

## BANK OF ISRAEL

The Government and  
Finance Committee of the Knesset  
Jerusalem

In accordance with sections 59 and 60 of the Bank of Israel Law, 5714–1954, I respectfully submit herewith the Annual Report of the Bank of Israel for 1978.

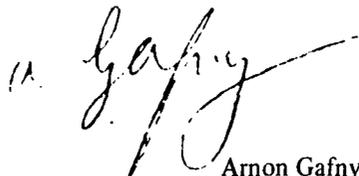
The Report was prepared by the Research Department of the Bank. Most of the statistical data in Parts One and Two were supplied by the Central Bureau of Statistics. There is a marked discrepancy between the estimates of employment and wages derived from different statistical sources, and therefore considerable caution is called for in interpreting the rates of change in these variables.

The dominant feature of the year surveyed was the renewal of economic growth and the expansion of domestic demands. The upturn in investment – and to a certain extent in private consumption as well – occurred in the early stage of the economic recovery and was greater than originally envisaged. The improvement in the balance of payments during the two preceding years was not sustained, and the advance of prices accelerated greatly in the latter part of 1978. The escalation of inflation was the combined result of demand and cost factors: a protracted rise of prices at an average annual rate of about 35 percent generated expectations of a continuation of inflation, with the result that the price structure became increasingly unstable. It transpired that external factors, whose force was relatively small, were able to unsettle the price structure and to push inflation up to an all-time high.

The arresting and significant reduction of the inflationary spiral while resuming the improvement in the balance of payments must be the principal economic policy targets in the coming period. A restrained government budget, an incomes policy that will weaken

the inflationary influences, the discontinuation of the subsidization of credit, and the reduction of customs duties in order to complete the unification of exchange rates and to slow the rise of import prices, all these are indispensable for success.

Sincerely yours,

A handwritten signature in black ink, appearing to read "A. Gafny", with a long horizontal stroke extending to the right.

Arnon Gafny  
Governor  
Bank of Israel

Jerusalem, 3 Sivan, 5739  
May 29, 1979