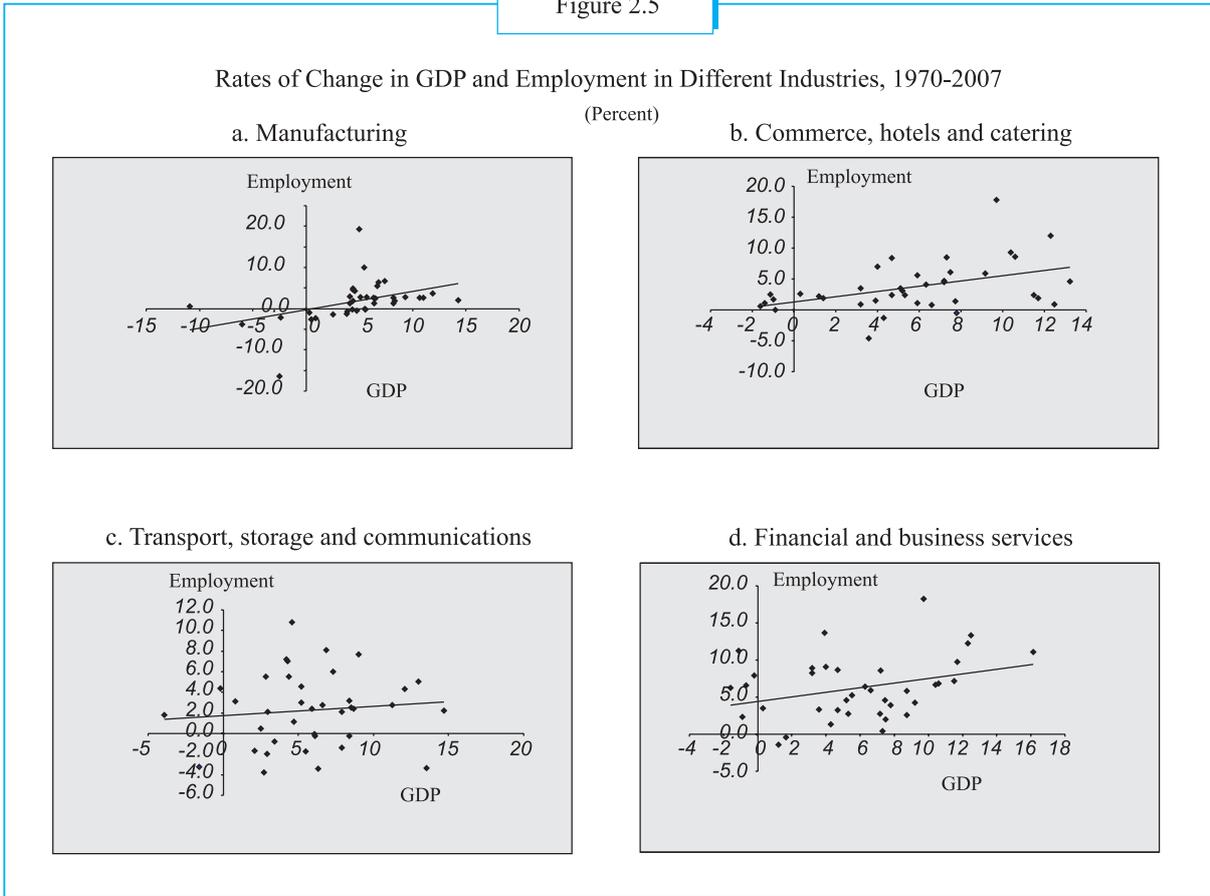
A simple regression, in which the dependent variable is the rate of change in the number of employees, and the explanatory variable is the rate of change of GDP, explains about a third of the variation of the rate of change of employment. According to the results of the regression, a one percentage point reduction in the rate of growth (e.g., from 4 percent a year to 3 percent) is matched by a reduction of one-third of a percentage point in employment in the business sector, on average.<sup>19</sup> One surprising result is that adding the rate of change in the wage per employee post does not improve the estimation, and the estimated coefficient of the wage variable is not statistically significant.

### Comparison of the GDP/employment relation in different industries

Under the assumption that the relation between GDP and employment is not uniform but varies from industry to industry, as a result of different production functions, and mainly different degrees of labor intensity, we studied the

<sup>19</sup> The purpose of this empirical investigation is to examine the relation between these two variables, and not to examine causality. Moreover, the Granger test refutes the causality between the two variables in both directions. Nevertheless, the Granger causality tests only whether past values of the explanatory variable can improve the explanatory power of the behavior of the dependent variable, beyond the explanation based on the past data of the dependent variable itself. Hence the Granger causality test does not indicate the existence of causality in the broader sense of the word.

Figure 2.5



relation in four industries: manufacturing; commerce, and hotels and catering; transport, storage, and communications; and financial and business services. Figure 2.5 shows the relation between the rates of change in GDP and employment in four principal industries in the period from 1970 to 2007.<sup>20</sup>

As can be seen from the trend line, the relation between GDP and employment is stronger in commerce, hotels and catering, manufacturing, and financial and business services, and very weak in transport, storage and communications. It is important to note, however, that the transport, storage and communications industry underwent very significant changes in the period reviewed, with the development of the internet and cellular communications.

More accurate results are obtained from a regression of the rate of change in employment against the rate of industry growth. The results are shown in the table.

<sup>20</sup> Three industries were excluded from the analysis: electricity and water, because of its small size, and agriculture and construction, because of the large number of non-Israeli workers in them.

According to these results, in a recession the major impact on employment is expected to be felt in the manufacturing, commerce and various service industries, in other words, in the labor intensive ones.

|                                          | Coefficient<br>(t-value in<br>parentheses) | Percent of<br>variation<br>explained<br>(R <sup>2</sup> ) |
|------------------------------------------|--------------------------------------------|-----------------------------------------------------------|
| Manufacturing                            | 0.431*<br>(2.637)                          | 0.194                                                     |
| Commerce, hotels and<br>catering         | 0.435*<br>(2.998)                          | 0.215                                                     |
| Transport, storage<br>and communications | 0.098<br>(0.686)                           | 0.088                                                     |
| Financial and business<br>services       | 0.308**<br>(1.973)                         | 0.104                                                     |
| Total business sector                    | 0.325*<br>(4.342)                          | 0.338                                                     |

\* Significant at the 1% level

\*\* Significant at the 10% level

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### Reducing the Incentives for Car Ownership

The predictions regarding the effects of global warming have succeeded in raising the priority of environmental issues, particularly vehicle emissions. This has led to the accelerated development of hybrid cars, as well as increased investment in public transportation and the development of alternative fuels. This is also true in Israel where, following the recommendations of the Committee for "Green" Taxation, it was recommended that vehicles be taxed differentially according to levels of emission. One of the Committee's recommendations was to change the car allowance so that it would no longer create an incentive to purchase a vehicle. This box examines the effect of this benefit and concludes that it indeed creates such an incentive.

The Committee for "Green" Taxation met during 2006 in order to outline a five-year program for "green" taxation in transportation and to formulate an overall policy towards vehicles and their level of emissions, as well as other issues.<sup>21</sup>

<sup>21</sup> The recommendations were published at the beginning of 2008 and are expected to be discussed by the Knesset in the near future. For more details, see the report of the Committee for "Green" Taxation: [http://www.mof.gov.il/taxes/docs/misu\\_yarok.pdf](http://www.mof.gov.il/taxes/docs/misu_yarok.pdf). Its recommendations are partly based on Eldad Shidlovski and Michael Sarel, "The Real Cost of Vehicle Use and Optimal Policy," *The Israel Tax Quarterly*, July 2007.

The Committee's main recommendations relate to the reduction of vehicle emissions through encouraging the use of less-polluting cars and fuels. This is to be done through the reduction of the purchase tax on new and "greener" cars, higher purchase tax on older cars and differential taxation of fuels according to the level of pollution they cause. To supplement this reform, the Committee recommended a series of changes to encourage the reduction in vehicle use, including a congestion tax, taxation of employers for employee parking, increasing the imputed tax value of company cars, etc. Within this context, the Committee also recommended changes in the structure of civil service salaries, including the replacement of the car allowance with some other benefit that is not conditional on car ownership.

The current car allowance encourages the purchase of a car in a way that is unrelated to the utility that a worker receives from it. As a result of the benefit, workers own more cars than they would if the benefit were unrelated to car ownership. Thus, the government is working against its own efforts to reduce the use of private transportation, which is known to have wide-ranging negative externalities (air pollution, traffic congestion and road accidents). Thus, on the one hand, the government is attempting to encourage a transition from private to public transportation by investing in the public transportation infrastructure, allocating lanes to public transportation and taxing vehicles and gasoline while, on the other hand, it has signed collective wage agreements that encourage the purchase of a private vehicle.

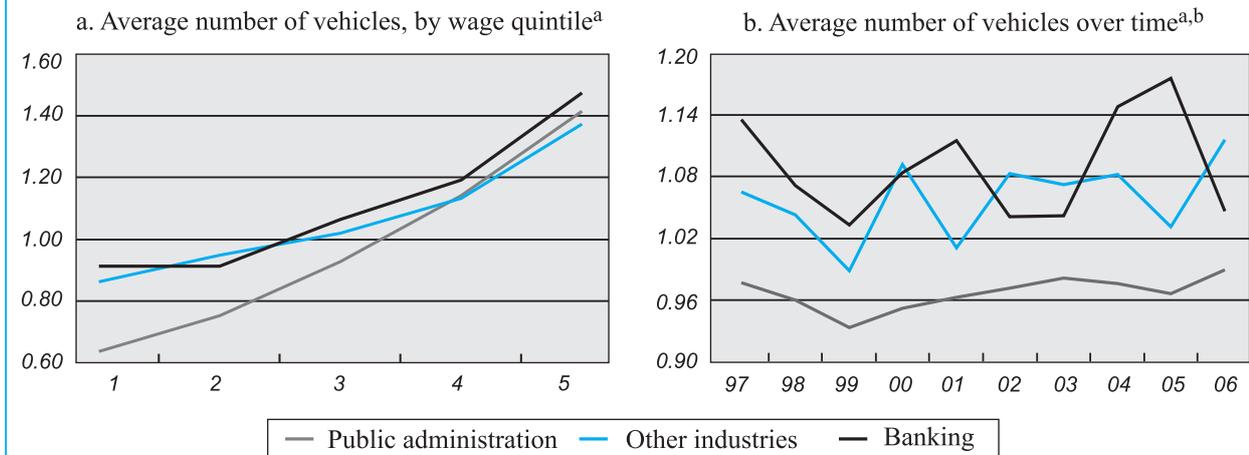
In order to assess the effect of this incentive on car purchase, a comparison was made between the various industries in which the car allowance is a common component of salaries (i.e., the civil service and the banking industry; hereon: the eligible industries) and the other (non-eligible) industries. It is assumed that as part of the collective wage agreements in these industries, a large proportion of their workers receive the benefit. However, not all the workers in these industries are eligible for the car allowance, and it is also reasonable to assume that in the other industries there are contracts that link car ownership to salary (particularly in recent years with the introduction of leasing arrangements). Therefore, the estimated difference between the industries constitutes only a lower bound for the effect of the car allowance on car purchases.

Figure 2.6a presents the average number of vehicles per family according to wage quintiles in the civil service, in the banking industry and in other industries.<sup>22,23</sup> As can be

<sup>22</sup> From the Survey of Family Expenditure for the period 1997-2006.

<sup>23</sup> The number of cars is a categorical variable that can receive three values: 0 - does not own a car; 1 - owns one car; and 2 - owns two or more cars.

Figure 2.6



<sup>a</sup> Average number of vehicles in households with a worker in the relevant industry.  
<sup>b</sup> The data in Figure b are regression residuals adjusted for the effect of differences in the workers' characteristics. see footnote 24.  
 SOURCE: Based on Central Bureau of Statistics data and Survey of Family Expenditure for the years 1997 to 2006.

seen from the graphs, in households with one worker in the civil service or the banking industry, the average number of vehicles is 12 percent higher than in other households. In the bottom income quintile, the difference increases to 39 percent while in the upper quintile the difference disappears.

Figure 2.6b presents the average number of vehicles in each industry over time, adjusted for the effect of differences in wages and other characteristics.<sup>24</sup> There is a clear difference between the number of vehicles per household in eligible and non-eligible industries.

Table 2.3 presents the estimated regressions for testing the difference between eligible and non-eligible industries. The first column presents the effect of belonging to an eligible industry on the number of cars per household, where a variety of variables were used to control for preferences or the need for a vehicle: standard of living (salary, non-durable consumption and home ownership), individuals' characteristics (age, education, size of household and number of children in the household) and the size of the city of residence. The regression results indicate that the difference in the number of vehicles between the eligible industries and the rest reaches 9.3 percent in the civil service

<sup>24</sup> The data are residuals from a regression of the number of vehicles onto household characteristics: age of the head of the household, education, size of the household, number of household members under the age of 18, size of the city of residence, salary, household expenses (apart from vehicle expenses) and home ownership.

and 12.5 percent in the banking industry.<sup>25</sup> Thus, it was found that an increase in standard of living significantly increases the number of vehicles. For example, an increase of NIS 1000 in wages leads to an increase of 2 percent in the number of vehicles per household, while home ownership raises the number of vehicles by 28 percent. The size of the household and level of education also have a positive effect on the number of vehicles, while the size of the city of residence has a negative effect. It should be mentioned that the estimated coefficient of the effect of the eligible industries on the number of vehicles is primarily affected by the addition of salary to the regression and only marginally by the addition of the other control variables. Additional regressions (not presented here) tested for the effects of occupation, in order to rule out the possibility of correlation resulting from greater need for a vehicle in these industries. It was found that for clerks, degree holders and managers, the number of vehicles was greater than among other workers, but that the effect of being in one of the eligible industries remained unchanged. It was also found that in the eligible industries the differences between workers due to occupation were smaller, which is evidence of the decisive effect of the incentive on car ownership in these industries.

In addition, it was found that when the sample is restricted to privately owned cars in order to eliminate the leasing

<sup>25</sup> The size of the variable (as it appears in Table 2.3) is approximately the percentage difference in the average number of family vehicles, which is 0.98 percent.

Table 2.3: The effect of the benefit and individuals' characteristics on car ownership and use (regression estimates)

|                                                                       | Number of cars per household | Probability of owning one car | Car expenses |
|-----------------------------------------------------------------------|------------------------------|-------------------------------|--------------|
|                                                                       | (1)                          | (2)                           | (3)          |
| Dummy for civil service workers                                       | 0.093***                     | 0.085***                      | 23.68        |
| Dummy for workers in the banking and finance industry                 | 0.125***                     | 0.082***                      | 40.18        |
| Age                                                                   | -0.002***                    | -0.002***                     | 0.36         |
| Education                                                             | 0.031***                     | 0.015***                      | 17.921***    |
| Size of household                                                     | 0.060***                     | 0.018***                      | 8.82         |
| Number of household members under 18                                  | -0.079***                    | -0.021***                     | -39.340***   |
| Size of city                                                          | 0.023***                     | 0.014***                      | 25.041***    |
| Wage (in thousands of NIS)                                            | 0.020***                     | 0.017***                      | 15.845***    |
| Household expenditure (thousands of NIS, apart from vehicle expenses) | 0.030***                     | 0.014***                      | 37.653***    |
| Home ownership                                                        | 0.276***                     | 0.198***                      | 29.655*      |
| Constant                                                              | -0.249***                    | 0.066***                      | 783.305***   |
| Number of observations                                                | 55,783                       | 43,165                        | 29,515       |
| R2                                                                    | 0.27                         | 0.16                          | 0.05         |

\* Significant at 10 percent level. \*\* Significant at 5 percent level. \*\*\* Significant at one percent level.

SOURCE: Based on Central Bureau of Statistics, Survey of Family Expenditure for the years 1997 to 2006.

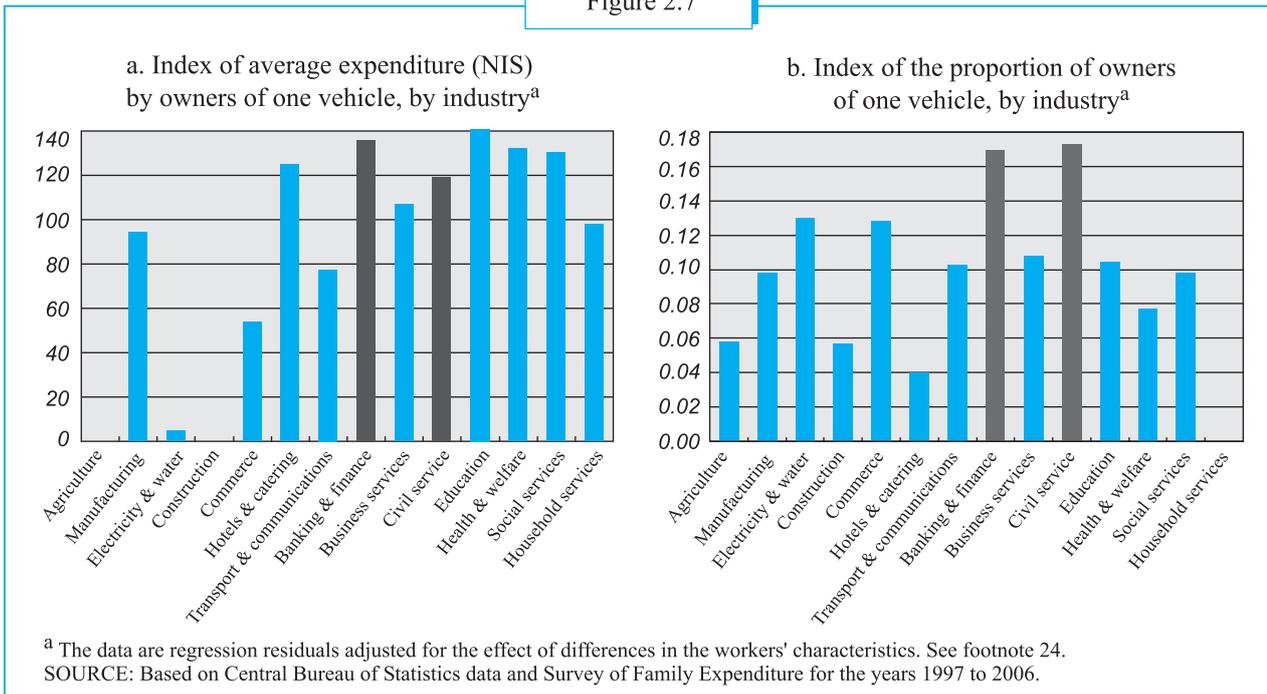
arrangements that are common in the business sector and which also constitute an incentive for vehicle use, the effect of being employed in the public sector on vehicle purchases grew by another 4 percentage points.

In contrast to the incentive to purchase a vehicle, the car allowance would not be expected to encourage vehicle use (beyond the income effect) since it is not dependent on actual mileage. As a result, one would expect that the difference in number of vehicles between industries will not be evident for vehicle expenses (which also reflect the extent of the vehicle use). In contrast, if the difference that was found is the result of industry characteristics (such as the character of the work which requires extensive use of a vehicle) we would expect it to remain unchanged. In order to decide this issue, regressions were run for expenditure per vehicle in the civil service and banking industry and the other industries. Since expenditure per vehicle decreases

with number of vehicles per household, it was not possible to include together in the same equation households with one car and households with two cars, but only households with the same number of cars. The graphs below present a comparison between industries of households with one car: Figure 2.7a presents expenditure per vehicle and Figure 2.7b presents their proportion in the population.<sup>26</sup> The figures indicate that in the eligible industries, expenditure per vehicle is no higher, while there are significant differences in the proportion of car owners. This can also be seen from Regressions 2 and 3 in Table 2.3: the probability of vehicle ownership in the eligible industries is about 8 percentage points higher than in the other industries, and the difference is statistically significant. In contrast, the difference in expenditure per vehicle in these industries is not statistically

<sup>26</sup> Restricting the sample to owners of two or more cars yields a similar picture.

Figure 2.7



significant, and the size of the coefficients (NIS 23 in the civil service and NIS 40 in the banking industry) represents only 1.5 percent of the average expenditure per vehicle. These findings provide support for the hypothesis that the difference in the number of vehicles is the result of the car allowance, which is a common component of salaries in the eligible industries.

It is not possible to estimate the additional cost of eliminating the condition that recipients of a car allowance be vehicle owners, though we can divide it into two types: the direct cost due to the fact that the benefit would be paid to workers who do not currently receive the benefit because they are not vehicle owners, and the indirect cost due to the change in the nature of the benefit, which is liable to lead to pressure to include it in the basic wage and therefore in the calculation of pensions, severance pay and the like. While the direct cost can be expected to be relatively small, the wide-ranging effects of the indirect cost could be very significant, and should be avoided through coordination with union representatives before any change is made.

The findings provide evidence of the difference in the number of vehicles per household between workers in the civil service and the banking industry and workers in the other industries (while controlling for worker characteristics). It was also found that this difference is not the result of a greater need for a vehicle since no difference was found in vehicle use. Thus, the difference in the number of vehicles can be explained by the existing incentive to own a vehicle in these industries.

Therefore, in agreement with the recommendations of the Committee for “Green” Taxation, it is proposed that the car allowance be replaced by some other benefit which is not conditional on car ownership and is equal in value to the current car allowance. According to the estimates presented here, this change will reduce by about 10 percent the number of vehicles in the industries in which workers are eligible for the benefit. This represents about 20,000 vehicles, which are primarily concentrated in the large metropolitan centers, particularly Jerusalem. Furthermore, the estimated effect of the car allowance incentive provides an indication of the potential efficacy of imposing «green» taxes in Israel, i.e., taxes that encourage the transition to less-polluting vehicles, the use of cleaner fuels and even the reduction in the use of private vehicles.

### Macroeconomic Forecasts for 2008 and 2009

GDP is expected to grow by 4.2 percent in 2008, with a decline in the unemployment rate to 6.4 percent. Growth in 2009 is expected to be 3.1 percent, with unemployment rising slightly to 6.6 percent. The upward revision of the forecast for 2008 compared with the previous one derives from the positive data on GDP and employment for the first quarter of the year, as well as positive developments in most advanced economies. Nevertheless, the realization of the slowdown in the growth of activity in the US, with a slowdown in the growth of global activity expected to follow, the sharp real appreciation of the shekel, the adverse change in the terms

of trade, and unencouraging data in company and industry surveys, all these show that a slowdown in the growth rate is still expected later in 2008 and in 2009. Thus the slowdown in activity is now expected to be delayed compared with the assessment in the previous forecast, so that the forecast for 2008 was amended upwards, and that for 2009, slightly downwards. The surplus on the current account is expected to shrink to about half a percent of GDP in 2008 as a result of the real appreciation of the shekel and the deterioration in the terms of trade.

## Sources and uses

### *GDP, employment and productivity*

The forecast of growth in 2008 was increased from 3.2 percent to 4.2 percent, and that of business sector product from 3.6 percent to 4.9 percent. The adjustment derived from the growth figures for the first quarter of 2008, which were higher than expected. According to the data, even if GDP does not increase any further by the end of the year, the annual rate of growth this year will be 3.5 percent. The growth forecast for 2009 was trimmed back in light of the expected delay in the timing of the global slowdown.

In light of the convergence of the economy to full employment and the expected global slowdown, the number of employees and GDP are expected to show only small increases as 2008 progresses. The annual rise in employment will be 3.6 percent, and unemployment will be 6.4 percent. Labor productivity will rise by a modest 1.1 percent, continuing along its recent trend towards moderation. Unemployment in 2009 is expected to be 6.6 percent, with further moderation in the rise in total factor productivity.

### *Private consumption*

Private consumption is expected to increase by 6.1 percent in 2008, similar to its increase in 2007. The previous forecast was revised upwards in light of the rapid growth of private consumption in 2008:Q1 that resulted from a rise in the real wage and a fall in the unemployment rate—which led to an increase in disposable income—and from the steep appreciation of the shekel that reduced the prices of imported consumer goods. The revision of the forecast was also due to the partial recovery of share prices following their decline in recent months, a decline which reduced the value of the public's wealth. That said, a large part of the rise in consumption consisted of vehicle purchases that derived largely from tax cuts and a change in legislation, and is therefore not expected to persist. The falls in the consumer confidence index also herald a slower rate of increase. Hence,

private consumption is expected to rise by 3.4 percent in 2009, similar to the previous forecast.

### *Exports*

Exports excluding diamonds are expected to increase by 8.8 percent in 2008, and by 5.4 percent in 2009, compared with the previous forecasts of 5.6 percent and 7.0 percent respectively. The change in the forecast for 2008 derives from the surge in exports and positive data from abroad in the first quarter of 2008. However, manufacturing industries are already recording a certain slowing of the rate of growth, and a large part of the increase comes from high-tech companies being sold. Factors that contributed to the downward revision of the forecast of growth in 2009 include the deterioration in the terms of trade and the real appreciation of the shekel, which tend to make exports less profitable, and also the expected global slowdown.

Note that the assumptions underlying the forecast of a significant slowdown in the increase in world trade are different from the data of the IMF, which has not till now reduced its forecast in light of the expected slowdown. It has, however, lowered its forecast growth in the advanced economies, headed by the US. The forecast rate of growth in the advanced economies in 2008 and 2009 is currently 1.3 percent, similar to the rate in the recession years of 2001 and 2002 (see figure). However, in light of the favorable data for the first quarter of 2008, the IMF is expected to raise its forecast of growth in 2008 slightly. Due to the close relation of Israel's exports with demand in the advanced economies,

Figure 2.8

GDP in the Advanced Economies 1999-2007,  
and Forecasts for 2008 and 2009  
(volume change, percent)

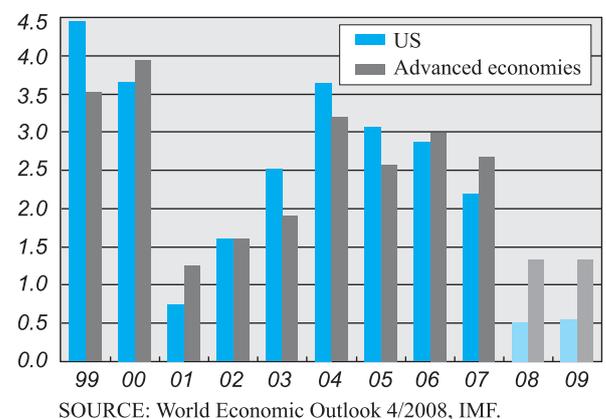


Table 2.4: Main economic indicators 2004–07, and forecasts for 2008–09, volume change, percent (unless mentioned otherwise)

|                                                    | Actual data |      |      |      | Forecast |      | Change from previous forecast |      |
|----------------------------------------------------|-------------|------|------|------|----------|------|-------------------------------|------|
|                                                    | 2004        | 2005 | 2006 | 2007 | 2008     | 2009 | 2008                          | 2009 |
| <b>I. Sources and uses</b>                         |             |      |      |      |          |      |                               |      |
| 1. GDP                                             | 5.0         | 5.3  | 5.2  | 5.3  | 4.2      | 3.1  | 1.0                           | -0.3 |
| <i>of which</i> i. Business sector                 | 7.0         | 6.6  | 6.5  | 6.1  | 4.9      | 3.6  | 1.3                           | -0.4 |
| ii. Public services                                | -1.3        | 1.3  | 1.4  | 3.1  | 1.8      | 1.9  | 0.0                           | 0.0  |
| 2. Imports                                         | 11.8        | 3.5  | 3.3  | 12.3 | 7.1      | 5.6  | 2.6                           | 0.4  |
| 3. Exports                                         | 18.1        | 4.3  | 5.9  | 8.4  | 6.9      | 4.2  | 2.7                           | -1.4 |
| 4. Private consumption                             | 5.6         | 4.0  | 4.5  | 6.6  | 6.1      | 3.4  | 2.7                           | -0.2 |
| 5. Public consumption                              | -2.5        | 2.9  | 2.3  | 2.6  | 1.6      | 1.7  | -0.0                          | -0.0 |
| 6. Gross domestic investment                       | 3.1         | 11.1 | 5.3  | 13.8 | 2.7      | 7.5  | -2.6                          | 3.0  |
| 7. Domestic uses                                   | 3.1         | 4.7  | 3.9  | 7.2  | 4.4      | 3.9  | 1.0                           | 0.5  |
| <b>II. The business sector</b>                     |             |      |      |      |          |      |                               |      |
| 8. Total factor productivity                       | 4.8         | 3.7  | 3.5  | 2.2  | 1.1      | 0.8  | -0.0                          | -0.2 |
| 9. Labor productivity (output per employee)        | 4.5         | 3.4  | 3.2  | 1.7  | 1.1      | 1.5  | -0.6                          | -0.2 |
| 10. Wage per employee post                         | 1.0         | 1.5  | 1.6  | 2.2  | 2.8      | 2.1  | 0.2                           | 0.1  |
| <b>III. The labor market</b>                       |             |      |      |      |          |      |                               |      |
| 11. Participation rate                             | 54.9        | 55.2 | 55.6 | 56.3 | 56.7     | 57.0 | 0.3                           | 0.3  |
| 12. Israeli employees                              | 3.0         | 3.9  | 3.2  | 4.2  | 3.6      | 2.2  | 1.6                           | -0.1 |
| 13. Unemployment rate                              | 10.4        | 9.0  | 8.4  | 7.3  | 6.4      | 6.6  | -1.0                          | -0.8 |
| 14. Employment rate                                | 49.2        | 50.2 | 50.9 | 52.2 | 53.0     | 53.3 | 0.8                           | 0.8  |
| <b>IV. Balance of payments (\$ million)</b>        |             |      |      |      |          |      |                               |      |
| 15. Net balance of goods and services account      | 0.4         | -0.0 | 1.0  | -2.1 | -5.8     | -7.9 | 0.8                           | -0.6 |
| 16. Current account, net                           | 3.0         | 4.3  | 8.5  | 5.2  | 0.6      | -1.6 | 1.2                           | -0.6 |
| <b>V. The public sector</b>                        |             |      |      |      |          |      |                               |      |
| 17. Public sector deficit (percent of GDP)         | -4.3        | -2.5 | -1.4 | -0.8 | -1.3     | -1.9 | 0.5                           | 0.5  |
| 18. Total public sector expenditure                | -1.0        | 0.7  | 3.6  | 2.4  | 3.2      | 2.8  | 0.8                           | -0.3 |
| 19. Debt/GDP ratio                                 | 99.9        | 95.9 | 86.8 | 80.6 | 77.4     | 76.9 | -1.2                          | -1.5 |
| <b>VI. The economic environment</b>                |             |      |      |      |          |      |                               |      |
| 20. World trade                                    | 10.8        | 7.5  | 9.2  | 6.6  | 4.5      | 3.0  | 0.5                           | -1.0 |
| 21. GDP of advanced economies                      | 3.2         | 2.6  | 3.0  | 2.7  | 1.3      | 1.3  | -0.5                          | -0.7 |
| 22. Relative export price (the real exchange rate) | -0.2        | 1.5  | -0.2 | -4.1 | -5.3     | -1.1 | -3.2                          | -0.6 |
| 23. Terms of trade                                 | -4.0        | -2.5 | -1.6 | -2.2 | -2.2     | -1.0 | 0.8                           | 0.0  |

the low growth forecasts of those countries are ascribed greater weight than the forecasts of world trade.

*Public consumption*

It is assumed that fiscal policy will not change in the next few years and that public expenditure will rise in accordance with the existing target—by 1.6 percent in 2008 and by 1.7 percent in 2009. Nevertheless, following the increase in the wage in the public services, the forecast wage rise for 2008 has been updated. The debt/GDP ratio is expected to continue to decline, and to reach 77.4 percent.

*Investment*

Gross domestic investment is expected to increase by 2.7 percent in 2008, and fixed investment by 4.2 percent. This is lower than the previous forecast because of the decline in current and expected activity based on responses to the Bank of Israel Companies Survey and the Industry Survey of the Manufacturers Association of Israel for the first quarter of 2008, declines that were not reflected in the National Accounts data. The revised forecast was also based on the rise in the real interest environment in the business

sector that derived from the rise in margins as a result of the increase in risks.

*Imports*

Civilian imports excluding diamonds, ships and airplanes are expected to increase by 9.4 percent in 2008. This is higher than the previous forecast because of the rapid rise in imports in 2008:Q1 and the sharp real appreciation of the shekel, which makes imports more worthwhile. That said, a not insignificant part of the increase in imports was due to the steep rise in vehicle imports, as stated above, which is not expected to continue, so that the forecast path till the end of the year hardly changed. As a result of the marked increase in imports and the deterioration in the terms of trade, the deficit in the goods and services account is expected to rise to \$5.8 billion. As a result, the large surplus in the current account in the last few years is expected to shrink to about \$0.6 billion in 2008, and for 2009 a deficit of \$2.3 billion is forecast.

### Diary of Events from January to April 2008

| Month   | Date | Event                                                                                                                               | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|---------|------|-------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| January | 1    | The Negative Income Tax Law, an adjustment of tax brackets, and an increase in imputed tax value of company cars go into effect.    | Under the Amendment of the Income Tax Ordinance Law (No. 160 and Ad Hoc Ordinance), 5768-2007, tax rates are lowered by spreading out the tax brackets and raising the value of a credit point. Concurrently, the imputed tax value of company cars begins to be raised in a process that will continue until 2011.                                                                                                                                                                                                                                                                                                      |
|         | 15   | National Insurance benefits are adjusted.                                                                                           | From January 2008, all National Insurance benefits are adjusted upward by 2.8 percent on account of the increase in consumer prices in 2007. Furthermore, a 4 percent decrease in several benefits—income maintenance, unemployment compensation, workers' disability, and death and bankruptcy grants—is repealed.                                                                                                                                                                                                                                                                                                      |
|         | 18   | The university heads and representatives of lecturers conclude a special collective agreement.                                      | The agreement, approved by Finance Minister Ronnie Bar-On and signed by the Committee of University Heads and the Coordinating Council of Senior Academic Staff, is achieved in full cooperation with the Chair of the Histadrut, Ofer Eini. It includes a three-phase wage increase: (1) from the January 2008 paycheck, a 2.7% increase for all members of academic staff; (2) from the December 2008 paycheck, a further increase of 8%, and (3) from the December 2009 paycheck, a further increase of 8%. Also, the seniority mechanism for academic staff is to be adjusted from the January 2008 paycheck onward. |
|         | 20   | Legislation for a program of increased income-maintenance benefits for indigent elderly and aid to Holocaust survivors is approved. | The new statute increases income-maintenance benefits in order to better the economic situation of indigent elderly and establishes relief provisions for Holocaust survivors.                                                                                                                                                                                                                                                                                                                                                                                                                                           |

| Month   | Date | Event                                                                                                | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|---------|------|------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| January | 21   | An exemption from land-betterment tax for enterprises that relocate to peripheral areas is approved. | The Knesset Finance Committee approves a Government-sponsored bill that creates an exemption from land-betterment tax for enterprises that relocate from the center of the country to Preferred Areas (Class A development areas), Sderot, or localities on the Gaza Strip periphery. The purpose is to encourage enterprises to relocate to peripheral areas that are economically disadvantaged or have high unemployment rates, order to develop them and create additional jobs there. The tax exemption is subject to several conditions, including purchase of premises in a Class A area by the end of 2009, employment of at least 75% of headcount in the plant's previous location in central Israel, and current headcount of at least 50, of whom 80% dwell in the local-authority jurisdiction of the development area. |
|         |      | A Government-sponsored bill for the regulation of provident funds is passed into law.                | The law states, among other things, that the withdrawal of funds at age 65+ shall take place on a monthly-benefit basis only, as opposed to a capital (lump-sum) basis. The minimum monthly benefit shall be NIS 3850 (half the national average wage) and shall be indexed to the CPI. The tax-exempt ceiling is NIS 9000 (as against NIS 6500 today) and the tax-benefit ceiling shall be four times the national average wage, i.e., approx. NIS 30,000.                                                                                                                                                                                                                                                                                                                                                                          |
|         | 27   | Israel concludes a tax treaty with Vietnam.                                                          | Israel and Vietnam initial a tax treaty as part of the Finance Ministry's policy of expanding Israel's system of tax treaties and eliminating tax barriers that impair foreign trade and investment therein. Israel's economic activity in Vietnam has expanded perceptibly in recent years.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |

| Month    | Date | Event                                                                                                                                                                | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|----------|------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| January  | 28   | Repeal of sales tax.                                                                                                                                                 | The Knesset Finance Committee approves on third reading a Government-sponsored bill that revokes, retroactive to August 2007, a 2.5% tax on the sale of undeveloped land or farmland. The measure may stimulate the real-estate market by eliminating barriers that may influence potential sellers' decisions. The Ministry of Finance believes that the repeal of the tax will reduce state tax revenue by NIS 350 million: NIS 500 million due to the revocation itself, partly offset by an NIS 150 million increase in income-tax revenue because sales-tax payments had been recognized for income-tax purposes. |
|          |      | Israel and France sign a mutual-recognition agreement allowing each country to rely on prospectuses approved in the other country for securities issues.             | The Israeli and French securities authorities sign a MOU that will allow, for the first, time, the opening of markets in both countries to bilateral trading of firms on the basis of each other's regulation. The MOU was signed by the chair of the Israel Securities Authority, Moshe Tery, and his French counterpart, Michel Prada.                                                                                                                                                                                                                                                                               |
|          |      | The Bank of Israel leaves its key interest rate for February unchanged.                                                                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| February | 3    | The Commissioner of the Capital Market adopts the recommendations of the Hamdani Committee on stimulating institutional entities' involvement in the capital market. | The Committee's recommendations emphasize ways of coping with conflicts of interests; compulsory participation of institutional entities in shareholders' and bondholders' assemblies, encouraging such entities of avail themselves of professionals in formulating voting recommendations; expanding institutional entities' involvement in appointing outside board members in public companies, and encouraging institutional entities to be actively involved in other areas of corporate governance in firms in which they are invested.                                                                         |

| Month    | Date | Event                                                                                                                 | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
|----------|------|-----------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| February | 3    | The Government approves a bill on the enforcement of labor laws.                                                      | The bill enshrines the recommendations of a steering committee that explored the question of enforcing labor laws. The panel was staffed by representatives of the Ministries of Finance and Industry, Trade, and Labor, the Histadrut, and the Coordinating Bureau of Economic Organizations. The committee's work centered on the premise that efficient enforcement of labor laws is one of the main ways of reducing the population of working poor, enhancing the incentive to participate in the labor market, and mitigating total reliance on the welfare system. |
|          | 11   | Fitch upgrades Israel's sovereign rating to "A" for the first time since 1995.                                        | Richard Fox, Head of Middle East and Africa Sovereign Ratings at Fitch, writes, "The upgrade reflects the rapid fall in the all-important ratio of public debt/GDP, which reached an all-time low of just over 80%. We expect further reductions in the debt ratio in the year ahead, despite likely slower economic growth due to the global slowdown."                                                                                                                                                                                                                  |
|          | 18   | The Provident Fund Portability Bill is passed into law.                                                               | The new statute establishes rules for the transfer of funds from one provident fund to another and from provident funds to pension funds and life-insurance plans.                                                                                                                                                                                                                                                                                                                                                                                                        |
|          | 20   | The Bank of Israel announces that in April 2008 it will begin printing the NIS 20 note on polymer for the first time. | The quality of the NIS 20 paper banknotes in circulation today is very poor due to extensive use. The use of polymer will make the new notes more durable and their lifespan in circulation.                                                                                                                                                                                                                                                                                                                                                                              |

| Month    | Date | Event                                                                                       | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|----------|------|---------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| February | 20   | The Yitzhaki Committee on the formulation of poverty indices publishes its recommendations. | The Committee made six recommendations: (1) release annual data on changes in the population's standard of living by quintiles, it being assumed that the bottom quintile overlaps the population of the poor; (2) present data in addition to the poverty index about the situation of weak groups, including income and major expenses; (3) publish data on government expenditure on social services—including transfers and welfare outlays—by quintiles, on the basis of per-capita disposable income; (4) compare Israel's poverty index with indices in countries that resemble Israel and in member states of the OECD, which publishes its own poverty index; (5) publish an annual report on non-financial social problems—a “state of society report”; (6) conduct a long-term survey on changes in individuals' and households' behavior, develop indices relating to the likelihood of surmounting poverty, improve the scope and quality of information about government services, and compare administrative data (on benefits, payments, and receipts) of the National Insurance Institute and the Tax Authority with data of the CBS Household Expenditure and Income surveys. |

| Month    | Date | Event                                                                                                                                     | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|----------|------|-------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| February | 25   | The Bank of Israel lowers its key interest rate for March by 0.5 percentage point, to 3.75%.                                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|          | 27   | The Knesset passes into law, by unanimous vote, a bill sponsored by the Minister of Finance to repeal the "Inflationary Adjustments Law." | The Income Tax (Inflationary Adjustments) Law, enacted in 1985, is an updated version of the 1982 Taxation under Inflationary Conditions Law. Passed at a time when Israel suffered from very high (triple-digit) inflation, the law was meant to neutralize the effects of inflation on the calculation of taxable income, so that the income obtained after the adjustments set forth in the law would be in real terms of the end of the tax year. An inter-divisional staff at the Ministry of Finance, headed by Finance Ministry Director General Yarom Ariav, examined the provisions of the "Adjustments Law" and reached the conclusion that the law was doing more harm than good. The Minister of Finance proposed that the law be repealed in view of low inflation rates in recent years and because the effect of inflation adjustment at such rates is marginal, creates distortions, and does not justify the cost and nuisance involved. The new legislation marks the end of a 26-year period of special tax legislation that aimed to neutralize the effect of inflation in calculating taxable earnings. |
|          |      | The Stock Exchange staff declares a labor dispute.                                                                                        | The dispute traces to the following reasons: the Exchange employs about 100 staff members as contract labor who are not covered by the collective agreement. The Exchange's works committee demands that their terms be equalized with those of permanent staff. The committee also demands a 4.5% wage increase whereas management is unwilling to grant more than a 0.8% across-the-board increase and a 3% differential raise.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |

| Month | Date | Event                                                                                                                               | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-------|------|-------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| March | 2    | The Ministers of Finance and Agriculture work out the contours of a subsidy plan for farmers on account of frost damage in January. | Finance Minister Ronni Bar-On and Agriculture Minister Shalom Simhon work out the contours of a subsidy plan for farmers who sustained damage in the January 2008 cold snap. The outline plan is designed to provide those affected with an appropriate response—in addition to the insurance proceeds to which they are entitled—by means of direct subsidy or credit on preferential terms. The frost damage, including that sustained by insured and uninsured farmers, is estimated at NIS 540 million (in terms of production costs.) On account of the total, the Disaster Fund will pay out an estimated NIS 325 million in compensation and the Government will allocate NIS 115 million in subsidies. Insured farmers will receive aid up to 20% of damage sustained; uninsured farmers will receive aid up to 10%. |
|       | 3    | Merrill Lynch downgrades the earning forecast of Israeli banks due an increase in their tax liabilities.                            | The reason for the increase in tax liabilities is the repeal of the “Inflationary Adjustments Law,” which had allowed banks to pay less taxes if the inflation rate rose. Now that the tax shelter has been revoked, equity will erode with inflation.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|       | 4    | The Knesset Finance Committee approves NIS 300 million for egg and poultry producers in Galilee.                                    | The committee, chaired by MK Stas Misezhnikov, approved an amendment to the “Galilee Bill” that allots NIS 300 million in grants and subsidies to egg and poultry producers in Galilee over the next ten years. The purpose is to encourage investment in the egg industry in order to enhance production and marketing efficiency and sanitary and veterinary conditions in poultry runs. The law will go into effect in January 2009.                                                                                                                                                                                                                                                                                                                                                                                      |

| Month | Date | Event                                                                                                                                                                                                                                      | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
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| March | 13   | Package of tax-relief measures for recent immigrants and returning Israelis                                                                                                                                                                | The reform, which introduces a series of tax-relief measures for recent immigrants and returning Israelis, was fashioned under the guidance of Finance Minister Ronni Bar-On in order to stimulate immigration and bring home hundreds of thousands of Israelis who are living abroad by eliminating significant tax barriers. The purpose of the reform is to encourage investment, reclaim human capital, and, thereby, help to develop the country's economic and social strength. The proposed relief measures include an exemption on tax and reporting for ten years on assets and income of foreign origin. The measures will apply to all kinds of income: interest and dividends of foreign origin; income from rent, occupation, salary, second jobs, and businesses; and capital gains from the sale of assets abroad. |
|       | 20   | The Bank of Israel announces that on March 24, 2008, it will begin to implement a program meant to build up the foreign-exchange reserves by some \$10 billion over two years by purchasing \$25 million per day in the course of trading. | After examining the matter thoroughly in recent months, the Bank of Israel decides to boost the foreign-exchange reserves to \$35 billion–\$40 billion in view of the needs of the economy, rapid GDP growth in recent years, and increased integration into the global economy and financial system.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |

| Month | Date | Event                                                                                                                                      | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|-------|------|--------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| March | 23   | The OECD Council approves the admission of Israel as a member of the organization's Development Centre.                                    | There are currently 32 member states in the Development Centre, of which 23 are members of the OECD and nine are candidates for the OECD or represent emerging economies. In its recent expansion, three states joined the Development Centre: Israel, which is a candidate for membership in the OECD and has 50 years' experience in international cooperation; Vietnam, which is an emerging economy in Asia; and Egypt, which holds an important place in the Arab world as well as among the African nations.                                                                                                                                                                                                                            |
|       | 24   | The Bank of Israel lowers its key interest rate for April by 0.5 percentage point, to 3.25%.                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|       | 31   | On April 1, 2008, the registration of motor-vehicle model year will be revoked.                                                            | Due to the revocation, the only information recorded will be the date on which the car is allowed to be driven. The decision to revoke the recording of model year is expected to facilitate parallel imports of motor vehicles, i.e., importation of new cars from one manufacturer by more than one importer.                                                                                                                                                                                                                                                                                                                                                                                                                               |
| April | 8    | The Minister of Finance presents the Ministerial Privatization Committee with an outline for privatization of Industrial Development Bank. | According to the outline, the state's shares in Industrial Development Bank will be sold en bloc in a private sale to an investor or investor group from Israel and/or abroad, as part of a comprehensive outline plan for the transfer of all shares of the Bank, including those in public hands, to a buyer. The shares shall be sold as part of an arrangement based on Section 30 of the Companies Law that shall be presented to the court for approval. Government corporations, including subsidiaries and mixed-ownership firms, will not participate in the sale proceeding directly or indirectly, on their own or in concert with others. Until the sale is completed, the Bank will continue to collect on its credit portfolio. |

| Month | Date | Event                                                                                                                                                   | Details                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|-------|------|---------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| April | 16   | A public tender for the construction of a hospital in Ashdod will be issued.                                                                            | An Interministerial Tenders Committee (Ministry of Finance, Ministry of Health, and Israel Lands Administration) has decided to issue a public tender for the construction of a hospital in Ashdod. The Committee performed a viability test ahead of the build-and-operate tender, in accordance with a special law pertaining to the construction of this facility. Several months ago, the committee issued a Request for Information that was answered by three entities that are active in the field. After analyzing the results, the Committee decided to issue the tender. The tender is expected to be issued in the coming months.                                         |
|       | 17   | The Director of Wages at the Finance Ministry and the Chair of the Histadrut sign a new wage accord that gives general-government employees a 5% raise. | The new accord is signed on the basis of an agreement on principles that the two officials concluded on July 26, 2007, in which the Histadrut undertook to maintain “industrial calm” until December 31, 2009. According to the agreement, employees will receive a 5% wage increase in the following installments: 1.5% starting in January 2008, another 1.5% starting in December 2008, and another 2% starting in December 2009. In the coming months, each trade union will negotiate with the Director of Wages over an accord that will determine how the wage increase will be apportioned among union members, and the increase will be paid when said agreement is signed. |
|       | 28   | The Bank of Israel leaves its key interest rate for May unchanged.                                                                                      |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |