Chapter 3
Prices

1. MAIN DEVELOPMENTS

The Consumer Price Index (CPI) rose by 18 percent in 1991, a rate similar to the annual inflation prevailing in Israel since the July 1985 economic stabilization program (ESP). The average rate of inflation in 1986–91 was 18.1 percent, ranging between 16.1 and 20.7 percent. The stability of the annual inflation rate as measured by the CPI is remarkable, persisting through periods of slump and prosperity alike, whether the exchange-rate remained unchanged (in 1988, for example), or the increase in the prices of housing and controlled goods accelerated. This does not mean that the rate of inflation did not change, and it was in fact especially variable in 1991; in the middle of the year inflation accelerated as the CPI rose by 22.5 and 31.7 percent (annual rates) in the second and third quarters respectively. In annual terms however, inflation moderated, returning to the rate immediately following the ESP. Inflation was relatively rapid in the first half of 1991, and slowed down in the second.

Prices of housing and controlled goods continued to have a strong effect on the CPI in 1991, as in the previous two years. Housing prices, which rose by 41.1 and 98.6 percent (annual rate) in the second and third quarters respectively, increased by 28.2 percent—slightly less than in 1989 and 1990—contributing to inflation and accounting to a great extent for the high level of the CPI in mid-1991.

The lag in measuring housing prices affected the publication of actual changes in the inflation rate. The CPI rose relatively quickly in the second and third quarters, but actual prices (calculated on the basis of up-to-date figures on housing prices, which are published later) indicate a slightly different pattern. The adjusted CPI, based on actual housing prices rather than on provisional estimates, shows that most of the excessive increase in prices occurred in the second quarter, with a relative decline in the third and fourth quarters (note 4, Figures 3.1 and 3.2, Table 3.4).

The weight of controlled and supervised goods[1] in the CPI continued to decline in 1991—from about 34 to 23 percent. Prices of controlled goods, comprising items which are subsidized (only bus fares since 1991) or provided by public-sector enterprises, rose by 22.1 percent. This was more than the rate of increase of the CPI, as has been the case every year since 1986 except 1988. Prices of supervised goods—mainly business-sector

[1] For definitions, see note B in Table 3.4.

Table 3.1
Selected Price Indexes, 1970–92:I

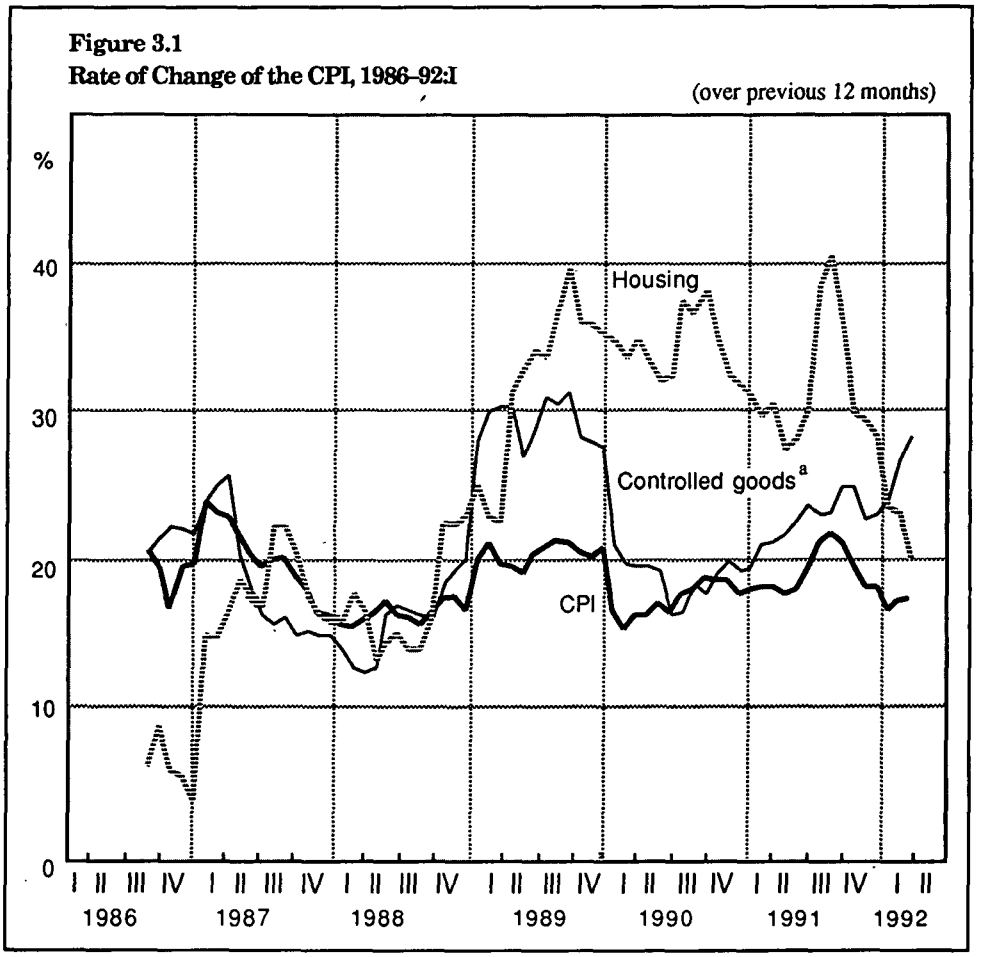
(percent change, annual rate)

	CPI	Implicit price index of		Wholesale prices[b]
		Domestic use of resources[a]	GDP	
Change during period[c]				
1970–73	15.4	17.4	16.2	
1974–78	41.2	42.4	43.1	
1979–82	118.9	119.2	120.5	123.1
1983–85	256.1	247.3	243.9	247.0
1986–90	18.1	19.3	19.6	16.8
1986	19.6	23.1	24.4	15.1
1987	16.1	19.7	18.4	20.9
1988	16.4	17.7	22.7	15.8
1989	20.7	19.9	17.7	19.5
1990	17.6	16.1	14.9	12.6
1991	18.0	16.7	21.8	14.6
1990				
I	12.0	11.3	15.5	12.8
II	21.2	29.0	34.8	9.5
III	23.3	12.9	2.0	9.6
IV	14.3	12.3	9.8	19.0
1991				
I	13.3	22.1	31.8	16.9
II	27.0	29.9	41.5	25.5
III	30.0	14.7	17.5	7.0
IV	3.7	2.0	0.9	9.8
1992				
I	10.4			9.6
Average change				
1986	48.1	47.9	50.6	45.1
1987	19.9	20.6	20.2	18.5
1988	16.3	17.3	19.8	17.5
1989	20.2	20.8	20.7	21.0
1990	17.2	15.9	15.8	11.6
1991	19.0	18.6	21.5	16.0

[a] Net of direct defense imports.
[b] Prices of industrial output for domestic market.
[c] CPI and wholesale price figures based on monthly data; GDP and resource use, on quarterly data.
SOURCE: Central Bureau of Statistics.

goods and services—rose at a lower rate than the CPI, however. Thus, excluding housing the CPI rose by 15.2 percent in 1991 (14.3 percent in 1990), and excluding housing and controlled goods it rose by 13.7 percent (12.9 percent in 1990).

Figure 3.1
Rate of Change of the CPI, 1986–92:I



[a] The definition of controlled goods was changed in 1991 (for details see text).

There was particularly large variance in the rates of change of two CPI items—fruit and vegetables, and clothing and footwear—which are highly seasonal, vary from year to year, and contribute appreciably to fluctuations in the rate of increase of the CPI. Net of housing, controlled goods, fruit and vegetables, and clothing and footwear, the CPI rose by only 13.7 percent in 1991, the lowest rate for the last six years. This trend, which applies to about half the CPI, may indicate that the basic inflation rate is slowing down. This view is borne out by the contribution to the CPI of VAT—between 1 and 2 percent—after being raised from 16 to 18 percent in January 1991. Without this increase, inflation would probably have been lower in 1991. According to the adjusted

index, the inflation rate was relatively slow in the second half of the year. Price trends in the first quarter of 1992 indicate that the trend is continuing.

A comparison of tradables and nontradables in the CPI,[2] shows that the gap between the rate of price-increase of these two categories is diminishing. Whereas nontradables prices rose by 11 percent more than tradables prices in 1988 and 1989, the difference was down to 8 percent in 1990 and 1991. If prices of housing and controlled goods are excluded from nontradables, and prices of controlled goods from tradables, there is almost no difference between them for the first time in many years—14.4 percent compared with 14.1 percent (Table 3.2). Thus, this year's real appreciation reflected changes mainly in the prices of housing and controlled goods.[3] National accounts figures confirm this conclusion. Changes in prices of domestic use of resources, when classified as tradables and nontradables, show that real appreciation was quite small in 1991, despite the relatively large gap arising from the country's improved terms of trade between prices of GDP and of imports, which rose by 21.5 and 11 percent respectively.

The dilemma created by the persistent disparity in price increases between Israel and its trading partners has become more acute in the last six years. On the one hand, using the nominal exchange rate as an anchor for the price level serves to prevent recurrence of the virulent inflation of the early 1980s. On the other, given Israel's economic conditions, over-rigid adherence to the anchor could damage exports and lead to an inordinate increase in imports. Since the ESP, a variety of approaches have been employed for dealing with this problem. In 1989 an exchange-rate regime was introduced consisting of a band around a midpoint rate, which was adjusted every few months.

Due to the recurrence of speculative cycles, in December 1991 the exchange-rate regime was modified, and a diagonal rather than a horizontal band was introduced, the midpoint rate being adjusted on a daily basis of 0.0236 to reach an annual target of 9 percent, while the band remained at ± 5 percent. This will be discussed in greater detail below (see also Chapter 6).

2. DETERMINANTS OF PRICES

Since the ESP, expectations have played a prominent role in economic developments, largely accounting for the notable stability of the inflation rate. For reasons which are not fully understood, economic agents have incorporated into their considerations and decis-

[2] Both in theory and in practice, it is difficult to make a clearcut distinction between tradables and nontradables; many commodities can be classified in either category. One way of estimating changes in their prices is to classify CPI items as tradable or nontradable, but this is problematic because the criteria for this classification are not always unambiguous. Another limitation arises from the fact that the CPI accounts for only part of final expenditures.

[3] The term 'real appreciation' means a rise in the price ratio of nontradables to tradables. It does not necessarily impair the competitiveness of tradables, whose relative profitability is also affected by unit labor costs. Thus, if in addition to appreciation there is a concomitant change in relative wages and/or productivity, the relative profitability of tradables will be unchanged.

Table 3.2
Prices of Tradables and Nontradables, 1986–91

(annual rate of change, percent)

	CPI[a]					Implicit price indexes[b]					
	Nontradables			Tradables							
	Total	Excluding housing	Excluding controlled goods and housing	Total	Excluding controlled goods	Domestic resource use	Narrow domestic resource use[c]	GDP	Business product	Imports[d]	Exports[e]
Change during period[f]											
1986	21.6	31.6	31.0	14.0	13.8	23.1	18.4	24.4	20.5	3.4	6.5
1987	19.4	20.8	20.0	12.3	13.5	19.7	18.6	18.4	16.8	29.4	16.8
1988	21.6	21.2	24.4	10.8	10.5	17.7	14.1	22.7	20.5	2.3	11.3
1989	24.7	20.3	16.8	13.7	14.2	19.9	18.5	17.7	15.0	21.9	19.1
1990	21.2	16.0	13.2	13.0	12.4	16.1	13.1	14.9	11.0	15.8	11.1
1991	21.3	17.3	14.4	13.4	14.1	16.7	15.9	21.8	23.2	4.8	16.3
Average change											
1986	52.0	64.2	62.6	42.3	41.5	47.0	44.8	50.6	49.4	26.2	31.1
1987	24.0	27.2	27.5	13.1	13.7	20.6	18.4	20.2	17.8	19.3	17.4
1988	19.7	20.7	22.4	11.6	11.9	17.3	15.2	19.8	18.4	7.3	11.7
1989	24.9	22.1	20.9	13.3	13.5	20.8	18.9	20.7	18.4	16.4	18.5
1990	20.6	14.9	11.4	11.6	11.7	15.9	12.9	15.8	12.4	11.8	9.3
1991	22.2	17.6	15.0	13.3	13.4	18.6	16.4	21.5	20.1	10.1	15.4

[a] Nontradables comprise services other than foreign travel, fruit and vegetables, butter and cheese, eggs, breads and bakery products, gas and electricity. Tradables are all other CPI items. The weights in the CPI are 58 and 42 for nontradables and tradables respectively.

[b] National accounts data: domestic resource use is net of direct defense imports.

[c] Narrow domestic business resource use is the price of domestic resources, excluding public services wages and housing services.

[d] Excluding defense imports and diamonds.

[e] Excluding diamonds.

[f] Change from fourth quarter.

SOURCE: Based on Central Bureau of Statistics data.

ions the assumption that the rate of inflation, as reflected in the CPI, would remain at an annual rate of 16–20 percent. Although expectations vary between economic agents and over time, in general they are stable. For example, a constant 'inflation factor' almost always appears in the budget, controlled prices are raised each year by slightly more than expected inflation, wage agreements allow for inflation, and the rate of change of the actual exchange rate partly accommodates price increases. The actions of the government and the Bank of Israel undoubtedly helped to strengthen these expectations and maintain the post-ESP inflation rate.

Several factors worked against stable expectations and a steady level of inflation, among them conditions on the labor market, which tended to exacerbate the situation. The exceptional increases in prices of controlled goods and housing in recent years have had a similar effect. Rising unemployment, the outcome of the fact that the increase in the labor supply—which was appreciable—rose faster than demand in 1990 and 1991, worked in the opposite direction. Unemployment tends to bring real wages down, thereby slowing both actual and expected inflation, and lower costs (of fuel, etc.) should have a similar effect. Naturally, monetary and fiscal policy also influence expected inflation rates.

Since 1986 fiscal policy has been consistent with the average inflation rate since the ESP. The deficit and the composition of income and expenditure have conformed with, and even strengthened, expectations that the same inflation rate would persist. The budget for 1991 and the path to which the government is committed for 1992–94 are in line with the present inflation rate. Inappropriate fiscal policy could impair the credibility of the anchor.

Amongst other things, since July 1985 monetary policy has supported exchange-rate policy as a disinflationary instrument. The policy is basically accommodative, and the development of the monetary aggregates is dictated by the Bank of Israel's interest-rate target. Monetary aggregates have risen faster than actual inflation (Table 3.3), but the gap is reduced when the increase in output and domestic use of resources, the volume of transactions, and the continuing shift to local-currency assets are taken into account.

Policy-makers can be said to have affected prices to a relatively small extent this year through monetary and fiscal policy. Their influence was restricted principally to incorporating inflationary expectations into the budget, to setting prices of controlled and supervised goods, and of course to determining exchange-rate policy, which played a crucial role in the development of inflation.

Exchange-rate policy and prices

The view that exchange-rate policy has a direct and vital effect on the inflationary process took hold in the early 1980s. It became apparent that not only were the prices of imports, exports, and their close substitutes affected by the exchange rate, but that prices of other—nontradable—commodities also responded to it indirectly. The idea underlying

Table 3.3
Price Developments: Related Indicators, 1988–91

(annual change, percent)

	Average				During period[a]			
	1988	1989	1990	1991	1988	1989	1990	1991
Imports and exports of merchandise								
Imports								
Intermediates[b,c]	13.8	20.8	7.4	8.3	11.0	22.4	6.0	7.5
Consumer goods[b]	6.8	8.0	12.2	9.6	7.8	10.8	12.7	8.1
Producer durables[d]	5.3	15.8	13.4	14.8	5.7	20.0	10.3	15
Exports (excl. diamonds)[d]	12.5	18.1	8.4	11.2	11.7	18.5	10.9	11.7
Real GDP and use of resources[d]								
GDP	2.6	1.7	5.4	5.9	1.5	2.7	6.5	8.4
Domestic use of resources[e]	3.3	–0.6	7.6	12.4	2.1	–0.7	10.3	14.4
Exports (excl. diamonds)	–4.0	7.7	6.6	0.4	–5.7	10.8	2.2	11.6
Unit labor expenditure	–0.4	–2.3	–1.4	–6.9				
Nominal labor cost								
Business sector wages	21.8	18.3	15.4	12.4	21.2	15.0	16.3	12.1
Public services wages	27.4	20.7	17.6	20.8	29.5	14.5	20.5	16.1
Unit labor cost[f]	19.7	15.1	8.7	12.5				
General government deficit (percent of GNP)[d]								
Total	–0.4	–4.0	–2.7	–2.6				
Domestic	–1.5	–6.0	–5.5	–5.4				
Monetary indicators								
Change in M1	33.5	25.8	26.8	28.2	13.9	37.2	29.8	15.0
Change in M2	28.3	17.5	24.6	35.1	4	35.0	37.5	27.0
Interest rate								
Bank credit	31.7	33.6	22.8	25.5				
Overdraft facilities	46.2	34.3	29.6	29.9				
Long term[g]	4.1	1.7	1.2	2.1				
Unemployment rate	6.4	8.9	9.6	10.6				
Change in exchange rates								
Currency basket	2.4	16.1	10.6	12.3	1.5	20.3	10.6	12.8
Dollar	0.3	19.9	5.2	13.	2.0	23.5	2.0	16.7

[a] Change from fourth quarter of preceding year to fourth quarter of current year.
[b] Excluding fuel and diamonds.
[c] Foreign trade data at effective exchange rate, including tariffs.
[d] National accounts data.
[e] Excluding direct defense imports.
[f] Business sector.
[g] Real gross yield to maturity on 5-year CPI-indexed government bonds.

SOURCE: Based on Central Bureau of Statistics data.

the ESP was that the exchange rate could serve as an anchor for the price level and other nominal variables, and so in July 1985 a regime involving a stable exchange rate which was occasionally and slowly adjusted to price-increases was introduced. Early in 1989 a policy regime under which the exchange rate moves within a band, enabling it to respond to supply and demand, was introduced, and the band was set at ±3 percent. The intention was to prevent sharp shifts in the actual exchange rate, to enable adjustments to be made more smoothly, and to moderate—and perhaps even prevent—speculative capital movements. The timing of midpoint-rate realignments would be less crucial because they would not be linked to announcements of changes. The midpoint rate was raised by 6 percent in June 1989, by the same amount in March 1990 (when the band was widened to ±5 percent), and by 10 percent in September 1990. The exchange-rate adjustments—an increase of 6–10 percent every 6–8 months—had settled into a pattern.

The realignment of March 1991 deviated from this design. Although it did not differ as regards timing or the extent to which the midpoint was raised, it was unique in that, after remaining near the lower limit of the band for six months, the actual exchange rate went up sharply because the new lower limit of the band was higher than the previous exchange rate. The increase in the actual exchange rate was not great (slightly less than 6 percent), but the signal was clear: the realignment of the midpoint rate at almost regular intervals of 6–8 months could involve a sharp increase in the actual exchange rate. This signal reinforced speculative capital movements in the last four months of 1991.

Concurrent with the subsequent speculative cycle of capital movements, which began in September, the actual exchange rate rose. The policy-makers decided not to realign the midpoint rate—thereby enabling market forces to be reflected in interest-rate increases—by not fully offsetting the reduction in liquidity which resulted from increased foreign-exchange purchases. Interest rates rose in October, and there was a reversal in the last week of that month, when excess demand for foreign exchange was replaced by excess supply. The midpoint rate was not adjusted following the surge of purchases, and the credibility of the exchange-rate policy was not impaired, but a price was paid, albeit a lower one than would otherwise have been the case, since the nominal interest on bank credit rose by more than 5 percent on average in the last quarter, pushing real interest above the desired level. The borrowing rate fell relatively slowly.

The exchange-rate policy was re-examined in the ensuing lull. While on the one hand there was a desire to avoid the speculative cycle, on the other policy-makers were reluctant to lose the effective anchor provided by the exchange rate. A new arrangement was introduced in 1991, since when there have been smooth daily adjustments of the midpoint rate, aiming at an annual rate of change of 9 percent. The band around the midpoint rate remains at ± 5 percent. The advantage of the new arrangement is that there is no longer any need for sharp periodic adjustments, the probability of speculative capital movements is reduced, and with it the level of uncertainty. The annual rate at which the midpoint is to be raised was set at 9 percent, the actual midpoint rate was increased by 3 percent as a preliminary step, and maximum inflation of 14–15 percent was announced for 1992. Thus, for the first time an inflation target was officially

declared. The test of this method will be if it succeeds not only in restraining speculative cycles but also in ensuring that there is no return to the inflationary processes of the past. If economic conditions are propitious, the new exchange-rate regime should not prevent the reduction of inflation.

Table 3.4
Selected Price Indexes and Exchange Rates, 1990–91

(rates of exchange of quarterly averages)

	1990				1991			
	I	II	III	IV	I	II	III	IV
CPI	3.0	4.9	4.5	4.7	2.8	5.2	7.0	2.4
Adjusted CPI[a]	3.7	5.1	3.6	4.0	3.5	7.0	3.4	2.4
NIS/basket ratio	1.5	3.3	4.0	1.5	1.3	7.7	0.1	3.3
NIS/dollar ratio	–0.8	3.1	1.0	–1.3	2.2	13.3	0.4	0.4
Controlled and supervised goods[b]	5.2	3.8	4.9	5.2	6.2	4.3	4.6	3.4
Controlled goods	5.4	3.1	4.6	5.0	6.2	4.9	5.5	4.6
Owner-occupied homes (actual)	7.9	10.1	7.7	2.8	5.8	16.3	3.0	–1.6
Owner-occupied homes (CPI)	3.7	9.3	11.5	6.6	1.0	5.6	21.3	–1.3

[a] The adjusted CPI reflects the development of consumer prices, with housing prices based on quarterly data.

[b] Controlled and supervised goods are listed as defined in 1990 and 1991 (bread, milk and taxi fares were moved from the subsidized to the controlled category in 1991). Supervised goods include mainly goods supplied under imperfect competition, i.e. flour, margarine, coffee, cocoa, textbooks, school supplies, medical supplies, taxi fares, fuel and motor oil, gas and gas services, kerosene, solar, refrigerators and their insurance services, cigarettes, tobacco, soft drinks, bread, milk, and dairy products. Prices of tea, sugar, sugar substitutes, frozen vegetables, cleaning tools, driving lessons, and car rental are no longer supervised, and the weight of the entire supervised group in the CPI fell from 14.8 to 9.6 percent.

SOURCE: Central Bureau of Statistics and Bank of Israel.

3. CONTROLLED AND SUPERVISED GOODS

Commodities whose prices are controlled by the government include those which are subsidized (only bus fares in 1991) or are supplied by public-sector enterprises. Gas, kerosene, and solar for home consumption were excluded from this category in 1991. Due to the policy of the last few years, the weight of controlled items in the CPI fell from 19.5 to 13.1 percent in the last few years. The prices of several supervised commodities have been removed from control in recent years, bringing their weight in the CPI down from 14.9 to 9.6 percent, and the total weight of controlled and supervised goods in the CPI has declined from 34.3 to 22.7 percent. Changes in the weight of controlled and supervised goods make it difficult to make comparisons with previous years. Prices of controlled goods rose faster than the CPI. On the other hand, prices of supervised goods

rose more slowly than the CPI in 1991, so that when controlled and supervised goods are taken together their rate of increase was the same as that of the CPI.

4. HOUSING

As Table 3.5 shows, while prices of owner-occupied housing rose by 27.8 percent (less than in 1989 and 1990), rents again rose at the high rate of 1987–89. Thus, the total increase in the index of dwelling services rose slightly less in 1991 than in previous

Table 3.5
Principal Components of Dwelling Services in the CPI, 1986–91

(annual change, percent)

	Prices of owner-occupied apartments	Index of rents	Other dwelling expenses	Index of residential services	CPI
During period[a]					
1986	3.1	22.1	8.6	4.9	18.5
1987	14.5	33.0	17.1	16.4	16.8
1988	20.4	38.6	24.5	22.6	17.0
1989	35.3	36.4	38.1	35.6	20.4
1990	34.7	20.8	30.5	32.8	18.2
1991	27.8	38.4	29.8	29.0	18.5
Annual average					
1986	30.9	44.4	36.7	32.3	48.1
1987	15.4	38.1	18.0	17.7	19.9
1988	14.7	33.6	21.2	17.0	16.3
1989	31.6	37.1	32.3	32.3	20.2
1990	36.2	20.3	34.9	34.2	17.2
1991	31.0	36.4	30.2	31.6	19.0
Weight in CPI	138.1	16.7	9.8	164.6	1000

[a] Change from fourth quarter of preceding year to fourth quarter of current year.

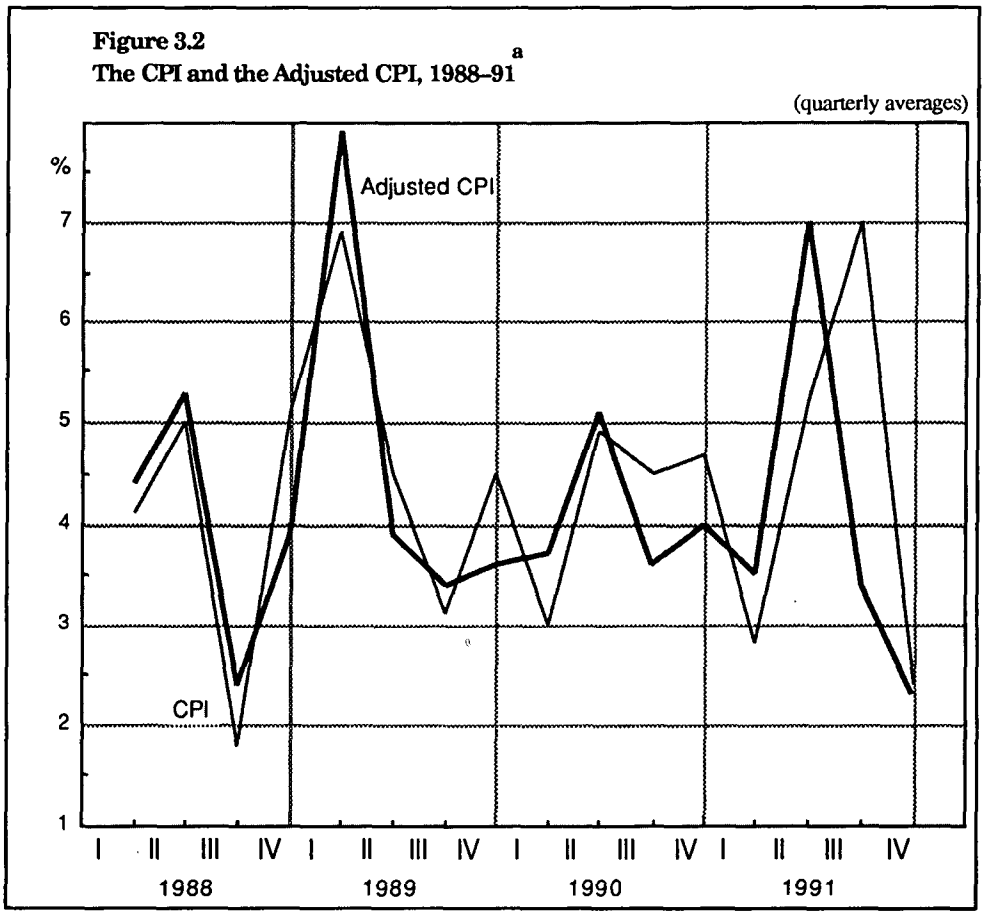
SOURCE: Based on Central Bureau of Statistics data.

years. The steep rise in the prices of owner-occupied apartments reflects rising demand which has not yet been matched by increased supply. The latter may affect housing prices in 1992, when the large number of building starts are completed. The geographical dispersion of building starts may, however, fail to meet needs, so that there may be a shortage in some areas, where housing prices continue to rise, and a surplus in others, where prices fall.

There was considerable variability in the housing component of the CPI in 1991, too; it rose by 13.7, 41.1, and 98.6 percent in the first, second, and third quarters respectively, and declined by 15.4 percent in the fourth. These trends are similar to those for 1990.

Because of the way it is calculated, the housing item in the CPI reflects prices with a lag of several months. Consequently, the dramatic increase in the CPI in the third quarter was recorded when actual housing prices had stabilized, so that the CPI partly reflected

Figure 3.2
The CPI and the Adjusted CPI, 1988–91[a]



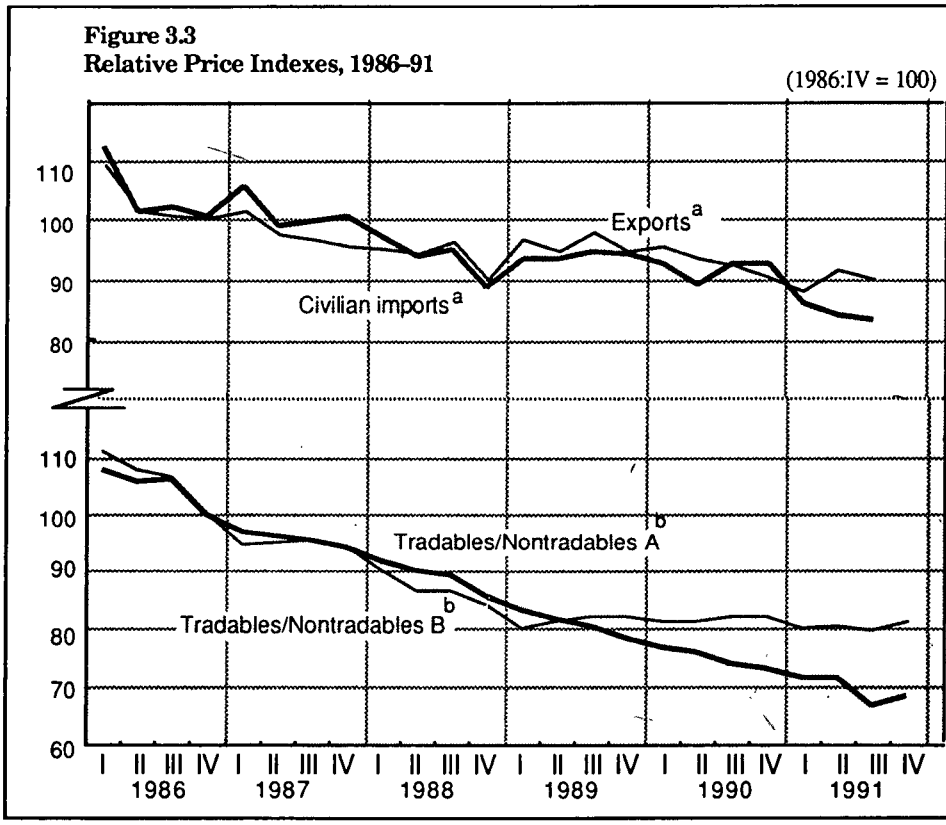
[a] Annual rates. For definitions, see text.

past trends. The CPI should be used with caution for reaching conclusions on which to base policy decisions. The index in Table 3.5 reflects more closely the way prices have changed, because it is based on actual housing prices rather than on estimates based on prices when the CPI is published. The adjusted CPI, which reflects the prices of the consumer basket more closely, sometimes diverges from the CPI.[4] Although in recent years the CPI and the adjusted CPI have followed similar trends, in 1991 the CPI was biased slightly downwards in the second quarter and substantially upwards in the third: in the

[4] This should not be regarded as criticism of the way the CPI is calculated. This is done in the best possible way in real time, but *ex post* it is possible to calculate an index based on data which is received with a delay.

third quarter the CPI rose by 7 percent and the adjusted CPI by only 3.4 percent, in the second quarter the CPI rose by 5.2 percent and the adjusted CPI by 7 percent. Thus, the price-increase accelerated in the second quarter in 1991, while there were relatively moderate increases in the last two quarters (the adjusted CPI rose by 3.4 and 2.4 percent

Figure 3.3
Relative Price Indexes, 1986-91



[a] Prices of exports (imports) excluding diamonds, relative to implicit prices of domestic resource use, excluding direct defense imports.

[b] Variant A, all CPI items, Variant B, excluding controlled goods and housing.

in the third and fourth quarters respectively, Figure 3.2 and Table 3.4). Three main factors explain this price-change, which includes the 'true' change in housing prices (a 16.3 percent rise in the second quarter): first, excess demand for housing in the second quarter, before supply had expanded and when large-scale immigration was expected to continue; second, increased economic activity after the Gulf War, in the wake of the extensive second-quarter demand, which moderated subsequently; third, the appreciable rise in the dollar exchange rate in the second quarter of 1991 (an average of 13.2 percent),[5] compared with the preceding quarters. The last factor had a marked effect,

[5] The rapid change in the dollar exchange rate at this time was due to the March 1991 devaluation and the depreciation in April and May, with the concurrent weakening of the dollar.

partly because the dollar continued to serve as the unit of account on the housing market, and changes in the dollar exchange-rate had a relatively large effect on this market.

5. WAGES AND PRODUCTION COSTS

The influx of immigrants which began at the end of 1989 has changed the labor market drastically. In the past, real wages have hardly ever fallen, except for limited periods and with the agreement of the Histadrut (General Federation of Labour); this was the case in the first few months after the ESP was launched, for example. In the last three years, however, real wages have declined throughout the business sector. In 1989 the fall is explained as an adjustment after the real increase in the years following the ESP. In 1990, and particularly in 1991, however, it is due chiefly to surplus supply in the labor market and the persistence of this surplus. Unemployment was 11 percent in 1991, the highest rate since the 1966–67 recession.

Nominal wages per employee post rose by 12.4 percent in the business sector and by 20.8 percent in the public services. Nominal unit labor costs went up by 12.5 percent in the business sector, and nominal prices of imported intermediates, excluding fuel and diamonds, by 8.3 percent. Interest rose in the last quarter as a result of the speculative cycle, although annual average overdraft credit remained at the same level as in 1990 and average bank credit rose by 3 percent, so that the cost of working capital remained more or less stable (Table 3.3). These indicators show that the increase in costs, particularly in the business sector, moderated, together with the pressure on the inflationary process.