

# **Recent Economic Developments 134**

May - August 2012

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## Part 1: Review of Recent Economic Developments, May - August 2012

- Economic activity during the reviewed period continued to grow at a moderate pace.
- The Bank of Israel’s monetary policy provided a measured response to the continued moderate activity through the reduction of the July interest rate by 0.25 percentage points.
- Toward the end of the reviewed period, the government decided to increase the government deficit target to 3 percent, while at the same time increasing taxes, in order to deal with a higher than expected deficit.
- The global environment during the reviewed period was characterized by the risk of an economic crisis in Europe following the debt crisis in a number of eurozone countries.
- According to Bank of Israel estimates, home prices are in accord with the level of demand, supply, and interest rates in the market. With that, it should be noted that that mortgage volume data indicated a return of buyers to the housing market, and this data in and of itself may create expectations of continued price increases. If these expectations are fulfilled, a price bubble may develop in the housing market.
- The high level of activity in the economy, and the low unemployment rate, are likely to help the Israeli economy should a crisis erupt in Europe.
- The real exchange rate in the economy has indicated a prolonged depreciation since 2011 in light of the departure of foreign investors from the local market and in light of the increase in the trade deficit.

### Main developments

From May to August 2012, Israel’s economy continued to grow at a moderate rate. The annualized growth rate during the second quarter of 2012 was 3.4 percent, below its long-term average and near the rate consistent with the Bank of Israel’s forecast for 2012. (The forecast was for 3.1 percent growth, while the average annualized growth rate for the year to date has been 3.24 percent.) Export and manufacturing indices, as well as other indices, continued to hover around the same level as last year. The inflation rate in the past 12 months continued to fall during the reviewed period, as part of a continued trend in the past year, reaching one percent per year—close to the lower bound of the inflation target range. The slowdown in activity was also expressed in the Business Climate Index, which showed that the economy is in a low and moderating growth environment.

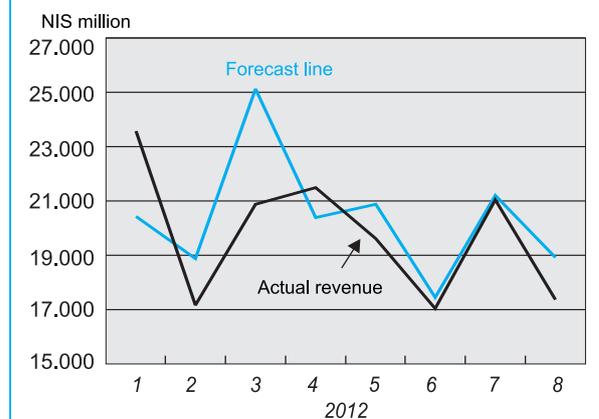
The slowdown in economic activity is the result of weakening growth in demand, against the background of a global slowing of activity. Manufacturing and export indices, which are more heavily influenced by global demand, indicate a slowdown. In contrast, goods and services revenue indices—which are more affected by local demand—continued to grow, although at a more moderate pace than in the past. The slowdown comes during a period when the economy is enjoying a high level of activity by historical comparison.

The Bank of Israel’s monetary policy provided a measured response to the continued moderate activity through the reduction of the July interest rate by 0.25 percentage points; this, against the background of the low level of interest rates in the economy. Four additional factors influenced the decision to reduce the interest rate: (1) the weakness of the shekel, which helped the Israeli economy cope with the slowdown; (2) inflation expectations for the coming year, which were around the center of the target range; (3) uncertainty regarding fiscal policy at the beginning of the reviewed period, which limited the maneuverability of monetary policy; and (4) concern over the continued increase in home prices.

Estimates of state revenues from taxes, upon which the state budget is constructed, were based on a higher growth rate than actually achieved. As such, the government deficit was higher than expected. The domestic deficit excluding provision of credit (January–August) totaled NIS 13.7

Figure 1.1

Domestic revenues excluding credit, forecast compared to actual revenue, 2012



billion, compared with an expected deficit of NIS 8.8 billion. According to assessments, the deficit is expected to reach 4 percent of GDP by the end of the year. Figure 1.1 shows the forecast path of state revenues excluding credit compared with actual revenues. The figure indicates that state revenues were below those forecast in most months, though the deviation was low, and a significant portion of the surprise in the deficit was the result of revenues that were lower the expected path in March.

During the reviewed period, the government approved a package of measures intended to deal with developments in the economy. The higher than expected deficit, which developed against the background of global weakening and of expectations of a crisis, presented a dilemma to decision makers: if they decided to deal with the deficit by fiscal constraint (or imposing taxes that could reduce private consumption), it could reduce demand and make the impending recession more severe. In contrast, dealing with moderating activity and the impending crisis by expanding the deficit while many countries around the world are facing default was liable to involve costs and risks. Toward the end of the reviewed period, the government reached a decision which took both aspects into account—the government deficit target was increased to 3 percent, while VAT rates were increased by 1 percentage point, the income tax rate was increased by one percentage point for income over NIS 14,000 per month, tax brackets were changed, and a broad cut in expenditures was decided upon in order to finance the increase in expenditures in various budget items in accordance with government decisions.<sup>1</sup> These decisions are expected to increase state revenues from taxes and to contribute to a reduction in the deficit.

Capital market indicators showed that investors are placing their trust in the government's steps. An increase in the government deficit on its own would have increased the government's risk premium and the yields on government bonds. In contrast, the market responded by lowering yields on government bonds, mainly unindexed ones. This development apparently shows investor trust in the government's over all program—in the fact that the government acted proactively and in time to deal with the deficit by increasing the deficit target and increasing tax revenues.<sup>2</sup>

<sup>1</sup> The reference is to extraordinary expenditures such as dealing with work-seeking infiltrators, firefighting, and so forth.

<sup>2</sup> It should be noted that later in the reviewed period, bond yields rose again, apparently against the background of increasing geopolitical tensions in the region.

## Global developments and their effect on the economy

The stagnation in global real activity continued and deepened during the reviewed period. Real global trade remained stagnant at the same level as the first quarter of 2011 (Figure 1.2). US GDP increased at a low rate of 1.7 percent, in annual terms, during the second quarter of 2012. While unemployment there declined from its record levels of 2009, it has remained at a relatively high level of 8 percent for the past few months. Eurozone GDP contracted by 0.7 percent in the second quarter of 2012, and unemployment there reached a record of 11.3 percent (Figure 1.3). The crisis in the eurozone is expanding to other economies. While the German economy grew in the second quarter, it was at a

Figure 1.2

Real global trade indices, 2002 to March 2012  
(January 2002 = 100)

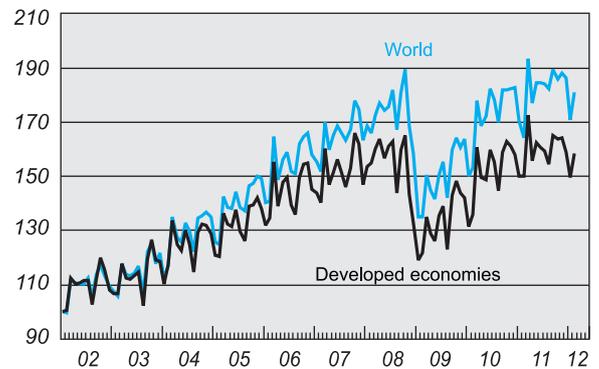


Figure 1.3

Real gross domestic product in the eurozone  
2004 to June 2012  
(Quarterly percentage change, seasonally adjusted, annual terms)



slower rate (0.3 percent compared with 0.5 percent in the first quarter), and toward the end of the reviewed period, Moody's lowered Germany's rating forecast (as well as that of the Netherlands and Luxembourg) from stable to negative. The European Central Bank's interest rate, which fell to a low of 0.75 percent, has still not managed to encourage demand. Emerging market countries have also recorded growth rates below those of the long term. In the second quarter of 2012, there was a slowdown in growth in China, and for the first time since the 2008 credit crisis, the interest rate there was lowered. Disappointing macro data was published in Brazil, showing a contraction of manufacturing production, and investment houses are expecting moderate growth of just 2 percent.

The global environment during the reviewed period was primarily characterized by the risk of a crisis in Europe, as a result of the debt crises of a number of countries in the eurozone and their ramifications on the rest of the eurozone and the rest of the world. During the reviewed period, there were a number of occurrences in this context: At the beginning of the reviewed period, and after signing a supervised debt arrangement with its creditors, Greece encountered difficulties in establishing a government and concerns that it might leave the eurozone increased. Later in the period, the situation in Greece improved, and it even received the first rescue package. Toward the end of the period, concerns that it might leave grew stronger again when it did not meet the conditions put in place by the European Union. Other concerns arose at the beginning of the period and were actualized later on when Spain—the fourth largest economy in the eurozone—asked for assistance from the banking sector in June.

During the reviewed period, European leaders issued a number of announcements of steps intended to deal with the developing crisis: the establishment of a growth encouragement fund in Europe, the establishment of Europe-wide banking supervision—as a first step toward pan-European fiscal supervision, assistance to Spanish banks and the establishment of new mechanism for the purchase of government bonds. However, not only is there a doubt as to the leaders' ability to implement the steps, it is possible that these steps have been taken too late. The prevailing uncertainty in the market regarding the effectiveness of the steps has found expression in continuing high yields on ten-year bonds in Spain and Italy.<sup>3</sup>

In addition to the concrete tools for dealing with the crisis, Western leaders carried out monetary expansions in order

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<sup>3</sup> Yields on two-year bonds fell sharply during September following an assurance by the European Governor that the ECB would do all that was necessary in order to maintain the eurozone's unity.

to spur activity. It seems that these expansions did halt a further financial crisis at this stage in Europe and the United States, but as of now, they have not managed to inject new life into stagnant real activity, and in July, the IMF published a downward revision of growth forecasts for 2012 and 2013.

There is an apparent consensus among world leaders as to how to use monetary tools to deal with the crisis, but they still disagree over how to use fiscal tools. In particular, there is no conclusive answer to the question of whether to use a restraining fiscal policy in order to deal with the costs and risks inherent in inflated deficits or whether to use expansionary fiscal policies in order to deal with the economic recession.<sup>4</sup> The dispute has found expression in world leaders' modus operandi. In the US, greater weight is given to the costs and risks of an economic recession, and an expansionary fiscal policy has been adopted even though the result is deficit levels that are unsustainable. In contrast, a contractionary fiscal policy has been adopted in Europe, where greater weight is being given to the risks inherent in increasing debt.

It is possible that the difference in how economic distress is handled results from the difference in the character of that distress. If the crisis in Europe is a result of a debt crisis, while the crisis in the United States is a result of slowing demand, then different forms of treatment are required. However, it is possible that it is a matter of different approaches. In particular, the approach supporting fiscal contraction can be interpreted as "budget discipline", which takes into account the costs and risks resulting from a deficit or it can be interpreted as "austerity", which gives too much weight to costs and risks, to the point of harming long term growth. In this context, we note that there have recently been more calls for moving toward an approach of fiscal expansion. For instance, the International Labour Organization estimates that if significant steps are not taken, it could lead to the loss of 4.5 million jobs.<sup>5</sup>

Despite the slowdown in global economic activity, there was a sharp increase in the prices of goods during the reviewed period. This is particularly notable in the prices of food and energy, due to the serious draught in the United States and due to sanctions placed on Iran, which is a significant petroleum exporter.

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<sup>4</sup> For a broader description of the dispute, see: Frankel, Jeffrey, "The First World's Fiscal Follies", Project Syndicate, published July 18, 2012. <http://www.project-syndicate.org/commentary/the-first-world-s-fiscal-follies>

<sup>5</sup> "Eurozone job crisis: Trends and policy responses", International Labour Organization, published July 11, 2012.

The slowdown that has begun and the looming crisis have ramifications on activity in the Israeli economy. The global slowdown and the stagnation in global trade have led to stagnation in growth rates of demand for goods and services exported by Israel. Against this backdrop, Israeli exports remain stagnant at the same level as during the first quarter of 2011. During the reviewed period, there was real devaluation, which improved the competitiveness of Israeli exporters and should have increased quantitative exports from Israel even when global trade remains stagnant. Despite this, Israeli exports remain, as stated, at the level they were during the first quarter of 2011, apparently against the background of a high level of activity. The crisis in the eurozone may have direct effects on the Israeli economy—through a reduction in demand for Israeli exports, damage to the public’s assets portfolio or the massive exit of nonresidents from investments in Israel—and it could also have indirect effects, through harming Israel’s other trading partnerships.

**Economic Activity**

During the second quarter of the year, there was 3.4 percent annualized growth in GDP, similar to the growth rate in the three previous quarters (3.1 percent, 3.1 percent, and 2.8 percent, respectively). The growth reflected rapid expansion in exports (30.6 percent), private consumption (3.9 percent), and public consumption (2.1 percent), together with real appreciation of 2.5 percent in the real effective exchange rate. However, in contrast, the data show that after two years of accelerated growth in investments, the first quarter of 2012 saw a moderation of growth in investments in fixed assets, and a contraction in the second quarter (1.2 percent).

This development apparently testifies to corporate concerns of a turnaround in business turnover following a period of very high levels of investment. National Accounts figures, particularly exports, were influenced in the second quarter by uncommon developments (particularly microchip plant activity). Net of these effects, exports have remained stagnant since the beginning of 2011.

The Composite State of the Economy Index published by the Bank of Israel increased from April to July by an annualized rate of 2.15 percent, compared to an average annualized rate of 3.34 percent during the previous reviewed period, indicating a slowdown. The Manufacturing Production Index rose between April and July at an annualized rate of 4.2 percent, similar to the rate during the previous reviewed period. The Trade and Services Revenue Index increased rapidly by 6.5 percent, after it had slowed to moderate growth of 1.5 percent in the previous period. An analysis of the data over a longer period indicates that the index of manufacturing production has remained relatively constant since January 2011. The Trade and Services Revenue Index shows a return to its highest levels from mid-2010.

The slowdown in the Composite State of the Economy Index also found expression in the Climate Indices derived from the Business Tendency Survey which show a deterioration in the growth rate, which has continued since April. This deterioration is seen both in expectations and in reports on activity, and it appears in all primary industries of the economy, particularly in manufacturing, services and trade. The Business Climate Index indicates that the economy is in a low and moderating growth environment (Figure 1.5).

Figure 1.4

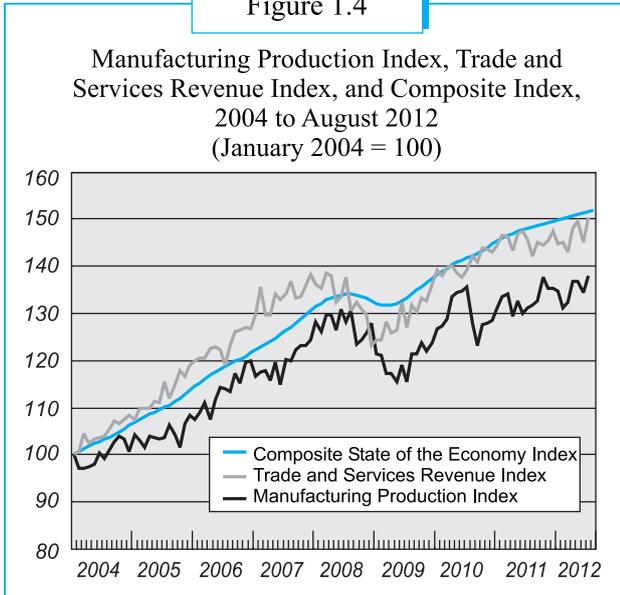
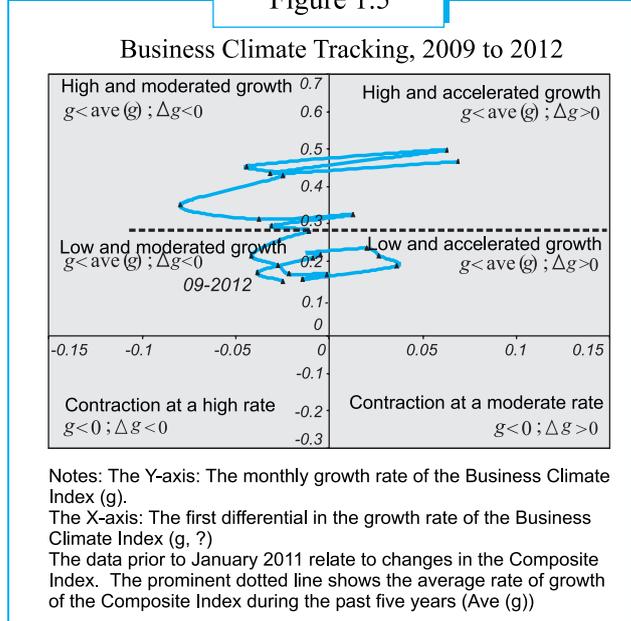
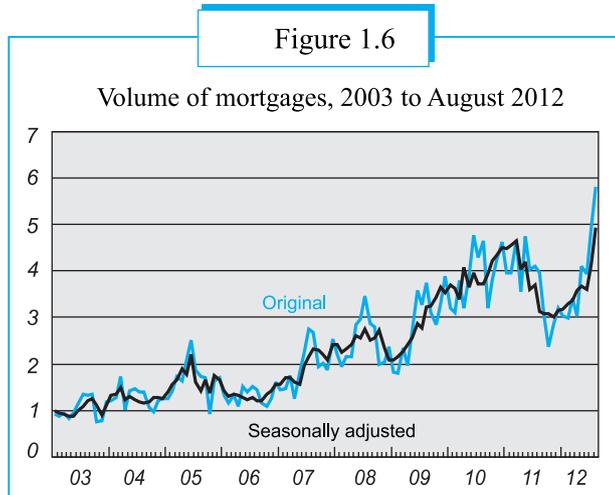


Figure 1.5



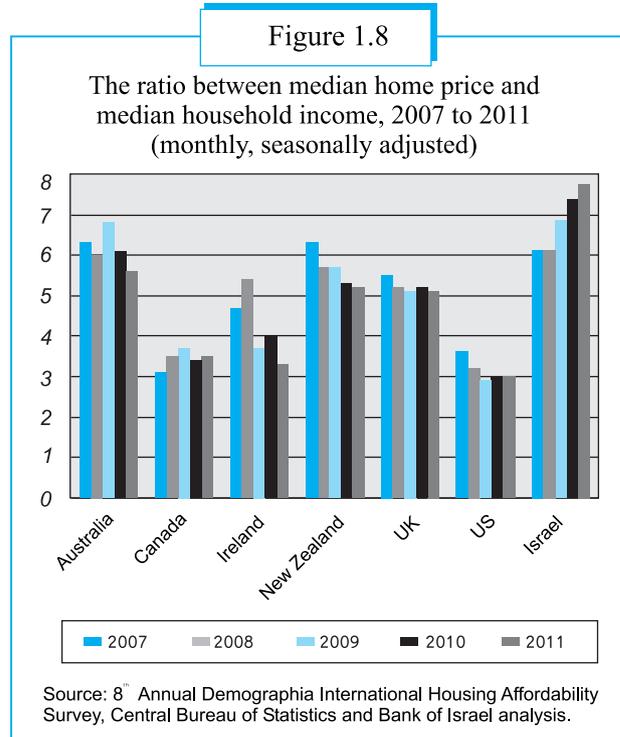
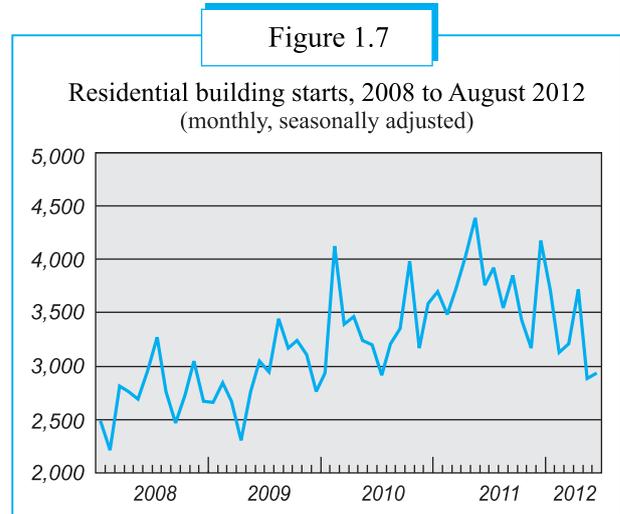
Indicators from the housing market point to the possibility of a revival in this market. Data on mortgage volume point to a return of buyers. Home prices continued to rise during the reviewed period, although at a more moderate rate than in previous years. Toward the end of the reviewed period, the number of real estate transactions increased, following a number of months of cooling in this market, and the amount of mortgages climbed to record levels (Figure 1.6). The



accelerated growth in mortgage volume may be a one-time correction, or it may be the result of long term factors. It may be a correction of the significant drop in the number of transactions concluded in the months previous to this data, against the background of the social protests. Alternatively, it may be a response to the expected increase in the VAT rate, although the VAT increase mainly affects new homes, which are just one-quarter of the market. If the increase is the result of one of these reasons, then it will apparently not be permanent. In contrast, it is possible that the increase reflects a change in consumer attitudes regarding the chance of future price decreases, in light of the reduction in housing starts in recent months (Figure 1.7). In such a case, the increase can be expected to be permanent, and may lead to a renewed increase in home prices.

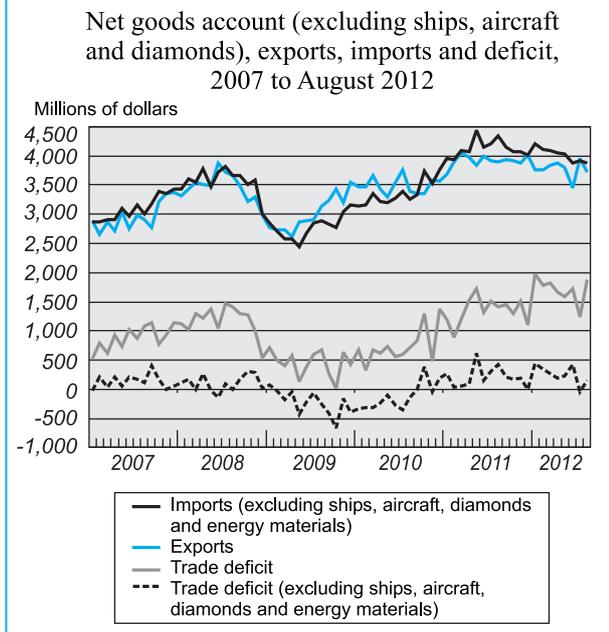
According to Bank of Israel assessments, housing prices can be explained by real factors of demand, supply, interest, and so forth.<sup>6</sup> It should be emphasized that in any scenario, the accelerated growth itself may create expectations of continued price increases, and if these do come to pass, a price bubble may develop in this market. As such, it is important to deal with the issue as needed.

<sup>6</sup> For more information, see: Dovman, Polina, Sigal Ribon and Yossi Yakhin, (2012) "The housing market in Israel 2008–2010: Are house prices a 'bubble'?", Israel Economic Review (IsER) Vol. 10, No.1



Home prices in Israel are at historically high levels, and dealing with this deviation from the long term trend may take the form of increasing the supply of homes (dealing with developments in the short term). Additionally, and in parallel, the long term average of real home prices (as these prices are measured, for instance, in years of salary), is at a high level relative to other countries. Figure 1.8 shows the median price of an apartment in terms of salary years. The figure shows that in 2011, about 8 years of gross salary per household were required in order to purchase a home in

Figure 1.9



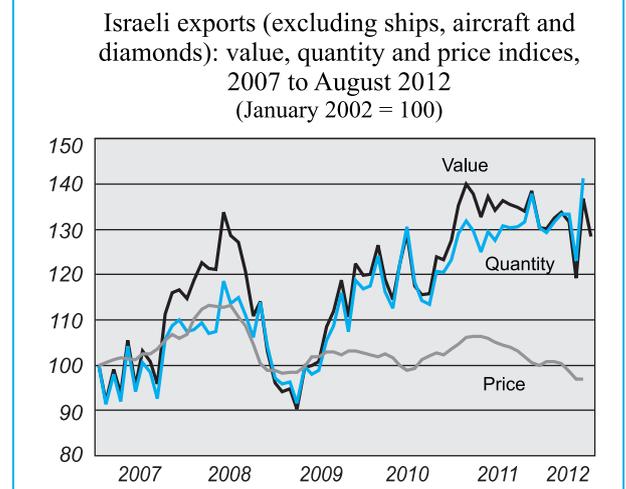
Israel.<sup>7</sup> In contrast, just three years are required in the United States, and five years in the UK. The higher price levels, as expressed in this index, prevailed in Israel even before the dramatic increase in home prices, and are apparently the result of long term factors. As such, the method of handling this phenomenon must be different, and it must be directed at handling long term factors and be supported by the planning, construction and land marketing institutions. Through the planning and construction institutions, it is possible to reduce the costs of investor financing by reducing the amount of time from when the investment is made until it is exercised. If the time period from when the decision is made by the institutions until the apartments enter the market is reduced, it will provide policy makers with more effective tools that will enable them to rein in prices as necessary.

Israel's foreign trade continues to show signs of a slowdown. From April to August, total goods exports declined by 7 percent, based on original data. Manufacturing exports, excluding ships, aircraft and diamonds, fell by 4.5 percent according to data in seasonal terms. The industries that were hit hardest during this period were the mining, base metal products, and oil refinery industries. Exports by

<sup>7</sup> The current estimate differs from past estimates since it is defined differently for purposes of comparison to global data. The estimates presented in the past were that the average price of a home is equal to roughly 12 years of average salary for an individual. Here, the estimate is based on the median price and the median household salary. The difference between the previous estimate and the current one is due to the need to adjust the index to international estimates.

technological intensiveness show a downward trend in exports in the high tech and medium-high tech industries, compared with relative stability in the other industries. Most of the decrease in the reviewed period resulted from a long term trend of price decreases worldwide. Since the beginning of 2011, export values have been in a downward trend resulting mainly from price decreases (Figure 1.10). Quantitative export volume, in contrast to the level from the

Figure 1.10

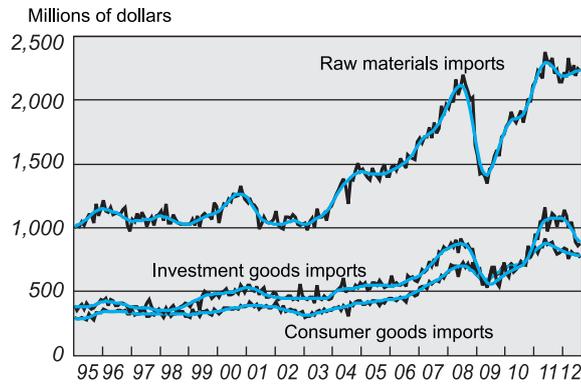


beginning of 2011, is 20 percent higher than the top levels from before the crisis. This development in Israeli exports is very similar to developments in overall global trade: since the beginning of 2011, there is fixation in export volume together with price decreases there as well. Service exports increased from April to June by 2.5 percent, with most of the increase coming from exports by start-up companies.

Imports to Israel have been at very high levels since the beginning of 2012, due *inter alia* to the increase in imports of energy materials resulting from the increase in the quantity of oil that is replacing Egyptian gas and gas from the Yam Tethys fields. From April to August, Israeli imports fell by 0.2 percent, based on original data. Seasonally adjusted data show that imports excluding ships, aircraft and diamonds increased by one percent, with most of the increase coming from an increase in the import of energy products (Figure 1.12). If energy materials are excluded, imports declined by 4.4 percent. The most significant decrease during the reviewed period was in the import of investment goods. The import of investment goods has been increasing since the low reached due to the crisis. During 2011, there was accelerated growth of this item, and its weight in total imports rose to record levels of 27 percent (a pattern similar to the weight of total investment in GDP). The decrease during the surveyed period may indicate a return to equilibrium. Alternatively, it

Figure 1.11

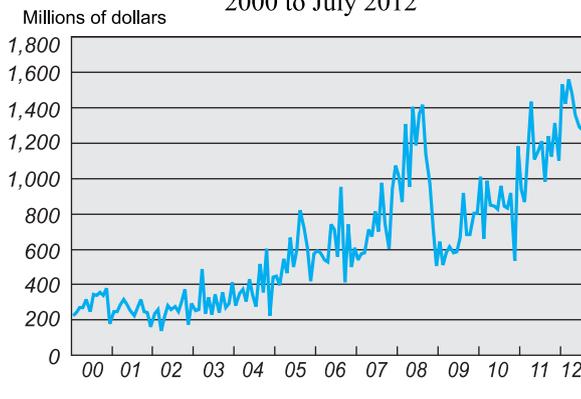
Imports by end use: consumer goods, investment goods (excluding ships and aircraft) and raw materials (excluding diamonds and energy materials), 1995 to July 2012



may be an indicator of expected slowdown. The decline in the import of investment goods was joined during the reviewed period by a five percent decrease in the import of consumer goods. The import of raw materials increased during this period at a moderate rate of 1.5 percent, following a similar decline in the months preceding the reviewed period. A long term view shows relative stagnation in total imports and in the import of raw materials during the past year, in light of the stagnation in exports and in manufacturing production. Import volumes also remained at the level from the beginning of 2011.

Figure 1.12

Energy material imports  
2000 to July 2012

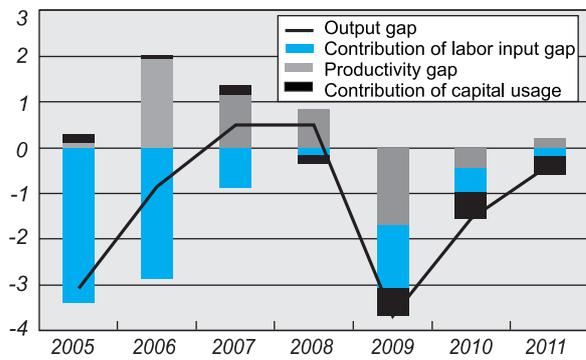


Despite the recent slowdown, there are a number of indicators showing that there is a high level of activity in the economy, which could help the Israeli economy should crisis erupt in Europe. The output gap estimated through various methods

has been at very low levels for a long time. The output gap measured by the production function enables us to see the contributions of its components (Figures 1.13 and 1.13a). According to this method, while the output gap during the recent period widened slightly in light of the slowdown, it is still at a low level. The expansion of the output gap this year is mainly the result of the productivity gap. In contrast, the capital utilization gap and the labor input gap are apparently continuing to contract. The labor input gap is in a positive value environment, which may show that the labor market is heating up. The capital utilization gap has been contracting since the middle of 2010, even though the weight of investment in GDP reached very high levels during this period.

Figure 1.13

Output gap by components, 2005 to 2011



In parallel with the direct estimate of the product gap, there are several indicators showing a high level of activity in the economy. The unemployment rate has been 7 percent since the second quarter of 2011—a low level in historical terms. This low level of unemployment exists despite the fact that the participation rate in the labor market is at record high levels of 63.6 percent. In parallel, real wages are in an upward trend of 2 percent since the end of 2010 (though they are still 2 percent away from the record levels prior to the crisis), and the rate of job vacancies is at a high level. In addition to labor market indicators, we see that investment in industries of the economy grew during the past year and a half at an accelerated rate, which may be the result of supply limitations in the labor market. The rate of investments decreased recently, but the share of investments in GDP is still higher than in the past (20 percent of GDP). In addition, capital inventory per employee in the economy reached a historically high rate (Figure 1.14 and Figure 1.15). These all indicate the possibility that the Israeli economy is at a high level of activity.

Figure 1.13a

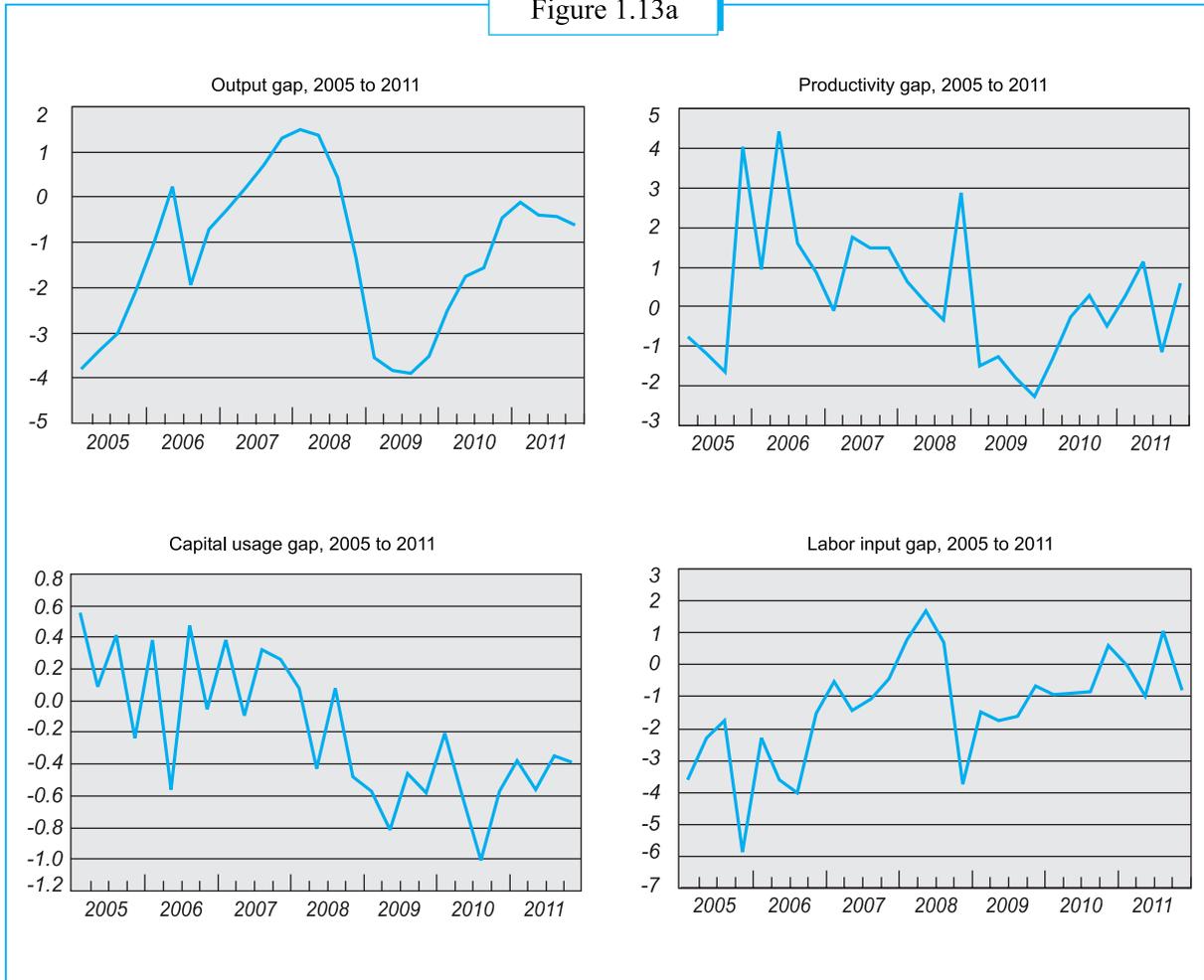


Figure 1.14

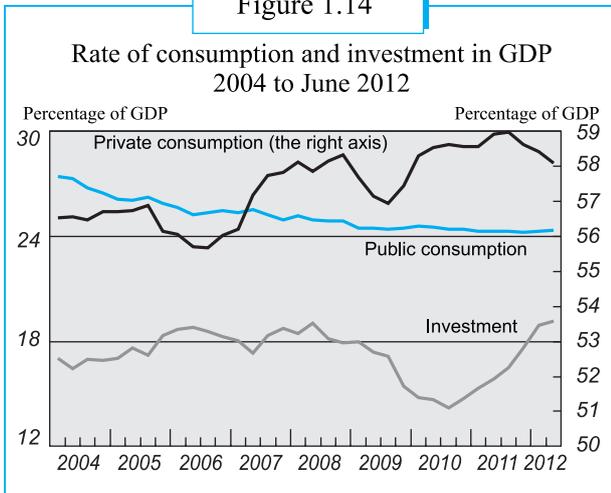
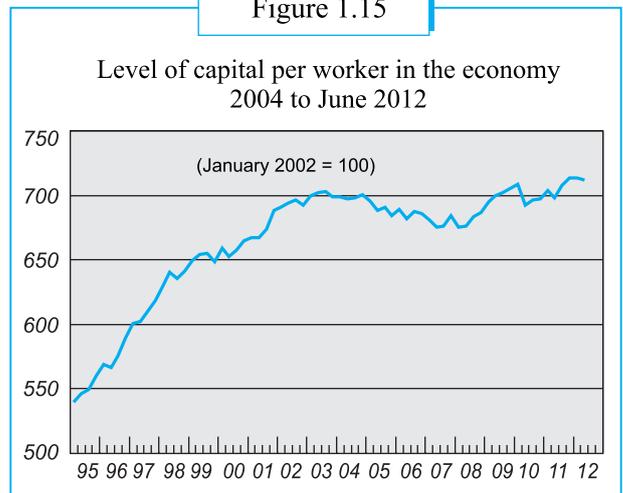


Figure 1.15



## The Labor Market

Labour Force Survey data for the second quarter of 2012 indicate a continued high level of activity. The unemployment rate remained around 7 percent during the second quarter—the same level it has been for the past year and a half. The participation rate increased greatly during this quarter—by 0.8 percentage points to a level of 63.6 percent—alongside a 0.6 percentage point increase in the employment rate to 59.1 percent. It is important to note that the expansion of employment is apparent in all occupations. In addition, we can identify a significant expansion of employment in public services. The business sector saw an expansion of employment of about one percent.

The rate of participation in the workforce among those aged 15 and older increased from April to July and reached 63.9 percent. The participation rate among those aged 25–64 remained relatively stable, at 78.7 percent. The number of employed persons rose from April to July by one and a half percent to reach 3.4 million employed persons. The rate of employment among those 15 and older was 59.8 percent in July. The employment rate among those 25–64 was higher, at 74.3 percent. From April to July, the number of those unemployed fell by 2.3 percent. Among those aged 25–64, the number of unemployed declined by 5.3 percent, and reached 160,400. The unemployment rate fell from April to July by 0.3 percentage points, with most of the reduction coming from a reduction in the unemployment rate among women. The number of claims for unemployment benefits rose by 4 percent during the reviewed period.

## Inflation

The Consumer Price Index rose by 0.85 percent from May to August. The dominant components of the index during this period were housing prices, which contributed 0.54 percentage points, education, culture and leisure, which contributed 0.19 percentage points, and transport and communications, which contributed 0.1 percentage points to the increase. Clothing and footwear prices contributed a reduction of 0.33 percentage points to partially offset these increases.

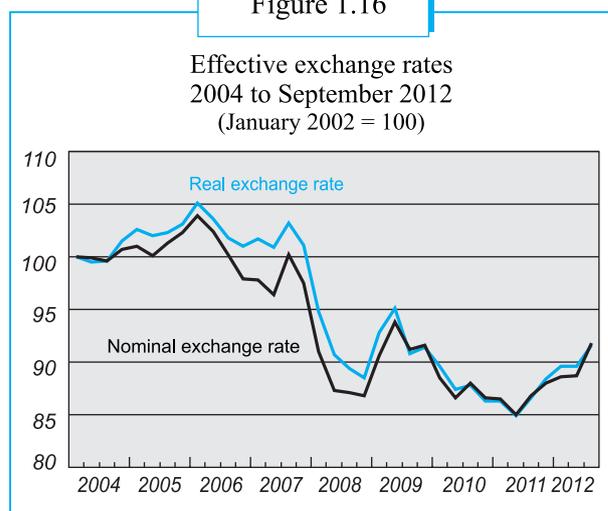
There has been a noticeable downward trend in the annual inflation rate during the past year, with inflation during the reviewed period behaving in accordance with this general trend. Inflation over the previous 12 months at the end of the reviewed period (July) was 1.9 percent, near the midpoint of the inflation target range. The increase in the Consumer Price Index during the previous 12 months expresses the increase in the prices of housing and housing maintenance (which contributed 0.9 and 0.58 percent to the index, accordingly).

In July, there was a dramatic increase in the price of oil as a result of sanctions placed on Iran. In parallel, the drought in the United States led to a significant increase in global food prices. These price increases will apparently be expressed in price indices for later periods.

## The Real Exchange Rate

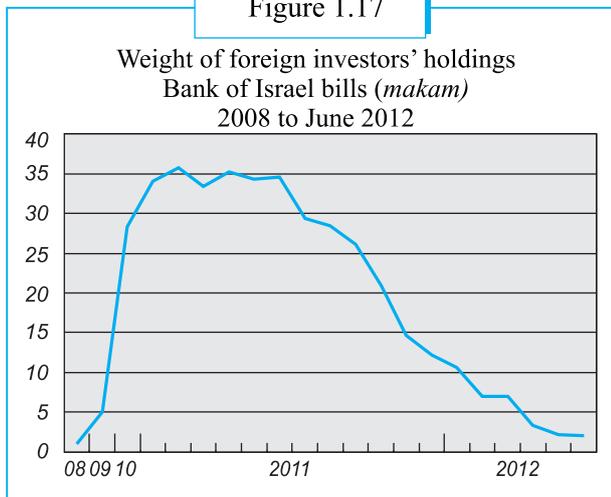
The real exchange rate has indicated a prolonged depreciation in the shekel since 2011 in light of the departure of nonresident investors from the local market and in light of the growth in the trade deficit (Figure 1.16). During the reviewed period, there was a real devaluation of 3 percent. The devaluation during the reviewed period is part of the devaluation that began in early 2011 and took place against

Figure 1.16



the background of limitations placed on the foreign currency market in Israel, which led to the exit of foreign investors from *makam* issued by the Bank of Israel (Figure 1.17). The weight of foreign residents among those holding *makam* at the beginning of 2011 was 35 percent. With the imposition of the limitations, their proportion fell to 2.5 percent during the reviewed period. The exit of foreign residents from the *makam* market activated forces that promoted a real depreciation, as seen in the real effective exchange rate, but these have now dissipated as the rate of foreign investors has reached its nadir. Additionally, the interruption in the use of natural gas (Egyptian and Israeli) led to an increase in the import of expensive alternative energy materials, and was expressed in an increase in the trade deficit and in the demand for foreign currency, which led in turn to further devaluation pressure as seen in the real exchange rate.

Figure 1.17



The shekel depreciation seen in the real exchange rate took place despite the high level of activity and the moderate increase in real salaries. The fact that the economy is maintaining a low unemployment rate is causing real appreciation pressure since the continued growth in demand in such an environment can be answered only by a rise in prices and in costs. However, real salaries have been in a moderate upward trend since the beginning of 2010. Now, when the number of foreign investors has reached its nadir and the depreciation pressure from them has dissipated, real appreciation pressure may become more dominant (obviously, without taking into account geopolitical developments that may change the risk premium of the Israeli economy).

**Table 1.1. National Accounts, 2011-2012**  
(percentage change in annual terms, at constant prices, seasonally adjusted)

|  | 2011 | Change from previous quarter |      |      |      |       | II/2012                          |                                     |
|--|------|------------------------------|------|------|------|-------|----------------------------------|-------------------------------------|
|  |      | 2011                         |      |      | 2012 |       | Year-on-year change <sup>a</sup> | Last month for which data available |
|  |      | II                           | III  | IV   | I    | II    |                                  |                                     |
| GDP  | 4.6  | 3.7                          | 3.1  | 3.2  | 3.1  | 3.4   | 3.5                              | June                                |
| Business-sector product                                | 5.1  | 2.7                          | 3.5  | 3.1  | 2.6  | 3.9   | 3.3                              | June                                |
| Private consumption expenditure                        | 3.8  | -1.2                         | 3.3  | -0.1 | 7.1  | 3.9   | 2.9                              | June                                |
| Gross domestic investment                              | 23.5 | 19.0                         | 26.3 | 9.4  | 72.8 | -52.2 | -4.0                             | June                                |
| Fixed investment                                       | 16.0 | 11.8                         | 16.2 | 12.4 | 2.2  | -0.3  | 6.9                              | June                                |
| Goods and services exports excl. diamonds              | 4.1  | -1.4                         | -1.9 | -3.4 | 12.0 | 30.6  | 11.0                             | June                                |
| Goods exports <sup>c</sup>                             | 5.6  | 5.1                          | -8.4 | -6.1 | -1.3 | 32.0  | 3.8                              | June                                |
| Services exports <sup>c</sup>                          | 5.2  | 2.7                          | -8.7 | 3.5  | 20.9 | 20.1  | 9.8                              | June                                |
| Goods and services imports excl. diamonds <sup>d</sup> | 9.4  | 5.5                          | 6.3  | 0.3  | 43.9 | -10.2 | 6.6                              | June                                |
| Goods imports <sup>e</sup>                             | 12.2 | 6.2                          | -6.9 | -0.2 | 34.3 | -2.7  | 3.1                              | June                                |
| Services imports <sup>e</sup>                          | 7.9  | 31.6                         | 0.4  | -3.8 | 66.8 | -44.1 | -2.7                             | June                                |
| Public sector consumption                              | 2.9  | 4.5                          | 3.0  | 8.5  | 3.1  | 2.1   | 4.3                              | June                                |
| Public consumption excluding defense imports           | 2.7  | 4.3                          | 3.1  | 6.0  | 2.2  | 4.3   | 4.5                              | June                                |
| Domestic use of resources                              | 6.6  | 4.6                          | 6.5  | 3.1  | 15.4 | -9.7  | 2.0                              | June                                |

<sup>a</sup> Unadjusted data.

<sup>b</sup> Compared with previous year.

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

<sup>d</sup> Excluding defense imports, ships and aircraft.

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

SOURCE: Based on Central Bureau of Statistics data.

Table 1.2. Indicators of Business Activity, 2012  
(percentage change, in annual terms, seasonally adjusted)

|   | Change from previous month |      |       |       |       |      | May-August 2012             |                                  |                                      |
|---|----------------------------|------|-------|-------|-------|------|-----------------------------|----------------------------------|--------------------------------------|
|   | 2012                       |      |       |       |       |      | Change from previous period | Year-on-year change <sup>a</sup> | Last month for which data available* |
|   | Mar                        | Apr  | May   | Jun   | Jul   | Aug  |                             |                                  |                                      |
| Composite state-of-the-economy index                              | 0.2                        | 0.2  | 0.2   | 0.2   | 0.2   | 0.1  | 0.7                         | 2.3                              | August                               |
| Large-scale retail trade  | -4.8                       | 7.6  | -0.5  | -1.4  | 2.8   | 0.4  | 2.8                         | 6.1                              | August                               |
| Industrial production (excl. diamonds)                            | 0.8                        | 3.3  | 0.0   | -1.6  | 2.7   |      | 2.3                         | 6.3                              | July                                 |
| Index of trade revenue  | -2.3                       | 3.6  | 0.4   | -3.5  | 3.5   |      | 0.7                         | 2.2                              | July                                 |
| Index of trade and services revenue                               | -1.6                       | 3.6  | 1.0   | -3.0  | 3.7   |      | 2.0                         | 4.1                              | July                                 |
| Index of services exports   | -1.7                       | 5.9  | -2.3  | 4.7   | -3.6  | 1.8  | 2.6                         | 5.7                              | August                               |
| Tourist arrivals  | 0.0                        | 3.8  | -0.5  | 2.4   | -1.0  | 1.3  | 4.1                         | 7.6                              | August                               |
| Residential construction  |                            |      |       |       |       |      |                             |                                  |                                      |
| Starts  | -2.1                       | 17.2 | -21.5 | 7.6   | -22.1 |      | -16.0                       | -32.2                            | July                                 |
| Completions   | -7.6                       | 15.2 | -5.9  | 7.6   | -6.4  |      | 3.3                         | 8.3                              | July                                 |
| ILA land permits (units) <sup>a,b</sup>                           | 3,790                      | 974  | 723   | 1,896 | 690   |      |                             |                                  | July                                 |
| Climate indices based on Business Tendency Survey <sup>c</sup>    |                            |      |       |       |       |      |                             |                                  |                                      |
| Assessment of present activity: total business sector             | 0.22                       | 0.19 | 0.19  | 0.20  | 0.17  | 0.16 |                             |                                  | August                               |
| Assessment of present activity: manufacturing industry            | 0.21                       | 0.21 | 0.19  | 0.21  | 0.17  | 0.13 |                             |                                  | August                               |
| Assessment of present activity: services industry                 | 0.23                       | 0.17 | 0.19  | 0.20  | 0.15  | 0.15 |                             |                                  | August                               |
| Assessment of future activity: total business sector <sup>d</sup> | 0.17                       | 0.23 | 0.25  | 0.24  | 0.23  | 0.20 |                             |                                  | August                               |
| Business Climate Index (total business sector)                    | 0.21                       | 0.23 | 0.22  | 0.22  | 0.21  | 0.17 |                             |                                  | August                               |

\* For monthly indicators, when the last month for which data is available is August, the previous comparison period is January–April; when the last month with data available is July, the comparison period is January–March. When the last month with data available is June, the comparison period is January–February. For indicators produced quarterly, the comparison is to the last complete quarter in the previous period reviewed.

<sup>a</sup> Unadjusted data.

<sup>b</sup> Land transactions authorized by the Israel Lands Administration in the relevant period.

<sup>c</sup> Figures are in terms of monthly growth of business product and refer to the month in which the survey was conducted.

<sup>d</sup> Expectations are attributed to the middle of the three month period following the survey.

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

Table 1.3. Indicators of Labor Market Developments, 2011-2012  
(percentage change, seasonally adjusted)

|  | Percent change from previous quarter |                              |      |      |      |      |      | May-August 2012                      |   |  |
|--|--------------------------------------|------------------------------|------|------|------|------|------|--------------------------------------|---|--|
|  | II/2012<br>(‘000)                    | 2011                         |      |      | 2012 |      |      | Change<br>from<br>previous<br>period | Year-<br>on-year<br>change <sup>a</sup> | Last<br>month for<br>which data<br>available * |
|  |                                      | II                           | III  | IV   | I    | II   | III  |                                      |   |  |
| Civilian labor force   | 3,596.2                              | 0.4                          | 0.4  | 0.4  | 0.6  | 1.6  | 1.6  | 2.5                                  | June                                    |  |
| Israeli employees  | 3,343.5                              | 0.9                          | 0.4  | 0.5  | 0.5  | 1.5  | 1.5  | 2.5                                  | June                                    |  |
| <i>of which</i> : in public services   | 1,168.8                              | -0.7                         | -0.8 | 0.7  | 1.0  | 3.2  | 3.2  | 4.4                                  | June                                    |  |
| in business sector   | 2,167.5                              | 2.3                          | 0.6  | 0.5  | 1.1  | -0.7 | -0.7 | 1.5                                  | June                                    |  |
| Foreign workers and Palestinians<br>(unadjusted)                                     |                                      | 2.3                          | 1.7  | 0.5  |      |      |      |                                      | December                                |  |
| Average hours worked weekly per<br>Israeli employee                                  | 36.7                                 | -0.5                         | 0.0  | -1.1 | 1.2  | 1.0  | 1.0  | 4.2                                  | June                                    |  |
| Weekly labor input in business<br>sector (incl. foreign workers and<br>Palestinians) |                                      | 0.6                          | 1.5  | 1.1  |      |      |      |                                      | December                                |  |
| <i>of which</i> : Israelis   |                                      | 0.4                          | 1.5  | 1.1  |      |      |      |                                      | December                                |  |
| Weekly labor input in public<br>services (Israelis)                                  |                                      | 1.4                          | -3.5 | -0.7 |      |      |      |                                      | December                                |  |
| Unemployed   | 252.7                                | -6.4                         | 0.2  | -2.3 | 0.9  | 4.0  | 4.0  | 2.7                                  | June                                    |  |
| Job seekers  | 185.5                                | 0.3                          | -1.0 | -0.3 | 0.5  | 1.6  | 0.5  | 0.7                                  | July                                    |  |
| Claims for unemployment benefit  | 74.1                                 | -1.3                         | 3.3  | -0.9 | 0.8  | 1.6  | 3.8  | 3.7                                  | 5.6                                     | August   |
| Balance of Employment <sup>b</sup>   |                                      | 1.3                          | 1.5  | 0.7  | 0.4  | 1.0  |      |                                      | June                                    |  |
| Job vacancies <sup>a</sup>   | 67.5                                 | 0.2                          | -0.7 | 4.8  | 2.3  | -2.9 |      | -2.4                                 | August                                  |  |
|  | (NIS)                                |                              |      |      |      |      |      |                                      |   |  |
| Real wage per employee post <sup>c</sup>   |                                      | 0.3                          | 0.7  | 0.4  | -0.1 | 0.9  | 0.4  | 1.0                                  | 2.3                                     | July   |
| In public services   |                                      | -0.1                         | 0.5  | 1.3  | -0.3 | 1.1  | 0.6  | 1.1                                  | 2.8                                     | July   |
| In business sector   |                                      | -0.3                         | 0.4  | 0.8  | -1.4 | 1.7  | 0.6  | 1.9                                  | 2.1                                     | July   |
| Nominal wage per employee post <sup>c</sup>  | 8,826.0                              | 0.8                          | 0.8  | 0.9  | 0.7  | 1.2  | 0.2  | 1.0                                  | 3.7                                     | July   |
| In public services   | 8,474.0                              | 0.6                          | 0.5  | 1.7  | 0.4  | 1.5  | 0.5  | 1.1                                  | 4.2                                     | July   |
| In business sector   | 8,960.0                              | 0.7                          | 0.6  | 1.1  | -0.9 | 2.2  | 0.7  | 2.2                                  | 3.4                                     | July   |
| Unit labor cost  |                                      | 0.0                          | -1.9 | -0.8 |      |      |      |                                      |   | December                                       |
|  |                                      | Percent, seasonally adjusted |      |      |      |      |      |                                      |   |  |
| Participation rate   |                                      | 62.7                         | 62.6 | 62.6 | 62.8 | 63.6 |      |                                      |   | June   |
| Employment rate  |                                      | 58.3                         | 58.3 | 58.3 | 58.5 | 59.1 |      |                                      |   | June   |
| Unemployment rate  |                                      | 7.0                          | 7.0  | 6.8  | 6.9  | 7.0  |      |                                      |   | June   |
| Depth of unemployment <sup>d</sup>   |                                      | 19.4                         | 20.8 | 21.8 | 24.5 | 26.0 |      |                                      |   | June   |

<sup>a</sup> For monthly indicators, when the last month for which data is available is August, the previous comparison period is January–April; when the last month with data available is July, the comparison period is January–March. When the last month with data available is June, the comparison period is January–February. For indicators produced quarterly, the comparison is to the last complete quarter in the previous period reviewed.

<sup>a</sup> Unadjusted data.

<sup>b</sup> Posts filled minus terminations of employment, as a percentage of the total number of employees in businesses in the Employers Survey Sample. The calculation is made by the Bank of Israel.

<sup>c</sup> Including foreign workers and Palestinians. Seasonally adjusted data.

<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 (CBS) National Accounts estimates; job seekers, which are derived from the Israeli Employment Service; claims for unemployment benefit, which are derived from the National Insurance Institute; job vacancies, which are derived from the CBS Survey of Job Vacancies, and the Balance of Employment, which is derived from the Ministry of Industry, Trade and Labor's Employers Survey.

Table 1.4. Government Budget Performance, 2011-2012

|  | 2011 <sup>a</sup> | Change from previous quarter |      |       |                                    |      |      | May-August 2012             |                     |                                      |
|--|-------------------|------------------------------|------|-------|------------------------------------|------|------|-----------------------------|---------------------|--------------------------------------|
|  |                   | 2011                         |      |       | 2012                               |      |      | Change from previous period | Year-on-year change | Last month for which data available* |
|  |                   | II                           | III  | IV    | I                                  | II   | III  |                             |                     |                                      |
|  |                   | Mar                          | Apr  | May   | Jun                                | Jul  | Aug  |                             |                     |                                      |
| Domestic deficit, as percent of GDP                                      | -2.1              | -1.9                         | -1.6 | -6.8  | 0.7                                | -3.2 |      |                             | June                |                                      |
| Total deficit excluding credit, as percent of GDP                        | -3.3              | -2.9                         | -2.2 | -8.5  | -0.5                               | -4.0 |      |                             | June                |                                      |
| Deviation from domestic budget path, excl. credit extended: <sup>b</sup> |                   |                              |      |       |                                    |      |      |                             |                     |                                      |
|  |                   |                              |      |       | (NIS billion)                      |      |      |                             |                     |                                      |
| Revenue  | -5.6              | -1.5                         | -4.6 | -0.1  | -2.9                               | -0.5 | -1.1 | -1.7                        | 0.4                 | August                               |
| Expenditure  | -3.1              | -2.1                         | -2.9 | 2.0   | -2.0                               | 0.7  | 2.2  | -0.5                        | 2.9                 | August                               |
| Deficit  | -2.5              | 0.6                          | -1.7 | -2.0  | -0.9                               | -1.2 | -3.3 | 0.7                         | -1.5                | August                               |
| Total deficit excluding credit   | -28.7             | -6.4                         | -4.9 | -18.5 | -1.2                               | -9.2 | -8.5 | -8.8                        | -4.6                | August                               |
|  |                   |                              |      |       | Real change year-on-year (percent) |      |      |                             |                     |                                      |
|  |                   |                              |      |       | 2012                               |      |      |                             |                     |                                      |
|  |                   |                              |      |       |                                    |      |      |                             |                     |                                      |
| Government domestic revenues excluding credit                            |                   | -14.3                        | 9.1  | -2.1  | 5.8                                | 4.5  | 1.3  |                             | 2.2                 | August                               |
| Government tax revenue   |                   | -5.3                         | -2.2 | -3.2  | 1.6                                | 2.0  | 2.2  |                             | 0.6                 | August                               |
| of which: income tax, net  |                   | -0.5                         | -0.6 | -8.6  | 8.3                                | -1.5 | -1.6 |                             | -1.4                | August                               |
| VAT, gross   |                   | -3.3                         | 2.6  | -1.6  | 10.1                               | 3.4  | 10.2 |                             | 4.9                 | August                               |
| Government expenditure excluding credit                                  |                   | -1.5                         | 15.2 | -0.2  | 8.4                                | 10.7 | 6.4  |                             | 6.3                 | August                               |
| National Insurance allowances  |                   | 5.6                          | 6.4  | 4.2   | 4.9                                | 5.3  | 6.7  |                             | 5.3                 | August                               |
| of which: Unemployment benefit   |                   | 10.6                         | 5.1  | 12.9  | 12.6                               | 13.0 | 23.2 |                             | 15.5                | August                               |
| Income support <sup>c</sup>  |                   | -1.3                         | -1.7 | -1.8  | -1.0                               | 1.5  | -0.3 |                             | -0.4                | August                               |
| Payments to the National Insurance Institute by the public               |                   | 1.3                          | 0.7  | 0.6   | 2.8                                | 3.2  | 1.4  |                             | 2.0                 | August                               |

\* For monthly indicators, when the last month for which data is available is August, the previous comparison period is January–April; when the last month with data available is July, the comparison period is January–March. When the last month with data available is June, the comparison period is January–February. For indicators produced quarterly, the comparison is to the last complete quarter in the previous period reviewed.

<sup>a</sup> Compared with previous year.

<sup>b</sup> The path is determined in accordance with the deficit ceiling. The figures compared with the previous period and with the corresponding period are differences.

<sup>c</sup> Not including income support in old-age and survivors' pensions.

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

Table 1.5. Foreign Trade, Balance of Payments, and the Reserves, 2011-2012  
(Seasonally adjusted)

|   | 2011 <sup>a,b</sup> | Change from previous quarter           |        |        |            |        |        | May-August 2012             |                                  |                                      |
|---|---------------------|--|--------|--------|------------|--------|--------|-----------------------------|----------------------------------|--------------------------------------|
|   |                     | 2011                                   |        |        | 2012       |        |        | Change from previous period | Year-on-year change <sup>b</sup> | Last month for which data available* |
|   |                     | II                                     | III    | IV     | I          | II     | III    |                             |                                  |                                      |
|   |                     | (rate of change, percent) <sup>c</sup> |        |        |            |        |        |                             |                                  |                                      |
| Trade in goods <sup>d</sup>   |                     |  |        |        |            |        |        |                             |                                  |                                      |
| Goods imports   | 22.2                | 5.9                                    | -0.2   | -4.4   | 2.4        | -3.6   | -2.4   | -4.7                        | -5.0                             | August                               |
| <i>of which</i> : Consumer goods  | 15.5                | 5.4                                    | -1.6   | -6.4   | 0.2        | -1.3   | -2.2   | -2.6                        | -7.7                             | August                               |
| Capital goods   | 44.4                | 9.1                                    | 2.3    | -2.9   | 2.5        | -10.5  | -10.0  | -16.3                       | -14.4                            | August                               |
| Intermediates   | 16.4                | 4.7                                    | -0.7   | -4.3   | 3.1        | -1.1   | 0.9    | 0.1                         | 0.5                              | August                               |
| Goods exports   | 12.3                | 1.2                                    | -0.4   | 0.3    | -3.5       | -2.2   | 3.5    | -2.0                        | -5.4                             | August                               |
| <i>of which</i> : Manufacturing   | 12.5                | 1.4                                    | -0.3   | 0.2    | -3.7       | -2.1   | 3.1    | -2.2                        | -5.5                             | August                               |
| <i>of which</i> : High-tech   | 6.9                 | -1.8                                   | -7.1   | 8.6    | -8.9       | 1.5    | 6.3    | 1.8                         | -1.4                             | August                               |
| Balance of payments   |                     |  |        |        |            |        |        |                             |                                  |                                      |
|   |                     |  |        |        | \$ million |        |        |                             |                                  |                                      |
| Goods and services exports  | 90,503              | 22,880                                 | 23,021 | 22,184 | 22,210     | 23,228 |        |                             |                                  | June                                 |
| Goods and services imports  | 92,366              | 23,321                                 | 23,430 | 23,314 | 24,658     | 23,485 |        |                             |                                  | June                                 |
| Balance of trade in goods and services account                                      | -1,863              | -441                                   | -408   | -1,129 | -2,448     | -257   |        |                             |                                  | June                                 |
| Balance of trade in current account   | 1,264               | 202                                    | 745    | -780   | -1,444     | -90    |        |                             |                                  | June                                 |
| Surplus/deficit in financial account (excl. foreign exchange reserves) <sup>b</sup> | 1,827               | 3,862                                  | -2,691 | -672   | -833       | -756   |        |                             |                                  | June                                 |
| <i>of which</i> : Nonresidents' direct investments <sup>b</sup>                     | 11,374              | 1,941                                  | 2,436  | 4,707  | 1,565      | 2,591  |        |                             |                                  | June                                 |
| Nonresidents' portfolio investment <sup>b</sup>                                     | -5,558              | 428                                    | -2,440 | -5,391 | -597       | -2,444 |        |                             |                                  | June                                 |
| Residents' direct and portfolio investment abroad <sup>b</sup>                      | 8,189               | 1,136                                  | 1,826  | 1,859  | 1,511      | 1,579  |        |                             |                                  | June                                 |
| Bank of Israel foreign currency reserves, end-period <sup>b</sup>                   | 74,875              | 77,413                                 | 76,329 | 74,875 | 77,041     | 75,148 | 76,226 | -1.3                        | -3.1                             | August                               |
| Net external debt (percent of GDP) <sup>b,c</sup>                                   | -23.7               | -22.7                                  | -23.8  | -23.6  | -24.3      | -25.4  |        |                             |                                  | June                                 |

\* For monthly indicators, when the last month for which data is available is August, the previous comparison period is January–April; when the last month with data available is July, the comparison period is January–March. When the last month with data available is June, the comparison period is January–February. For indicators produced quarterly, the comparison is to the last complete quarter in the previous period reviewed.

<sup>a</sup> Compared with previous year.

<sup>b</sup> Unadjusted data.

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

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

<sup>e</sup> GDP is calculated at the end-of-period NIS/\$ exchange rate.

SOURCE: Based on Central Bureau of Statistics data.

**Table 1.6. Selected Price Indices, the Effective Exchange Rate, Nondirected Bank Credit, Interest Rates, Yields, and the Share Price Index, 2012**  
(rates of change, percent)

|   | Change from previous month                    |      |      |       |       |      | May-August 2012             |                     |                                      |
|---|---|------|------|-------|-------|------|-----------------------------|---------------------|--------------------------------------|
|   | 2012  |      |      |       |       |      | Change from previous period | Year-on-year change | Last month for which data available* |
|   | Mar   | Apr  | May  | Jun   | Jul   | Aug  |                             |                     |                                      |
| CPI   | 0.4   | 0.9  | 0.0  | -0.3  | 0.1   | 1.0  | 0.9                         | 1.9                 | August                               |
| Consumer price index, seasonally adjusted                     | 0.4   | 0.3  | -0.2 | -0.2  | 0.0   | 0.7  | 0.3                         | 1.9                 | August                               |
| Price index of owner-occupied homes <sup>a</sup>              | 1.0   | 0.4  | 0.0  | 0.8   |       |      | 0.8                         | 1.0                 | June                                 |
| General share-price index <sup>b</sup>                        | 2.4   | 3.3  | -8.2 | -1.9  | 2.6   | -0.8 | -8.3                        | -16.0               | August                               |
| Real effective exchange rate <sup>c</sup>                     | 0.5   | -0.9 | 0.5  | 0.5   | 1.8   | 0.5  | 1.5                         | 6.6                 | August                               |
| Nominal effective exchange rate                               | 0.2   | -0.5 | 0.5  | 0.4   | 2.1   | 1.1  | 1.8                         | 5.6                 | August                               |
| Nondirected bank credit                                       | 0.0   | -0.1 | 0.5  | 0.7   | 0.6   | -1.6 | 0.9                         | 4.9                 | August                               |
| Effective interest rate in daily deposit auction <sup>b</sup> | 2.5   | 2.5  | 2.5  | 2.5   | 2.3   | 2.3  | 2.4                         | 3.2                 | August                               |
| Yield to maturity on 5-year notes <sup>b</sup>                | 1.2   | 1.1  | 1.1  | 0.9   | 0.7   | 0.5  | 0.8                         | 1.5                 | August                               |
| Risk premium <sup>b,d</sup>                                   | 3.6   | 1.3  | 0.0  | -12.8 | -16.0 | -5.1 | -19.9                       | 24.0                | August                               |
|   | Change during previous 12 months <sup>e</sup> |      |      |       |       |      |                             |                     |                                      |
| CPI   | 1.9   | 2.1  | 1.6  | 1.0   | 1.4   | 1.9  |                             | 1.5                 | August                               |

\* For monthly indicators, when the last month for which data is available is August, the previous comparison period is January–April; when the last month with data available is July, the comparison period is January–March. When the last month with data available is June, the comparison period is January–February. For indicators produced quarterly, the comparison is to the last complete quarter in the previous period reviewed.

<sup>a</sup> Not part of the CPI.

<sup>b</sup> Daily average over the month.

<sup>c</sup> The real effective exchange rate is the weighted geometric mean of the exchange rate of the shekel against 28 currencies, representing 38 of Israel's main trading partners (weighted by the extent of Israel's trade with those countries), adjusted for the difference between the rate of inflation in Israel and the rates of inflation in those countries.

<sup>d</sup> As measured by 5-year credit-default-swaps (CDS). Calculated as the difference in basis points.

<sup>e</sup> Year-on-year period change.

SOURCE: Based on Central Bureau of Statistics data.

**Table 1.7. Indicators of Economic Development in Advanced and Developing Economies<sup>a</sup>**  
 (annual change, percent)<sup>b</sup>

|   |                                   | 2010 | 2011 | 2012<br>Projection | 2013<br>Projection |
|---|-----------------------------------|------|------|--------------------|--------------------|
| World GDP                                 |                                   | 5.3  | 3.9  | 3.5                | 4.1                |
|   | Advanced economies                | 3.2  | 1.6  | 1.4                | 2.0                |
|   | Emerging and developing economies | 7.5  | 6.2  | 5.7                | 6.0                |
| World trade                               |                                   | 12.9 | 5.8  | 4.0                | 5.6                |
|   | Advanced economies                |      |      |                    |                    |
|   | Imports                           | 11.5 | 4.3  | 1.8                | 4.1                |
|   | Exports                           | 12.2 | 5.3  | 2.3                | 4.7                |
|   | Emerging and developing economies |      |      |                    |                    |
|   | Imports                           | 15.3 | 8.8  | 8.4                | 8.1                |
|   | Exports                           | 14.7 | 6.7  | 6.6                | 7.2                |
| Commodity prices (\$)                     | Oil <sup>c</sup>                  | 27.9 | 31.6 | 10.3               | -4.1               |
|   | Nonfuel                           | 26.3 | 17.8 | -10.3              | -2.1               |
| Inflation (CPI)                           | Advanced economies                | 1.5  | 2.7  | 1.9                | 1.7                |
| Short-term interest rate (%) <sup>d</sup> | Dollar deposits                   | 0.5  | 0.5  | 0.7                | 0.8                |
|   | Euro deposits                     | 0.8  | 1.4  | 0.8                | 0.8                |
| Unemployment rate                         | Advanced economies                | 8.3  | 7.9  | 7.9                | 7.8                |

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

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

<sup>c</sup> The average price of a barrel of U.K. Brent, Dubai and West Texas Intermediate crude oil in 2011 was \$104.01, excluding freight costs. Estimated price for 2012 is \$114.71 and for 2013, \$110.00.

<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 2012.

## Part 2: Broader Review of Selected Issues

### Preliminary results of the first four years of implementation of the Earned Income Tax Credit Law

- During the first four years of implementation of the law, there has been a marked increase in the number of eligible persons, from 64,000 in the first year (2007) to 106,000 in the fourth year (2010). The increase derived primarily from the geographic expansion of the law's implementation.
- More than half of those eligible have exercised their eligibility: In treatment areas, the take-up rate rose from 45 percent in the first year to 53 percent in the fourth year.
- The ultra-Orthodox had the highest take-up rate: 64 percent of those eligible in treatment areas, and 78 percent in other areas, received the grant.
- The lowest take-up rate was among Arab residents of eastern Jerusalem, but this rate increased constantly over the years—from 26 percent in the first year to 44 percent in the fourth year.
- The average annual grant was around NIS 2,800. It is higher for population groups with a relatively high poverty rate and a low rate of participation in the labor force. The grant constitutes 7 percent of the average annual salary of those receiving it, and is supposed to increase in 2013 due to the implementation of the Trajtenberg Committee recommendations.

In 2007, the Earned Income Tax Credit Law was enacted in Israel as a new support tool intended mainly for workers with children, as well as for older workers.<sup>1</sup> As part of the law, many families are eligible for an income grant. This grant is paid only to people who are working, and its amount is affected by the make-up of the family: parents of three or more children are eligible for an increased grant. In addition to family characteristics, the amount of the grant is based on the average monthly salary during the work year (eligibility year), and it is paid quarterly during the year following the eligibility year (the payment year).<sup>2</sup> The maximum monthly grant currently stands at NIS 320 for those eligible with one or two children and for older workers aged 55 or

<sup>1</sup> For more information on the law, see “Earned Income Tax Credit (Negative Income Tax)—The results of the first year of implementation of the Law”, Bank of Israel, June 2010 [http://www.boi.org.il/en/Research/Pages/neumim\\_neum358e.aspx](http://www.boi.org.il/en/Research/Pages/neumim_neum358e.aspx)

<sup>2</sup> The amount of the grant is also affected by the family's other income, including the salary paid to the eligible person's spouse. Under the law, eligibility for a grant is annual (eligibility year) where the grant is paid in the year following the eligibility year (payment year).

more, and at NIS 470 for those eligible with three or more children. As of 2013, the grant will increase by 50 percent for mothers with children up to age 19 in accordance with the recommendations of the Trajtenberg Committee (the Committee for Economic and Social Change) to improve the economic welfare of the families of workers with children.<sup>3</sup>

The law was first implemented in a number of selected regions (“treatment areas”). In 2009, it was expanded to the remaining regions only for mothers with children up to age 2. As of 2011, the law applies across the country.

The survey covers the first four years of the law's implementation (2007-2010), and presents the main data regarding the eligibility for and the take-up rate of the grant.

### Eligible Population

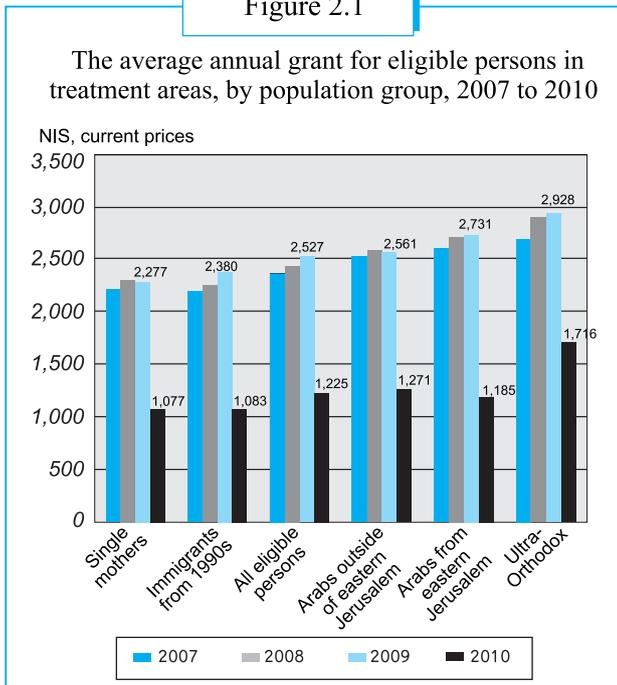
Eligibility for the grant is determined by the Tax Authority based on reports that it has.<sup>4</sup> The data shows that during the reviewed period, the number of those eligible rose from 64,000 individuals to 106,000. This growth derived mainly from the geographic expansion of the application of the law, which began in the 2009 eligibility year for mothers with children up to age 2. The grant amounts generally remained similar over the years, and averaged around NIS 2,500. An exception to this rule was 2010, when the average grant amount fell temporarily due to statutory changes as a result of the cessation of the Lights to Employment (“Orot LeTa'asuka”) welfare-to-work program in May of that year. That program was a legal basis for the Earned Income Tax Credit Law in the treatment areas. Therefore, in 2010, the income grant was calculated for work during January-April (Figure 2.1).<sup>5</sup>

<sup>3</sup> The increased grant for women with children will be paid in 2013 in respect of their work in 2012. The increased grant also applies to a working father in a single-parent family, whose children are under his care and financial support.

<sup>4</sup> Eligibility is determined based on Form 126, which the employer files with the Tax Authority. The form includes information, at the individual level, on total payments and deductions in respect of the tax year.

<sup>5</sup> On the other hand, the eligibility of mothers with children up to age 2, which was arranged in the Assistance to Working Mothers Law (“Caregivers Law”), is not limited to geographic affiliation. For more information on this matter, see: “Three Years since the Introduction of the Earned Income Tax Credit,” Bank of Israel, Recent Economic Developments, number 130, 2011.

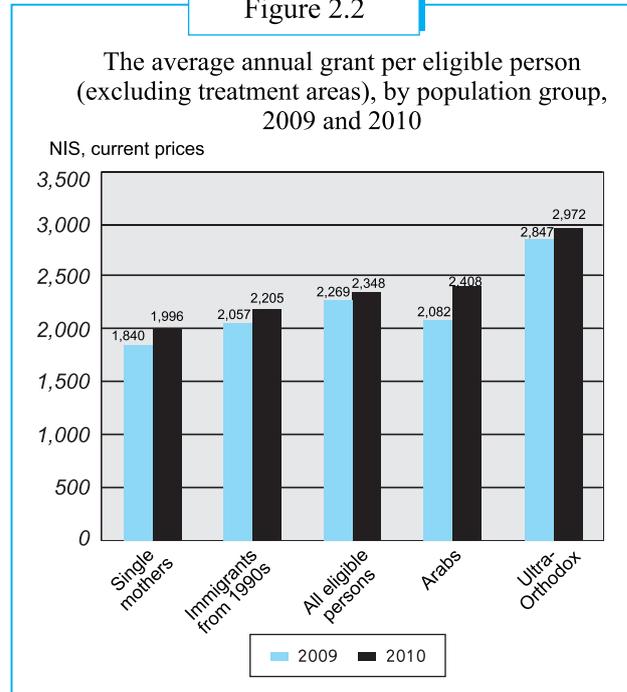
Figure 2.1



Over the years, the differences in the level of the grant have been maintained between different population groups in the treatment areas. Groups with high level of poverty and low level of involvement in the labor market are eligible for a relatively large grant, emphasizing the precise focus of the law on the weaker segments of the population. As such, the ultra-Orthodox and Arab populations are eligible for a larger grant than other eligible persons. Among these population groups, there is a high rate of workers with three or more children, who are eligible for an increased grant. In contrast, single mothers are eligible for the lowest annual grant since, compared to other eligible groups, they have both fewer children, on average, and a lower salary. A similar trend also exists among those eligible from areas where eligibility applied only to mothers with children up to age 2 in 2009 and 2010 (Figure 2.2). In these areas, the gap between the amount of the grant for which ultra-Orthodox women are eligible and the average grant to all those eligible expands up to one-fourth.

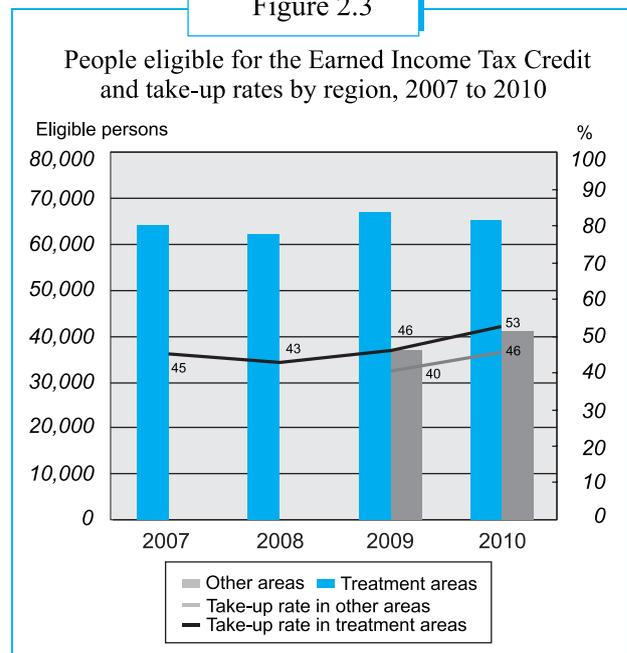
In order to take up eligibility for a grant, the worker must fill out a short form and file it with the Tax Authority. The process is simple and fast, and claims can be made through the post office. In addition, with the aim of raising the take-up rate, each eligible person is sent a notice from the Tax Authority each year, even if he has not filed a request, with information on eligibility including the amount of the grant to which he is eligible.

Figure 2.2



Over the first four years of the law’s implementation, the take-up rate in the treatment areas rose from 45 percent in the first year to 53 percent in the fourth year (Figure 2.3). In the other areas, the rate rose from 40 percent in 2009 to 46 percent in 2010. The overall take-up rate among those eligible was 51 percent in 2010—similar to the standards of

Figure 2.3



comparable programs around the world in the first stages of their implementation.<sup>6</sup>

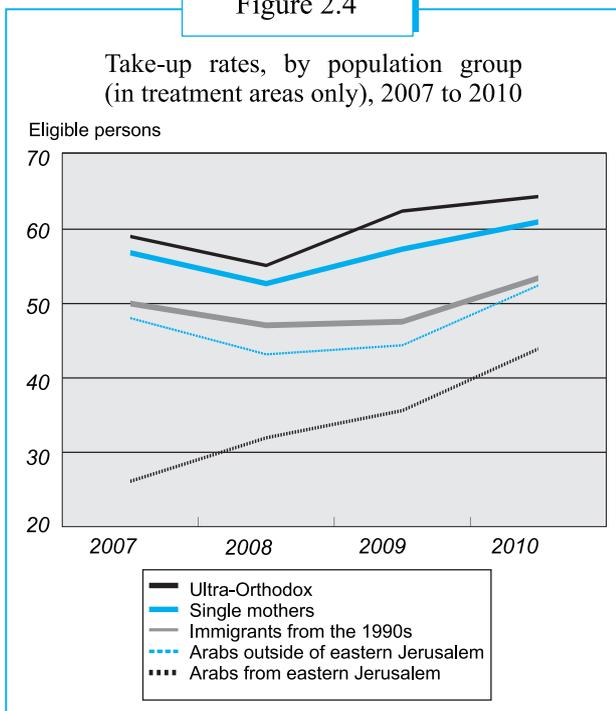
In the first year of the law’s implementation, there was a relatively high take-up rate thanks to widespread publicity activities conducted that year. In the second year, the take-up rate fell slightly, since during that year, there was less publicity about the program. Among the factors with more influence on the probability of taking up eligibility are awareness of the new program’s existence, and the level of the grant.<sup>7</sup> The highest take-up rate was among the ultra-Orthodox, who are eligible for a relatively large grant due to the number of children in their families, and who have a high level of awareness of the new law. In the first year, 59 percent of ultra-Orthodox eligible persons in the treatment areas received the grant. In the last year, this total rose to 64 percent in the treatment areas and 78 percent in the other areas (Figure 2.4).

In contrast, the take-up rate among eligible persons from eastern Jerusalem was very low, both compared to those eligible among the general population, and compared to those among the Arab population living in other areas. Just 26 percent of those eligible received the grant in the first year of the law’s implementation. At the same time, over the years, awareness of the law has increased, and the take-up rate grew to 44 percent in the fourth year.

The probability of eligibility take-up is positively correlated to the amount of the grant. Therefore, the average grant amount actually paid is also higher (by 11 percent) than the average eligibility grant (Figures 2.1 and 2.5). The average annual grant paid is over NIS 2,800 (in the 2009 eligibility year—the last full eligibility year for which there is data), which is 7 percent of the average annual salary of those receiving the grant. The maximum grant for those with three or more children stands at an average of 12 percent of the eligible person’s salary. It is supposed to increase to 17 percent for women with children, as a result of the implementation of the Trajtenberg Committee’s recommendations. The rate is lower than the maximum grant of 40 percent of salary in the United States among those eligible with 2 or more children.

The take-up differences between population groups have affected the relative level of the grant that is paid. The highest average grant was paid to Arabs from eastern Jerusalem (for the 2009 eligibility year), due to the low take-up rate compared to the other population groups, as only those eligible for a very large grant filed a claim.

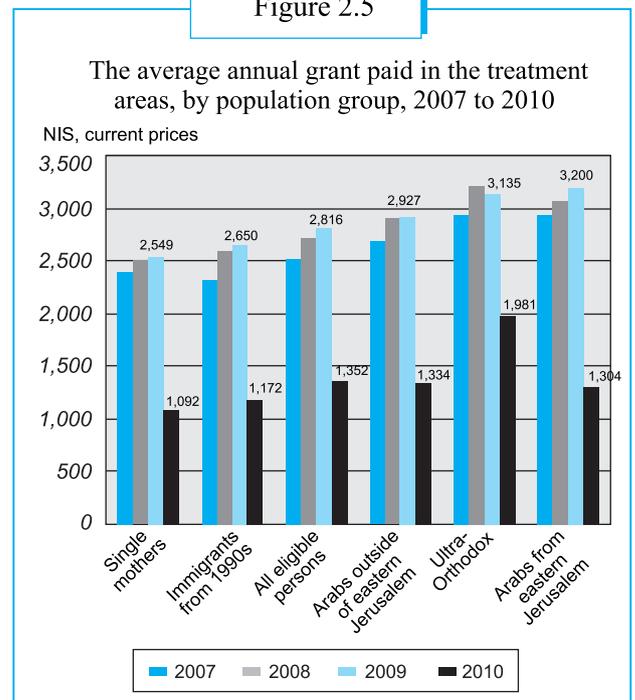
Figure 2.4



<sup>6</sup> For more information on the level of use of “negative income tax” in the United States, see: “Interim review since Israel’s Earned Income Tax Credit (EITC) program was activated in September,” Bank of Israel, Recent Economic Developments, number 123, 2009.

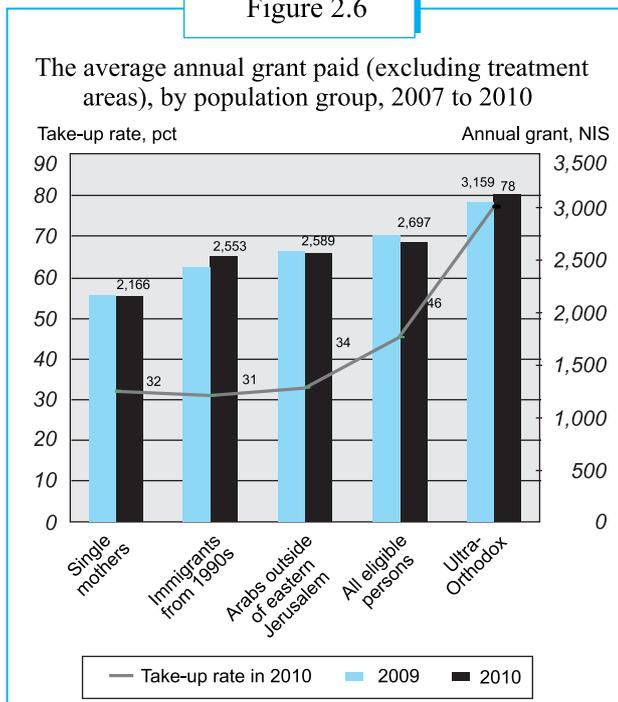
<sup>7</sup> For more information on the factors affecting the eligibility take-up probability, see: “Earned Income Tax Credit (Negative Income Tax)—The results of the first year of implementation of the Law”, Bank of Israel, June 2010 [http://www.boi.org.il/en/Research/Pages/neumim\\_neum358e.aspx](http://www.boi.org.il/en/Research/Pages/neumim_neum358e.aspx)

Figure 2.5



A different picture emerges from an analysis of the take-up rate in areas where the law was only implemented in the last two years of the surveyed period, without significant publicity, resulting in low rates of exercise. The average take-up rate in 2010 was 46 percent, but most of the population groups showed a low take-up rate, and just one third of all eligible women in these areas (other than ultra-Orthodox women) received the grant (Figure 2.6). Only among working women from the ultra-Orthodox sector was there a high take-up rate (78 percent). Arab women were eligible for a larger-than-average grant (see Figure 2.2), but in practice, they enjoyed a lower grant due to their relatively low rate of exercise.

Figure 2.6



An analysis of the take-up rate in the new areas where the law has just recently been implemented shows the need to conduct widespread publicity activities in the early stages of the Law's implementation on a national scale, with the aim of increasing the law's efficiency, which depends on, among other things, how much the target population takes advantage of it.

### Municipal financing of primary school education and its effect on affirmative action<sup>8</sup>

- During 2001-2009 local municipalities financed an average of 1.5 weekly teacher work hours per class in the regular official primary school track. This number reflects just 2.5 percent of the total hours per week, and some 25 percent of the hours not financed by the Ministry of Education.
- Municipalities in areas of higher socio-economic status finances in Hebrew education many more hours than municipalities in Arab education or lower socio-economic areas, most of which are Arab.
- If only the hours that the Ministry of Education finances are taken into account, then the scope of affirmative action in primary education in the Hebrew-State education system, benefiting students from weaker socio-economic backgrounds, stands at 32 percent. This rate falls to 27 percent when taking into account hours that are financed by the municipalities, because fiscally strong municipalities allocate many more resources to the primary schools than other municipalities, and notwithstanding the fact that the wealthier municipalities conduct a significant affirmative action policy within their jurisdictions to benefit schools whose students come from weaker socio-economic backgrounds—an additional 2-3 weekly hours per class.

The Central government would like to reduce the gaps between populations and between geographic regions. As such, it generally conducts a policy of affirmative action (a progressive policy) in budgeting education, benefiting students from weaker socio-economic backgrounds and from the geographic periphery of the country. On the other hand, local government widens the gaps in education, (a regressive policy), since those municipalities with greater fiscal strength can allocate many more resources to the education system in their jurisdictions than the weaker municipalities. The residents of those stronger municipalities, which are generally characterized by a stronger socio-economic background, benefit from these additional resources.

This phenomenon is part of the growing involvement of the private sector in financing and providing services, including educational services. In particular, economic, social and political processes have led to growing competition between the municipalities over the basket of services provided to residents, mainly in order to attract stronger populations that are marked by their readiness and ability to finance more quality services through higher municipal taxes.

<sup>8</sup> Base on ongoing research by N. Blass, S. Tsur and N. Zussman.

Very little has been written about the education expenditure of municipalities in Israel or its development over time. Earlier articles<sup>9</sup> give the impression—which has gained traction in public opinion—that the scope of resources that the stronger municipalities have allocated to the education system has turned the situation on its head and cancelled out the Ministry of Education’s affirmative action policy. However, as we will see below, this is not the case, at least in relation to the work hours of primary school teachers.

Following is an overview of the scope of independent sources that the municipalities allocate for teachers’ work hours.<sup>10</sup> The outline focuses on regular (not special education) official (not ultra-Orthodox) primary schools, mainly in the Hebrew-State educational system, in the 2000/2001 (5761) and 2008/2009 (5769) school years. It relies on the “standard audit”, which reviews a sample of one-fifth of the schools and is conducted for the Ministry of Education.<sup>11</sup>

During 2001-2009 the municipalities financed an average of 1.5 weekly work hours per class in the regular official primary school tracks. This number reflects just 2.5 percent of the total hours, and some 25 percent of the hours not financed by the Ministry of Education. We note that during 2000-2008 the municipalities financed an average of close to 6 percent of the current national expenditure for primary school (without depreciation)<sup>12</sup>, and in 2008, the expense total NIS 1 billion in current prices.<sup>13</sup>

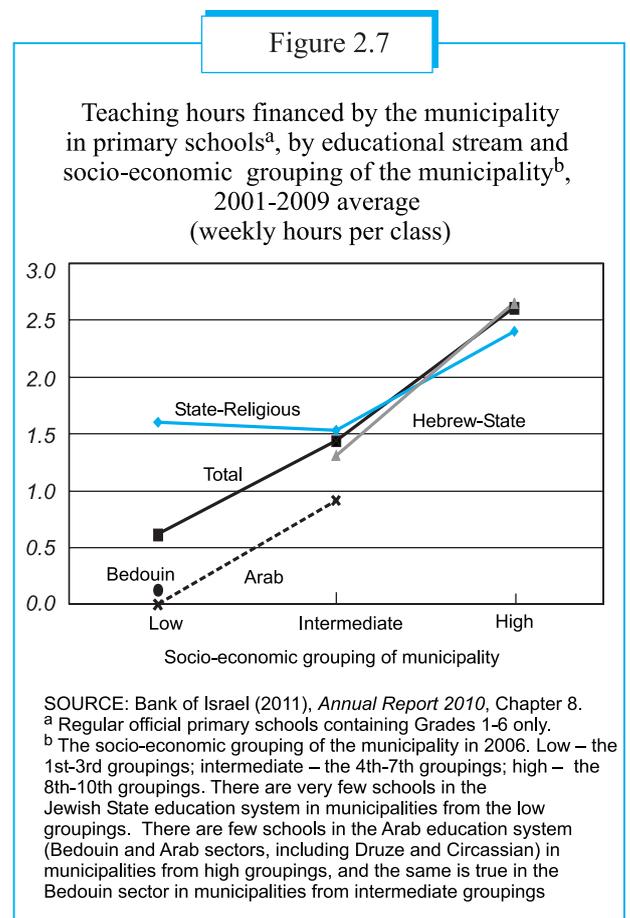
<sup>9</sup> See, for instance, A. Ben-Bassat and M. Dahan (eds.) (2009), *The Political Economy of the Municipalities*, Israel Democracy Institute, Jerusalem. The analysis provided there, as well as in other places, is based on the financial reports of the municipalities. But the low level of detail in those reports makes examination very difficult, and harms its credibility.

<sup>10</sup> Not including support staff (secretaries, maintenance workers, and so forth). The analysis also does not deal with expenses for activities outside of the study program, purchasing, construction and so forth. But this does not pose a significant difficulty, since teaching hours are the core of education, and salary expenses account for a significant majority of total education expenses.

<sup>11</sup> For explanations of the “standard audit”, see N. Blass, S. Tsur, and N. Zussman (2010), *The Allocation of Teachers’ Working Hours in Primary Education, 2001–2009*, Bank of Israel, Research Department, Discussion Paper Series 2010.18, Jerusalem.

<sup>12</sup> 2008 is the last year for which data was published on national expenditures for education by financing sector and level of education. Municipality expenditures include, inter alia, the salary of support staff and of educational administration employees, purchasing and so forth, and these do not constitute part of the teachers’ work hours to which the analysis here relates.

<sup>13</sup> The Central Bureau of Statistics (2011), *National Expenditure for Education 1962-2009*, Publication number 1447, Jerusalem; the Central Bureau of Statistics (2012), *National Expenditure for Education 2008-2011*, Press Release 226/2012, Jerusalem.



Municipalities from higher socio-economic status—which contain mainly schools whose students come from strong backgrounds—participated more in the financing of work hours than municipalities from lower status (Figure 2.7 and Table 1). Arab municipalities, most of which are poor, provided almost no financing for hours.<sup>14</sup>

In the Hebrew-State education stream, the municipalities financed 2 teaching hours per class, comprising 3.6 percent of the total hours, the vast majority of which were financed by the Ministry of Education, and some 32 percent of the hours that were not financed by the Ministry of Education. Fiscally strong municipalities financed more hours than fiscally weak municipalities. This is true in absolute terms—estimates show that each additional socio-economic grouping unit (on a scale of 1 to 10) is accompanied by an average increase of 0.7 weekly teaching hours per class—and also in relative terms, as a percentage of the total teaching hours available to the class (10 percent of strong municipalities compared

<sup>14</sup> An analysis of the gaps in the level of sources that do not come from the municipalities, by education stream and socio-economic background of the students, can be found in Blass et al. (2010), and Bank of Israel (2011).

Table 1: Teachers work hours in primary schools<sup>a</sup>, by source of financing, socio-economic background of the students<sup>b</sup> and educational track, 2001-2009 average (weekly hours per class)

| Source of Financing   | Socio-Economic Background |             |             |                  |             |             |                 |             |             |                |             |                     |
|-----------------------|---------------------------|-------------|-------------|------------------|-------------|-------------|-----------------|-------------|-------------|----------------|-------------|---------------------|
|                       | Total                     |             |             | Hebrew Education |             |             |                 |             |             | Arab Education |             |                     |
|                       | Weak                      | Medium      | Strong      | Hebrew-State     |             |             | State-Religious |             |             | Total          |             |                     |
|                       |                           |             |             | Weak             | Medium      | Strong      | Weak            | Medium      | Strong      | Weak           | Medium      | Strong <sup>c</sup> |
| <b>Municipalities</b> | 0.7                       | 1.7         | 2.4         | 0.9              | 1.9         | 2.4         | 1.4             | 2.1         | 2.9         | 0.4            | 0.5         |                     |
| NGOs                  | 2.9                       | 3.3         | 2.2         | 4.5              | 3.8         | 2.0         | 4.3             | 4.0         | 2.9         | 1.5            | 1.0         |                     |
| Parents               | 0.0                       | 0.6         | 1.9         | 0.0              | 0.5         | 1.9         | 0.1             | 1.1         | 1.9         | 0.0            | 0.0         |                     |
| Ministry of Education | 54.7                      | 51.4        | 43.5        | 56.2             | 48.7        | 42.5        | 72.2            | 60.1        | 49.9        | 47.2           | 46.8        |                     |
| <b>Total</b>          | <b>58.4</b>               | <b>57.1</b> | <b>50.0</b> | <b>61.6</b>      | <b>54.7</b> | <b>48.8</b> | <b>78.0</b>     | <b>67.4</b> | <b>57.7</b> | <b>49.1</b>    | <b>48.3</b> |                     |

Source: "IDEA – Economic Management and Consulting, Ltd." and Bank of Israel analysis.

<sup>a</sup> Regular official primary schools containing Grades 1-6 only.

<sup>b</sup> Weak background – the 8th-10th nurture deciles; intermediate background – the 4th-7th nurture deciles; strong background – the 1st-3rd nurture deciles.

<sup>c</sup> There are few schools in the Arab sector whose students come from strong backgrounds.

to 2 percent of weak municipalities). This phenomenon is also apparent when comparing schools from the same socio-economic background in different municipalities.

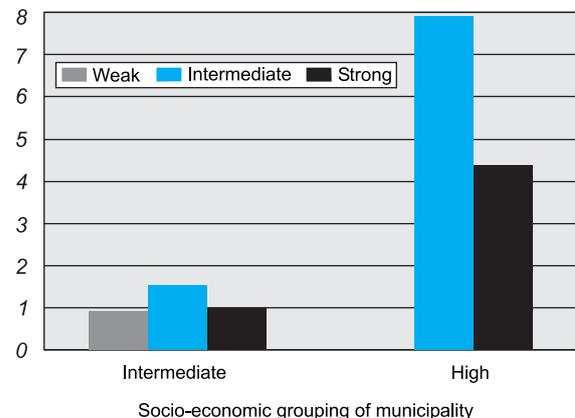
Therefore, if only the hours that the Ministry of Education finances are taken into account, the scope of affirmative action to benefit students from the weakest backgrounds (compared to the strongest) stands at 32 percent. This falls to 27 percent when we also take into account the allocation of hours by the municipality. The regressiveness of the municipalities in financing teachers' work hours is a result of the positive correlations between the municipality's fiscal strength, the socio-economic background of the students in its jurisdiction, and the scope of resources that it allocates to education.

This regressiveness exists even though municipalities in high-level groupings do conduct affirmative action policies to benefit Hebrew-State schools whose students come from intermediate socio-economic backgrounds rather than stronger ones (Figure 2.8). Estimates show that every unit on the school's cultivation scale (on a scale of 1-10 where 10 is a school from the weakest background) leads to an average increase of 0.2-0.3 weekly hours per class.

We note that during the period studied, there were no significant changes in the scope of hours that the municipalities allocated to Hebrew-State schools by the socio-economic backgrounds of the students and/or the municipality.

Figure 2.8

Teaching hours financed by the municipality in State primary schools<sup>a</sup>, by socio-economic background of the municipality<sup>b</sup>, and the school's students<sup>c</sup>, 2001-2009 average (weekly hours per class)



SOURCE: "IDEA – Economic Management and Consulting, Ltd.", Central Bureau of Statistics (2009), and Bank of Israel analysis.  
<sup>a</sup> Regular official primary schools containing Grades 1-6 only.  
<sup>b</sup> The socio-economic grouping of the municipality in 2006. Intermediate – the 4th-7th groupings; high – the 8th-10th groupings. There are few schools in the Jewish State education system in municipalities from the low groupings, and few schools whose students come from a weak socio-economic background in municipalities in high groupings. Therefore, information regarding these groups is not presented in the figure.  
<sup>c</sup> Weak background – the 8th-10th nurture deciles; intermediate background – the 4th-7th nurture deciles; strong background – the 1st-3rd nurture deciles.

We measured the inequality that the municipalities create when they finance teaching hours in the regular official Hebrew-State primary school system. For this purpose, we used the Gini Index, whose values range from 0 (full equality, all classes receive the same number of hours) to 1 (complete inequality, one class receives all of the hours and the others receive nothing). We found that the scale value was 0.744, which is considered a very high level.

When decomposing the same Gini Index for inequality between municipalities and for inequality within municipalities<sup>15</sup>, we find that 95 percent of the inequality exists between the municipalities. This means that the regressive differences between the municipalities in allocating teaching hours is relatively high, while the progressive gaps (the result of affirmative action) in allocations between schools in the same municipality are relatively small.

In summation, the municipalities have reduced the scope of affirmative action in allocating resources to education, since the stronger municipalities have made many more resources available to the Hebrew-State primary schools in their jurisdictions than the weaker municipalities, and since the affirmative action policies in their jurisdictions are limited. At the same time, the scope of resources that the stronger municipalities allocated was not large enough to overturn the Ministry of Education's affirmative action policy.

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<sup>15</sup> For explanations on how the decomposing is done, see: R. Lerman and S. Yitzhaki (1984), "A Note on the Calculation and Interpretation of the Gini Index", *Economics Letters*, Vol. 15, No. 3-4, pp. 363-368.

Diary of Events: May to August 2012

| Month    | Date | Event   | Details   |
|----------|------|---|---|
| May 2012 | 1    | Excise on fuel rose by NIS 0.10 per liter of gasoline.  | The increase came after a number of months during which the excise was lowered in order to moderate the increase in fuel prices. Even with the increase in excise, the price of 95 octane gasoline fell by NIS 0.14 per liter in May.   |
|          | 8    | The Prime Minister and leader of the opposition signed an agreement to establish a national unity government.                           | In light of concerns over advancing the elections, the Kadima party joined the government, increasing the number of Members of Knesset in the coalition to 94. Under the agreement, the Kadima party head was appointed Minister without Portfolio and Deputy Prime Minister.                       |
|          | 8    | Moody's credit ratings agency reduced its rating outlook for the Israeli banking industry from "stable" to "negative".                  | The company noted that the reduction in the outlook mainly reflected the expected slowdown in growth in the Israeli economy due to harm to exports to Europe and due to economic security challenges resulting from geopolitical tensions.  |
|          | 15   | The credit card clearing market is opened to competition.   | For the first time, the law enables all clearing companies operating in the industry to carry out settlement services for Isracard cards. These cards constitute 17 percent of the credit card market, and beforehand they could only receive clearing services from the Isracard company.          |
|          | 21   | The Supervisor of Banks requires banks to prepare for the possibility that the bank will be managed without a controlling core.         |   |
|          | 23   | The Ministry of Finance approved a security cushion of NIS 2.5 billion for the veteran pension funds not included in the arrangement.   | In order to prevent damage to the rights of members, the retirement age will be gradually pushed back: for men, it will be pushed from 65 to 67 and for women from 60 to 62. In addition, the Supervisor of Insurance increased the benchmark for investment in stocks and bonds from 10% to 22%.   |
|          | 28   | The Bank of Israel interest rate for June was left unchanged at 2.5%.   |   |
| June     | 1    | The marketing margin for a liter of gasoline rose by NIS 0.05 against the background of a reduction in global gasoline prices.          | After the marketing margin for gas stations was reduced in August 2011 in order to minimize the rise in the consumer price of gasoline, the Ministry of Energy and Infrastructure raised the marketing margin. At the same time, the full service commission was reduced from NIS 0.21 to NIS 0.16. |
|          | 1    | As a result of the reform in the cellular communications market, companies began offering unlimited communications plans at low prices. | Following the opening of the market to mobile virtual network operators (MVNOs) operating on the infrastructure of existing companies, a number of new companies entered the market, leading to a sharp decrease in cellular communication prices.  |

BANK OF ISRAEL RESEARCH DEPARTMENT

|      |    |   |   |
|------|----|---|---|
| June | 4  | The “Rafael” government company transferred a dividend to the State totaling NIS 316.4 million.   | As per the policy of the Government Companies Authority, “Rafael” transferred the amount of half of its profits for 2010.   |
|      | 7  | The Team to Increase Competitiveness in the Banking System submitted its conclusions.   | Among other things, the Team recommended (1) to require banks to notify customers of the fees they are actually paying and about the information the bank has gathered on the customer, (2) to cancel the holding fee for investments in <i>makam</i> , and 3) to provide easements in regulations on Internet banking.   |
|      | 7  | The Chinese central bank’s interest rate fell for the first time since the credit crisis in 2008.   | The Chinese central bank lowered the interest rate by 0.25 percentage points to 3.25 percent.   |
|      | 9  | The eurozone finance ministers decided to lend Spain up to €100 billion in order to prevent the collapse of Spain’s financial system.                                   | The decision was made after the IMF published a report stating that, due to the crisis in the Spanish real estate market, and after granting credit to companies in Greece, Portugal and Ireland, there is a serious concern over the stability of Spanish banks.   |
|      | 10 | The Population and Migration Authority of the Ministry of the Interior began Operation “Going Home” to airlift illegal migrants from South Sudan back to their country. | As part of the operation, each person will receive a plane ticket and financial assistance totaling €1000. According to data from the Population and Migration Authority, there 2031 infiltrators along the Egyptian border in May, mostly from Eritrea.  |
|      | 18 | Elections in Greece. The leading party supports having Greece remain in the eurozone.   |   |
|      | 22 | Moody’s rating agency announced a lowering in the rating of 15 large banks throughout the world.  | The lower credit rating reflects the risk of losses that the banks face against the backdrop of the global economic situation. Most of the banks fell by two ranks, including the leading banks: Royal Bank of Canada, Citi, Goldman Sachs, JP Morgan Chase, and Deutsche Bank.   |
|      | 24 | The government approved the permanent institution of a two-year budget.   | The proposal by the Minister of Finance, which was approved in principle, includes two situations in which a one-year budget would be instituted, subject to approval by the Knesset: if elections are held before the end of the first budget year, and under extenuating economic circumstances. The proposal sets forth that the Ministers of Finance and Justice would prepare a memorandum within 45 days that would amend the Basic Law: The Budget and the Basic Law: The Knesset. |
|      | 25 | The Bank of Israel’s interest rate for July was lowered by 0.25 percentage points to 2.25%.   | In the decision, the Bank stated that the reduction in the interest rate would contribute to strengthening the economy’s ability to cope with the possible negative ramifications of the global economy upon the Israeli economy.   |

RECENT ECONOMIC DEVELOPMENTS NO. 134, MAY–AUGUST 2012

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| June | 27 | UK bank Barclays was fined some \$452 million for manipulating the LIBOR interest rate.   | The scandal began after US and UK authorities revealed that from 2005 to 2008, Barclays had reported forged interest rates. The Director of the bank resigned a few days later, and other financial institutions were investigated in relation to the LIBOR rate forgeries.   |
|      | 29 | A European leaders summit in Brussels decided to establish a uniform supervision mechanism over banks in the eurozone.                              | In addition, an immediate incentive mechanism was decided upon totaling €120 billion to countries with heavy debts, and it was agreed that the rescue money for banks would be transferred directly from the rescue funds and not through the purchase of government debt. European stock markets responded with sharp increases. |
| July | 1  | The Ministerial Committee on Equipment, led by the Prime Minister, approved a security exchange transaction with Italy totaling some NIS 4 billion. | As part of the transaction, the Ministry of Defense will purchase 30 training planes made in Italy for the Israeli air force. Against this, the Italian government will make a return purchase from Israeli security industries.  |
|      | 1  | The government approved raising the deficit target from 2013 from the 1.5 percent set in the law to 3 percent.                                      | According to the new outline, the deficit target will fall each year and will reach 1.5 percent from 2019 onwards. The Prime Minister and the Minister of Finance announced that in order to maintain the target, it will be necessary to raise taxes and shrink the budget.  |
|      | 4  | The Ministry of Finance established a VAT return fund in respect of guarantees under the Sales Law for real estate, totaling NIS 6 billion.         | This is in order to enable the banking system to increase credit to the construction industry and to remove credit blockages.   |
|      | 5  | The European Central Bank (ECB) lowered the eurozone's interest rate by 0.25 percentage points to 0.75%.  |   |
|      | 10 | The Knesset approved the "Haircuts Law".  | The law sets forth mainly that in any debt arrangement that includes a haircut or a material change in the terms of repayment for bonds, the court will appoint a supervisor to ensure the protection of the public interest.   |
|      | 11 | The Minister of Finance signed an order to reduce customs fees and import taxes on hundreds of consumer goods.                                      | Among others, customs fees were lowered on food items, which constituted an import barrier. The reduction will be gradual and will be spread over four years.   |
|      | 14 | A demonstrator set himself on fire during social justice protests.  | The demonstrations, a continuation of the protest from last summer, were more bitter and included a smaller number of demonstrators. The demonstrator who set himself on fire left a letter detailing his distress and his claims against the court, the National Insurance Institute, and the government.                        |

BANK OF ISRAEL RESEARCH DEPARTMENT

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| July   | 16 | The Team to Examine How to Increase Competitiveness in the Banking Industry concluded the interim stage of formulating its recommendations.                  | The team's main recommendations are: directing some of the public's long term savings toward increasing the credit supply for households and small businesses; encouraging the establishment of an Internet bank; publishing the actual interest rates on credit and deposits and increasing accessibility to information for the purposes of comparison; sending information on the customer to the customer (banking ID card), including information on his rating in the bank at which his account is managed; the improvement of information about borrowers that will enable credit offices to develop a rating model for households and small businesses and to share this information with all lenders; creating an effective alternative for public short term savings through the cancellation of <i>makam</i> (bills) management fees and monetary funds; and imposing supervision over the number of fees, including fees for information, actions in securities and fees for small businesses. |
|        | 17 | The Kadima faction left the government, lowering the number of members of Knesset in the coalition to 66.  |  |
|        | 23 | The Bank of Israel's interest rate for August 2012 was left unchanged at 2.25%.  |  |
|        | 26 | As part of preparations for the 2013 State Budget, the purchase tax on cigars, cigarettes and beer was raised.   | A further tax of NIS 2.5 per packet of cigarettes, and of NIS 2 per liter of beer, was imposed. This is expected to bring NIS 1.04 billion into the State coffers. The Prime Minister and Minister of Finance announced that in order to meet the 2013 Budget, it will be necessary to make cuts and to raise additional taxes.  |
|        | 30 | The government decided upon a series of steps intended to reduce the deficit and to deal with the ramifications of the global crisis on the Israeli economy. | The main steps include an increase in income tax by 1%, setting a 2% supplementary tax, increasing employers' tax and VAT, and a broad cut in the budgets of government ministries.  |
|        | 31 | An agreement was signed to strengthen the economic ties between the government of Israel and the Palestinian Authority.                                      | The agreement is intended to deepen trade between Israel and the Palestinian Authority, and it includes mainly cooperation in the war on smuggling, tax arrangements and coordination between the tax authorities, and streamlining the transfer of goods and fuel.  |
| August | 1  | As part of the tax reform, VAT on fuel rose by NIS 0.06 per liter of gasoline.   | The price of gasoline rose by 5.91%, mainly due to a rise in global fuel prices and the change in the exchange rate.   |
|        | 6  | The Knesset approved an amendment to the law to reduce the deficit and to change the tax burden.   | The main Sections in the law are: raising income tax by 1 percentage point for tax brackets between NIS 14,000 and NIS 40,230, and the imposition of a supplementary tax of 2% on the sale of a home worth NIS 4 million or more, as of January 2013.  |

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| August    | 6  | The Ministry of Finance approved Israel Railways receipt of a loan totaling NIS 500 million from the company's VAT fund.                                    | This followed difficulties experienced by Israel Railways in paying suppliers and repaying loans to banks.   |
|           | 7  | The Finance Minister and the Finance Committee Chairman announced that VAT would rise by 1 percentage point in September.                                   |  |
|           | 8  | The government increased the provision of credit to the construction industry by NIS 3 billion each year from 2013 to 2015.                                 | The socio-economic cabinet approved the Minister of Finance's proposal. The process will include the establishment of a fund for the repayment of VAT in respect of guarantees under the Sales Law, and it will enable the banking system to increase credit to the construction industry.   |
|           | 9  | The European Central Bank (ECB) reduced the eurozone growth forecast for 2013.  | The growth forecast fell from a growth rate of 1% to a rate of 0.6%. The report notes that risks surrounding the economic forecast for the eurozone continue to be serious, and are mainly connected with tensions in the financial markets in the eurozone and their spread to its real economy.  |
|           | 21 | The Supervisor of Banks published a draft report on bank fees.  | The main contents of the amendment relate to the cancellation of fees on: information cards; cash withdrawal cards; handling credit and securities (increasing the exemption to a ceiling of NIS 100,000); changing the credit card charge date; management fees for small businesses; and management fees for <i>makam</i> and monetary funds. In addition, the amendment relates to the cancellation of minimum fees for managing securities deposits and setting a maximum fee for the purchase and sale of securities. |
|           | 27 | The Bank of Israel interest rate for September 2012 was kept at 2.25%.  |  |
| September | 1  | The VAT rate increased from 16% to 17%.   |  |
|           | 1  | The IDB Holding company was forced to publish a going concern warning in its financial reports after losing NIS 1.27 billion in the second quarter of 2012. |  |

