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# RECENT ECONOMIC DEVELOPMENTS, 107\*

April–September 2004

## Main developments

In the period from April to September 2004 (the period reviewed) the trend of expansion in economic activity evident since the second half of 2003 continued, although it slowed in 2004:III. The increase in activity was based on a rise in the business sector, mainly in exports, whereas the share of public consumption in GDP declined. Nevertheless, some indicators, such as the composite state-of-the-economy index, suggest a slowdown in the rate of growth in the third quarter or even a real decline, and others, such as the Bank of Israel Companies Survey, point to continued expansion at a rate similar to that in the second quarter. The government stuck to its fiscal policy of reducing expenditure while cutting taxes that is consistent with the achievement of the deficit target. The financial markets were stable, and Israel's country risk premium remained low.

Growth in 2004:II was based on an increase in business-sector product, mainly in goods and service exports. Private consumption rose from its level in 2003:II. Companies' expectations of a slower rate of expansion of economic activity were reflected in a decline in investment in machinery and equipment in the second quarter, following its rise in the first quarter. Most of the data relating to 2004:III indicate a moderation in the rate of growth, in particular a reduction in goods exports and a slight decline in capital goods imports. The latter decline is consistent with expectations of a slowdown in economic activity in 2004:IV, as can be seen from the responses reported in the Companies Survey for the third quarter. The following may be enumerated as leading to continued growth in 2004:IV, albeit at a reduced rate: (1) More firmly based growth world wide, i.e., worldwide growth, including increased demand for the goods and services of high-tech industries that contributed to the recovery of those industries in Israel. It appears that in 2004:III the global rate of growth slowed somewhat mainly due to the rise in oil prices, and the same occurred in Israel. (2) The relative calm on the security front. (3) A fiscal policy consistent with the achievement of the deficit target with reduced public expenditure. (4) An

expansionary monetary policy and financial stability. All these supported low long- and short-term interest rates and the preservation of the low level of Israel's country risk premium following its marked reduction in the second and third quarters of 2003.

The rise in exports from their level in the equivalent period (April to September) in 2003 persisted, against the backdrop of revived demand world wide, the increase in trade, and the depreciation seen in the real NIS exchange rate. Manufacturing exports went down in 2004:III, partly due to the dock strike. At the forefront of the increase in exports in the period reviewed was the rise in exports of the knowledge-technology industries (computer services, R&D and high-tech manufacturing), and the improvement in the high-tech industries persisted in the third quarter too, in contrast to the decline in the mixed and traditional industries. The rise in the knowledge industries (which accounted for some 18.4 percent of business-sector product in 2003) was also expressed in a considerable and constant increase in venture-capital-funds' investments in companies in those industries since the beginning of the year.

Developments in the labor market were in accord with the picture of continued growth. The number of employed persons continued to rise in 2004:II in the business sector, and to a lesser degree also in the public sector. The total number of employees has been rising since 2003:III, and the number of non-Israelis employed has been declining since 2002:II. The rate of participation in the labor force continued its steep rise for the fourth successive quarter and reached an unprecedented level. The rate of unemployment remained stable, although high, in 2004:II, at 10.7 percent, but the depth of unemployment rose. Despite the increase in the number of employed persons, unemployment did not go down, due to the rise in the participation rate. The real wage was 1.5 percent higher in April–July 2004 than in the equivalent period in 2003 (2.2 percent higher in the business sector and 0.3 percent lower in the public sector).

With regard to fiscal policy, the domestic deficit,<sup>1</sup> cash basis, for January to September 2004 (excluding credit given) was NIS 8.1 billion—similar to the level of the

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

<sup>1</sup> The figures relate to the domestic deficit, as the deficit abroad is highly volatile.

deficit in the equivalent periods in 2001 and 2002 when the annual deficit came to 4 percent of GDP—and represents a marked improvement from the deficit of NIS 19.3 billion in the equivalent period in 2003. The Research Department of the Bank of Israel assesses that the government will meet the deficit target of 4 percent of GDP in 2004, given the under-performance on the expenditure side, despite the tax cuts. Israel's country risk premium declined in 2003:II and 2003:III by much more than the risk premiums of emerging markets. Since then it has remained stable at its low level, against the background of the fall in the domestic deficit in terms of GDP since the third quarter of 2003 (Figure 9) and the assessment that the government will continue to reduce the deficit and will meet its fiscal targets that will result in a lower deficit/GDP ratio.

In the period reviewed calm prevailed in the areas of prices and the exchange rate. The CPI rose by 1.2 percent in the period reviewed. In 2004:II it rose by 1.5 percent, with most of the rise occurring in April; in 2004:III the CPI went down. In the period reviewed expected inflation for the next twelve months was around the mid-point of the price-stability target of 1–3 percent.

The stability in the financial markets in the period reviewed, expressed in stable foreign-currency, government-bond and Treasury bill markets, together with fiscal policy consistent with the achievement of the deficit target, all these strengthened the ability of the Bank of Israel to keep the interest rate at 4.1 percent, due to the stabilization of inflation expectations within the target range. The interest rate was kept low despite the rise in interest in the US by 0.75 of a percentage point in the third quarter. The Bank of Israel's low rate was reflected in the lowest level of short-term real interest for several years, at an average of 2.5 percent in the period reviewed. The accelerated rise in economic activity and the low level of short-term interest resulted in a marked increase in the M1 money supply.

The General Share Price Index fell by 4.3 percent in the period reviewed—rising by 5.8 percent in the second quarter and falling by 9.6 percent in the third—while the Nasdaq went down by 4.9 percent. Turnover rose by far more than in the equivalent period in 2003. The decline in the Share Price Index in 2004:III was apparently due to expectations that the rate of growth would ease.

Continued growth depends on various factors: continued global recovery, calm with regard to the security situation, a return to downward path of public debt, and stability on the political front. During the period reviewed the government consistently adhered to the policy of reducing expenditure and cutting taxes while observing the deficit target. This fiscal policy contributed to its

credibility and thereby helped to keep Israel's country risk premium in the international markets at a low level, and hence to the stabilization of long-term and short-term interest at relatively low levels following their reduction in the course of 2003. Keeping a tight rein on public expenditure and reducing the share of public debt in GDP are necessary conditions for the provision of a firm base for growth that will enable long-term interest to stay low, and price stability to be maintained with low short-term interest. The 2005 budget passed by the government in 2004:III supports a policy of lowering the debt/GDP ratio, but the budget has not yet been passed by the Knesset. The planned pull-out from Gaza will apparently require an increase in public expenditure and will make the deficit exceed its target.

### The National Accounts and the principal industries

The National Accounts show that GDP continued to increase in 2004:II, by 4.7 percent in annual terms (Table 1), following its rise in the first quarter. Business-sector product rose by 6.3 percent in 2004:II. These figures indicate continued growth in the second quarter, based on business-sector growth. The monthly economic indicators do not paint a uniform picture, but suggest that GDP rose more slowly in 2004:III: the composite state-of-the-economy index (Figure 1) shows that economic activity eased, while the data of the Bank of Israel's Companies Survey for the third quarter point to continued expansion.

The backdrop to growth in the second quarter, and its more moderate continuation in the third, was provided by the recovery in the global economy, and specially the modest growth in the US economy and in Europe, the increase in demand in China, and in particular the rise in demand for the high-tech goods in which Israel specializes, so that the growth in 2004:II was based on further improvement in goods and services exports, mainly of information technology (IT). Against the background of fiscal policy that reduced government expenditure and led to greater government credibility and to the stabilization of the long-term interest rates at a relatively low level, the slow rate of price increases and the stabilization of inflation expectations within the target range, the Bank of Israel kept the interest rate relatively low and thus supported increased demand.

Israel's exports (excluding diamonds), following their rapid rise in 2004:I, continued to increase considerably in 2004:II due to the marked improvement in the global economy and the more favorable exchange rate in the

Table 1. National Accounts,<sup>a</sup> 2003–2004

	2003	2003		2004			Apr–Sep 2004 <sup>b</sup>	Last month for which data available
		III	IV	I	II	III		
GDP	1.3	2.4	2.0	3.9	4.7		3.2	Jun
Business-sector product	1.7	2.2	3.6	4.6	6.3		4.2	Jun
Business-sector product excl. start-ups	2.1	1.6	3.4	5.2	5.6		3.9	Jun
Private consumption	1.3	7.2	4.3	4.7	–0.5		3.9	Jun
Gross domestic investment	–10.7	17.4	–27.1	1.5	13.7		–0.3	Jun
Fixed investment	–4.9	–15.3	2.5	6.1	–3.8		–3.0	Jun
Goods and services exports	6.2	26.3	2.7	23.4	7.7		14.6	Jun
Goods and services exports excl. start-ups and diamonds	6.2	39.5	5.4	30.7	15.5		22.1	Jun
Goods and services imports	–1.8	23.0	–3.4	25.4	10.4		13.3	Jun
Goods and services imports excl. diamonds	–1.6	14.8	0.0	27.0	19.7		14.9	Jun
Public-sector consumption	–2.0	0.3	–6.9	3.4	9.5		1.4	Jun
Public-sector consumption excl. defense imports	–0.7	1.4	–5.5	5.3	6.4		1.8	Jun

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

<sup>b</sup> Compared with April–September 2003.

SOURCE: Central Bureau of Statistics.

first and second quarters. According to foreign-trade data (Table 4) goods exports declined in 2004:III, reflecting a decrease in exports of the traditional and mixed industries, and an easing of the increase of high-tech exports. The decline in exports took place against the backdrop of the drawn-out dock strike and expectations of slower worldwide growth as a result of the rise in oil prices.

Goods and services imports (excluding diamond) rose by 19.7 percent (annual rate) in 2004:II, following their steep rise in the previous quarter. Foreign-trade data for 2004:III show a drop in goods imports: imports of production inputs went down, imports of consumer goods dipped somewhat, and imports of capital goods rose moderately. The decline in total goods imports occurred against the background of the drawn-out dock strike and expectations of slower worldwide growth

Private consumption went down by 0.5 percent in 2004:II, following a 4.7 percent rise in the previous quarter. This came in the wake of four quarters of considerable increase in private consumption, and against the backdrop of the steep rise in fuel that reduced the fuel and lighting component of private consumption, seasonally adjusted, by more than 18 percent. Excluding the fuel and lighting component, private consumption rose by 0.5 percent in 2004:II. The reduction in the average nominal and real

wage in 2004:II together with the switch from optimism regarding future growth that prevailed in the first quarter to expectations of a slowdown in the rate of growth may have contributed to the decline in consumption in 2004:II.

The decline in private consumption was reflected in the easing in the turnover indices that provide indicators of such consumption, and in the fall in some of them in 2004:III: the turnover index of commerce and services (Table 2) declined moderately in 2004:III, the turnover of commerce industries fell considerably in the third quarter, and large-scale retail trade rose in that quarter. Turnover in hotels and catering and in education and health services went down in the third quarter.

Public consumption was 1.4 percent higher in 2004:II than in 2003 II: civilian consumption was 0.5 percent lower due to fiscal policy that acted to reduce government ministries expenditure of wages and purchases and to cut transfer payments. On the other hand, defense consumption was 7.3 percent higher in 2004:II than in 2003:II; in particular defense purchases rose significantly, apparently due to the costs of constructing the security fence.

**Gross domestic investment**, at a level similar to that of 2003:II, rose significantly in 2004:II due to an increase in inventories. **Fixed investment** fell by 3.8 percent in 2004:II after rising in the previous quarter. The decline

reflects stability in construction investment and a fall in investment in machinery and equipment which are apparently affected by excess capacity in the economy. Foreign-trade data show that imports of capital goods rose in 2004:III. These data are consistent with the expectations shown in the Companies Survey of modest expansion in the last quarter of the year.

According to the assessment by the Central Bureau of Statistics, **infrastructure investment**, that generally reflect the government's initiative, will be lower in 2004 than in 2003. The reduction in infrastructure investment in the first and second quarters of 2004 encompassed most of the major infrastructure industries: transport, communications, and energy (electricity and gas), whereas investment in water rose. The fall in investment in transport was mainly in investment in roads, and was due to the government's decision to focus in 2004 on completing existing projects whose cost in that year was relatively low. There was a small increase in railway investment, and a marked rise in investment in the ports. Investment in airports dropped significantly with the completion of the work on the new Terminal at Ben Gurion Airport (the "Israel Airports Authority Ben Gurion 2000 Project"). Investment in the energy infrastructure dropped sharply due to a fall in investment by the Electricity Corporation and in the investment in gas.

The slowdown in the rate of expansion of activity in the period reviewed, mainly in the third quarter was mirrored in the **composite state-of-the-economy index** that reflects deviations from the long-term trend of increased activity (Table 2). After rising in 2004:I and increasing more moderately in 2004:II, the index started falling in 2004:III.

The **Companies Survey** for the third quarter was more optimistic than were the other indicators regarding growth in that quarter, and show that activity in that quarter was similar to the level in the previous quarter. Companies' responses indicate that activity continued to expand in the third quarter (except in construction) at a similar pace to that in 2004:II. Expectations in most industries were that both domestic and export activity would grow modestly in 2004:IV. In construction the decline in activity persisted, both in buildings and in infrastructure, and expectations were of continued decline in the next quarter. Reports on the severity of constraints on activity were not significantly different from those in the previous quarter.

**Manufacturing production** (excluding diamonds) increased considerably in the second quarter, and more slowly in the third quarter (partial data) (Figure 2). Production in the high-tech industries, constituting more than 37 percent of manufacturing production and about

58 percent of industrial exports, according to 2001 data, rose substantially compared to the same period last year and continued to expand in the third quarter. However, production of the mixed-high-tech and traditional industries decreased in the period reviewed and production in mixed-traditional industry rose at a low rate. These data should be viewed against the background of the industries' profitability data:<sup>2</sup> high-tech industry is the most profitable (based on average profitability in 2000 and 2001) while mixed-high-tech and traditional industries are the least profitable.

Expansion of manufacturing production was accompanied by a marked increase in exports, especially in high-tech exports. The actual hours worked in manufacturing rose by 2 percent compared to the same period last year. Contrary to the downward trend in the number of employees in manufacturing in recent years due to outsourcing, the number of Israelis employed rose by 4.4 percent in the second quarter compared to the same quarter in 2003.

Activity in the **construction industry** continued to decline during the period reviewed (Table 2 and Figure 3). Activity in the second quarter was similar to that recorded in the first quarter, yet was relatively low compared to the same quarter in 2003. Reduced employment (Israeli, foreign and Palestinians) supports the data on activity. The slight rise in demand compared to its low level in 2003 is expressed by increased sales of new and second-hand apartments. Building contractors' expectations about future output (as indicated by the Companies Survey for the third quarter of 2004) were pessimistic.

According to the National Accounts data, investment in buildings and other construction works in 2004:II remained at the level of the first quarter but was below the level in the same quarter last year. The decrease compared to 2003:II occurred mainly in construction of nonresidential projects, while investment in residential construction declined very slightly, according to the National Accounts data. The decline in building starts and completions continued in the second quarter, so that the area of active construction at the end of the second quarter was smaller than that in June 2003. These data indicate a possible decline in activity in the next quarters. Cement sales during January–August dropped by 6 percent compared to the equivalent period last year. The number of employees in the construction industry dropped by 6 percent in the second quarter compared to the same quarter in 2003; the highest decrease was recorded in

<sup>2</sup> More precisely, the rate of operating profit in output, including financing and return on capital in plants employing at least five employees.

Table 2. Indicators of Business Activity,<sup>a</sup> 2003–2004

	2003	2003		2004			Apr–Sep 2004 <sup>b</sup>	Last month for which data available
		III	IV	I	II	III		
Composite state-of-the-economy index	-1.9	1.4	4.7	7.2	3.7	-0.9	3.9	Sep
Large-scale retail trade	-2.4	3.5	11.2	-0.1	4.6	9.1	5.4	Sep
Manufacturing production (excl. diamonds)	-0.4	1.6	12.2	9.7	3.4	2.0	6.7	Aug
Business-sector consumption of electricity	4.2	3.7	-5.5	14.0	-12.9	8.9	0.5	Aug
Index of revenue in commerce	0.2	6.0	9.6	12.0	0.0	-6.0	5.2	Aug
Index of commerce and services revenue	-0.7	12.0	11.3	9.1	3.6	-1.0	7.3	Aug
Tourist arrivals	21.7	23.8	9.4	1.7	12.7	4.9	42.2	Sep
Construction (average change from equivalent period in previous year)								
Residential starts	-7.3	-7.1	6.9	-13.4	-16.9		-15.7	Jul
of which: Government-initiated	-3.9	4.6	-11.4	-49.6	-49.8		-47.0	Jul
Residential completions	-11.9	-22.7	0.6	-14.8	-15.4		-13.6	Jul
of which: Government-initiated	-15.0	-31.5	-1.5	-21.1	0.1		15.1	Jul
Survey of companies (net balance, percent) <sup>c</sup>								
Output of manufacturing firms		4 <sup>d</sup>	9	30	19	22		Sep
Sales by commercial firms		13 <sup>d</sup>	12 <sup>d</sup>	53	16 <sup>d</sup>	18 <sup>d</sup>		Sep

<sup>a</sup> Percentage change from previous period, in annual terms, at constant prices, seasonally adjusted except for construction industry data.

<sup>b</sup> Compared with April–September 2003.

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

<sup>d</sup> Not significant at 10% level.

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

legal foreign workers and in Palestinians, due to some extent to the security fence.

On the demand side, sales of new and second-hand apartments in January–July were 13 percent higher than in the equivalent period last year, according to land betterment tax data. The companies survey also indicates that the demand constraint on activity has steadily declining since the third quarter of 2003, despite the fall in the rate of immigration. Part of the increase may be attributed to the exceptionally low sales rate during 2003, especially in the first quarter, due to the war in Iraq and to the relatively low interest rate in the mortgage market, which led to a significant increase in the take-up of mortgages compared to 2003. The combination of increased demand and decreased apartments supply raised the prices of owner-occupied apartments. The index of owner-occupied apartments rose by 5.1 percent from the beginning of this year to July after declining in 2003.

**Incoming tourism** recovered considerably, due to the improved security situation. Tourists' bed nights increased by 48 percent in the period reviewed compared to the

equivalent period last year; yet its level was still 49 percent lower than in 2000, the peak tourism year. The Companies Survey indicates continued expansion of activity, due to the increase in tourists' bed nights. The hotels and catering services sector, which was mostly dependent on domestic demand in recent years, is beginning to revert to its previous dependence also on tourists from abroad. Tourists' bed nights in the reviewed period amounted to 26.5 percent of total hotel bed nights, compared to 19.7 percent in 2003 and 49.5 percent in 2000. The stability of bed nights of Israelis also contributed to the recovery of the situation of hotels. Revenues in US\$ from tourists rose in the second quarter by 66 percent compared to the same period last year (revenues from Israelis rose by 5.3 percent in nominal terms), accompanied by stable numbers of hotel bed nights of Israelis, thereby arresting the decline in prices for Israelis. Consequently, the price index of hotels rose by 5.25 percent in January–August, compared to the average of 2003. The steady recovery in tourism caused the government to cut its support to tourism significantly. The main support in 2004 was directed to marketing incentives.

## BOX 1 Expected Developments in 2005

The updated macroeconomic forecast for 2005 points to continued growth at a moderate pace, as the effect of the recovery from the recession was fully realized over the last two years. A 3.2 percent rise is expected in GDP, compared to 4 percent in 2004, while business-sector product is expected to rise by 4.2 percent, compared to a 5.5 percent increase this year. It should be noted that the growth rate during 2005 will still be higher than that expected in the second half of 2004.

An earlier forecast for 2004 and 2005, published in Recent Economic Developments No. 106, was based on partial data for the first half of the year and assumed a slowdown in the second half of the year. A comparison of the earlier forecast with the annual estimates of the Central Bureau of Statistics, assimilating information on economic activities in the three quarters of this year, indicates that the Bank of Israel forecast for investment was too high, while the forecasts for exports and public consumption were underestimated. The updated forecast was revised accordingly.

The impressive two-digit growth in exports and the marked increase in private consumption were in the forefront of the buoyant recovery from the recession during the second half of 2003 and the beginning of 2004. After the initial surge typical of the economic recovery stage, exports and private consumption may revert to a steadier pace of development; the consolidation stage evident during 2004 is expected to strengthen during 2005. A slower increase in exports will reflect the slowdown in global growth and world trade, according to a recent IMF estimate. A slower growth rate of private consumption reflects a significant reduction in consumption of consumer durables.

Two other factors which will contribute to the slowdown in the rate of growth in 2005 are sluggish investments in fixed assets and the direct effect of reduced public consumption. Recovery from the recession did not cause a real recovery in investment, except for increased investment in inventory. The surplus production capacity and low demand for residential construction are the factors behind this slow expansion rate in investment. Public consumption will be held back, in line with the government's economic policy, which restricts the increase of government expenditure to one percent and which includes a commitment to meet the deficit target.

It should be noted that this forecast does not express the economic implications of the process of unilateral disengagement from Gaza and parts of Northern Samaria expected to begin in the next few months. The process involves new construction, relocation of civilian and military infrastructures and considerable current expenditure for evacuation of settlements and military redeployment. The total cost of all these activities is currently estimated at some NIS 5 billion, but the direct effect of the disengagement process on the economy cannot be incorporated into a macroeconomic forecast before completion of the legislation, and the determination of the timetable and the budget. It is obvious, however, that execution of the plan involves increasing public expenditure and the deficit in excess of the preset objectives.

Reduction of transfer payments and stricter eligibility conditions caused a sharp increase in the participation rate in 2004. Consequently and in view of the ban on recruitment of new employees in the public sector, the unemployment rate did not go down, despite the firmer growth and the increased number of employees in the business sector. In the absence of any additional increase in the participation rate in 2005, the rate of unemployment is expected to drop to a level of about 10 percent. Detailed assumptions of the macroeconomic forecast for 2005 are as follows:

**Exports:** a slowdown in the growth rate of global trade in 2005 with a decrease in the share of the industrialized countries in it will act to moderate the expansion of the Israeli export. Renewed growth of the high-tech industries world wide will accelerate the expansion of the high-tech exports, while exports of the traditional industries may shrink, due to the increasing share of the emerging countries, led by China. Services exports, which will also benefit from the increased demand for high-tech and knowledge-intensive services, will be strengthened by a significant expansion in tourism, thanks to the relatively calm security situation. It should

## Indicators of Economic Development, 2003–2005

	2003	2004 estimate	2005 forecast
Sources and uses		Volume change, percent <sup>a</sup>	
1. GDP	1.3	4.0	3.2
2. Business-sector product	1.7	5.5	4.2
3. Private consumption	1.3	4.5	3.6
4. Public consumption excluding defense imports	-0.8	0.4	-0.3
of which: Civilian consumption	0.3	-0.9	-0.1
5. Domestic investment, gross	-10.7	12.0	3.4
Investment in capital assets	-4.9	-0.3	2.5
of which: Residential construction	-4.2	-2.3	0.2
Principal industries	-5.1	0.4	3.3
6. Domestic uses (excluding defense imports)	-1.3	4.6	2.5
7. Goods and services exports	6.2	11.5	7.6
8. Civilian imports	-1.0	12.2	5.7
Balance of payments		\$ billion, at current prices	
9. Civilian import surplus—goods and services	0.0	0.5	-0.2
10. Current account deficit	0.2	0.1	-0.6
Population, employment and prices			
11. New immigrants ('000)	23.3	19.6 <sup>b</sup>	
		percent change	
12. Average population	1.8	1.7	1.7
13. Rate of unemployment (percent of labor force)	10.7	10.7	10.0
14. Israelis employed, total	2.0	3.6	2.6
of which: In business sector	2.5	4.9	3.5
15. Wage per employee post, total	-3.0	2.4	1.2
Business sector	-2.5	2.3	1.0
Public sector	-4.1	3.7	2.0
16. Employment rate (aged 15+, percent of population)	48.7	49.5	50.0

<sup>a</sup> At 2003 prices.

<sup>b</sup> To end of August, in annual terms.

be noted, however, that the tourism industry, deeply affected during the Intifada years, has a long way to go before regaining the peak levels of the late 1990s.

**Private consumption:** The rapid rise in private consumption in 2004 is explained by the increase in disposable income the result of accelerated growth at the stage of recovery from the recession and tax cuts, with a surge in consumption of durables. These temporary effects may slow down in 2005 and together with falling transfer payments and tighter limits on credit to consumers, may slow down private consumption. However, the expected reduction in income tax in 2005 is expected to support private consumption.

**Investment:** Investment in different sectors is expected to expand in 2005, pursuant to the consolidation of the growth, and the fact that investments lagged behind the turnaround in the business cycle. However, no recovery is expected in investment in nonresidential construction, since there is surplus inventory of industry and commercial structures in the business sector. Thus, investment in the economy will increase mainly due to investment in machinery, equipment and vehicles. Despite the increase in disposable income, significant

adjustment of real estate prices during the recession years and reduced interest on mortgages, no sharp turn is expected in residential construction, as indicated by building starts data for 2004. Moreover, in view of the shrinking volume of immigration into Israel, no drastic change is expected in demand. Therefore, expansion of investment in residential construction will be rather moderate.

**Public consumption:** Restricting the expansion rate of government expenditure to one percent and continued reduction of transfer payments may prevent a rise in domestic public expenditure in 2005. This fiscal restraint, however, failed to ensure that the deficit target of 3 percent of GDP was met. Consequently, the budget proposal contains a plan for tax increases of some NIS 2 billion. This proposal includes, among other steps, revoking exemption from VAT in Eilat and reducing the exemption from income tax on provisions to advanced study funds. These steps may set-off the fiscal effect of the next stage in the income-tax reform, scheduled for 2005. Therefore, it seems that no significant change will occur in the tax burden.

**The labor market:** The forecast is based on the assumption that after the sharp increase in 2004, caused by a considerable cut in transfer payments in general and in unemployment benefits in particular, the participation rate will stabilize and remain at 55.0 percent on the average for 2005. Reduction in employment of foreign workers (including Palestinians) will continue at an ever decreasing rate: their number is expected to fall by 15,000, compared to a reduction of about 20,000 in 2004. A 4.2 percent growth rate of the business sector will increase the numbers of employed in it by about 2.5 percent only, with replacement of foreign workers with Israelis. The unemployment rate may drop slightly during 2005 and reach a 10 percent average annual rate.

The **real wage** will rise at a moderate rate, explained by a relatively slow increase of the demand for workers and by the increased participation rate. A decrease in unit labor cost will improve companies' profitability, which will be expressed by a sharp increase of income-tax revenues. The real wage is expected to rise at a rate similar to that of labor productivity.

Relative stability is expected in the **real exchange rate**, since the response to a rise in demand will be increased utilization of the factors of production in the economy.

## The Labor Market

The labor market is developing in a manner that corresponds to continued economic growth and the Government's policy of downscaling general-government employment. Total employed increased in 2004:II for the fourth straight quarter (Table 3 and Figure 5). General-government employment grew relative to 2004:I, after considerable declines in previous quarters, and business-sector employment continued to increase as more Israelis found work and less use was made of foreign and Palestinian labor. The unemployment rate, however, was unchanged in 2004:II due to an increase in the participation rate. What is more, the depth of unemployment worsened.

The decline in general-government employment in 2004:I probably traced to the early retirement of longstanding workers and the Government's policy of downsizing general government. In 2004:II, however, general-government employment increased by 0.7 percent. Business-sector employment expanded appreciably due to continued economic growth.

Although employment grew vigorously, real wages increased by a mere 1.4 percent in April–July relative to the year-earlier period. General government wages were flat and business wages rose by 2 percent relative to the year-earlier period. Strong growth of the civilian labor force and the high unemployment rate evidently combined to keep the wage increase small. Furthermore, general-government wages may have been depressed by strikes.

The labor-force participation rate increased perceptibly for the fourth consecutive quarter, climbing by 0.3 percent in 2004:II to a record 55.4 percent. The reasons for the uptrend are the cutbacks in income-maintenance benefits, tougher eligibility criteria, enforcement actions by the immigration police that are allowing Israelis to replace foreign workers, and continued economic growth, which has stimulated labor demand in the business sector and attracted erstwhile 'discouraged workers' back to the labor market.

The unemployment rate was unchanged at a steep 10.7 percent in 2004:II due to the confluence of strong employment growth, the higher participation rate, and growth in the labor force itself. The depth of

Table 3. Indicators of Labor Market Developments, 2003–2004

(seasonally adjusted data)

	2004	2004	2003		2004			Apr–Sep 2004 <sup>a</sup>	Last month for which data available
	II	III	III	IV	I	II	III		
	('000s)		percent change from previous quarter						
1. Civilian labor force	2,694		0.8	1.6	0.7	0.9		3.7	Jun
2. Israeli employees	2,406		0.5	1.6	0.9	1.0		3.5	Jun
of which: in general government	725		0.1	-1.4	-0.1	0.7		-0.5	Jun
in business sector	1,676		0.7	2.5	1.4	0.8		5.4	Jun
3. Foreign workers and Palestinians (unadjusted)	218		-1.8	-2.9	-4.9	-4.6		-13.5	Jun
of which: in business sector (unadjusted)	213		-1.8	-2.9	-5.1	-4.7		-13.8	Jun
4. Average hours worked weekly per employee	37		0.3	-0.3	0.5	-0.8		0.3	Jun
5. Labor input in business sector (incl. foreign workers and Palestinians)	80,107		-0.1	2.4	1.5	-1.3		2.4	Jun
of which: Israelis	70,667		0.2	3.2	2.5	-0.8		4.5	Jun
6. Labor input in general government (Israelis)	17,940		2.1	-1.8	-0.6	0.2		0.3	Jun
7. Unemployed	288		4.0	1.9	-0.9	0.3		5.9	Jun
8. Work seekers	229	236	11.0	6.1	-0.8	-1.2	3.1	10.1	Sep
9. Claims for unemployment benefit	74	73	1.2	-0.7	-3.5	-11.5	-2.1	-16.1	Sep
	Nominal NIS (unadjusted)								
10.1 Real wage per employee post <sup>b</sup>			3.3	-0.1	2.7	-3.7	0.8	1.4	Jul
In general government			6.4	1.6	7.8	-13.8	6.0	0.1	Jul
In business sector			2.5	-0.4	1.4	-0.8	0.1	2.0	Jul
10.2 Nominal wage per employee post <sup>b</sup>	6,853	7,089	2.1	0.0	2.6	-3.2	0.9	1.0	Jul
In general government	6,358	6,816	4.4	1.3	6.3	-11.1	4.1	-0.3	Jul
In business sector	7,094	7,217	1.0	-0.2	1.1	0.0	0.2	1.6	Jul
			percent						
11. Participation rate			54.3	55.0	55.1	55.4		2.3	Jun
12. Employment rate			48.4	49.0	49.2	49.5		2.2	Jun
13. Unemployment rate <sup>c</sup>			10.9	10.9	10.7	10.7		1.2	Jun
14. Depth of unemployment <sup>d</sup>			35.5	35.2	38.7	42.6		6.8	Jun

<sup>a</sup> Compared with April–September 2003 (unadjusted).<sup>b</sup> Including foreign workers and Palestinians.<sup>c</sup> Unemployed (Row 7) divided by civilian labor force (Row 1).<sup>d</sup> Percent of unemployed seeking work for more than six months.

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

unemployment continued to worsen, with increases in the proportions of jobless persons who have sought work for more than twenty-seven months and of those who have not worked in the past twelve months.

Some 184,400 foreign workers were present in the country in 2004:II, including 63,000 who were legal. The population of foreign workers has declined by 12,500 since the beginning of the year because fewer permits

for their employment are being issued and because the immigration police have been cracking down on those who are illegal. The number of territories workers is also continuing to contract, probably due to the separation barrier.

The increase in employment in recent quarters is reflected mainly in an upturn in the number of persons holding part-time jobs. Sectorial analysis of employment trends in 2004:II as against 2003:I (Israelis only) shows that the decline in general-government employment is composed of a large decrease in public administration, no change in health, welfare, and nursing services, and more in education. In the business sector, employment increased in all subindustries with no significant changes in composition except for a slight decrease in construction. Some of the upturn in employment of Israelis in hotels and catering and in household services may have been facilitated by the decrease in employment of foreign workers.

The participation rate of women rose more steeply in 2004:II (from 49.8 percent to 50.2 percent) than that of men (from 60.7 percent to 60.8 percent) because the unemployment rate among women declined slightly, to 11.9 percent, and that of men was unchanged at 9.6 percent, and because employment of women increased perceptibly (by 14,500 posts, mostly part-time) as against only a slight increase in the employment of men. The participation rate of women has been climbing steadily for years. Most of the increase in recent quarters has been in part-time posts, probably due to government measures designed to encourage non-participating population groups to join the labor force. The number of those who sought full-time jobs but found only part-time employment apparently increased significantly.

To complement the policy of downsizing the foreign-worker population, it is necessary to encourage the employment of Israelis. Thus:

a. The program that encourages single parents to join the labor force,<sup>3</sup> inaugurated in August 2003 due to the cutback in income-maintenance benefits and the introduction of an employment test for single parents, was recently extended to 2005. The goals of the program are to induce the target population to join or rejoin the labor market and to enhance single-parent households' earning capacity. The main benefits in the program are a financial grant for single parents who increase their labor income, an employers' incentive, reimbursement of travel expenses, vocational training, a discount on children's

<sup>3</sup> Based on reports from the Manpower Planning Authority at the Ministry of Industry, Trade, and Employment.

daycare, subventioning of afternoon child care, and a program for the encouragement of business entrepreneurship (not yet activated). As of August 2004, 1,371 single parents and 327 employers of single parents had received grants and 3,386 eligible single parents had attended courses offered by the Vocational Training Division—most in regular Division courses and some in courses sponsored specially by the program. About 600 children of single parents were enrolled at reduced rates in care facilities inspected by the Ministry of Industry, Trade, and Employment.

b. The plan to establish employment centers as recommended by the Tamir Committee (the "Wisconsin Plan") is designed to bring income-maintenance recipients back to work. The number of recipients fell short of the 2003 average due to the toughening of benefit eligibility rules in 2003. A tender for the establishment of four employment centers was published in July.

c. A plan to stimulate employment by means of a negative income tax exists but has not yet been implemented. An interministerial team has been established to look into the matter.

The problem of back pay owed to some municipal employees continued to fester during the period reviewed.<sup>4</sup> Employees in several localities had been unpaid for more than a year and those in other locations had not received wages for several months. The problem originated in cutbacks in the "balancing grant" and an across-the-board cutback in transfers from central government for education, health, and welfare, which plunged the authorities into budget deficits. After an extensive strike in general government in September, it was agreed that most employees would receive their back wages at once and that the rest (mainly in a group of municipal authorities that had been especially mismanaged and that refused to prepare recovery plans) would be paid by the end of October. By the end of October, almost all authorities had cleared their wage debts, at least in respect to the basic current wage, excluding social benefits and severance-pay provisions. (See box in the "General Government" section.)

At the beginning of September 2004, three actuarially balanced Histadrut-owned pension funds (established after 1995)—New Mivtahim, New Makefet, and Meitavit—were sold to private entities. The proceeds, totaling NIS 1.05 billion, will be used to draw down the

<sup>4</sup> According to the Center for Local Government, 13,000 employees of municipal authorities and 7,000 employees of religious councils, employed in fifty-two municipalities, did not receive any or part of their wages in the period reviewed.

Table 4. Balance of Payments, Foreign Trade, and the Reserves,<sup>a</sup> 2003–2004

	2003	2003		2004			Apr–Sep 2004 <sup>b</sup>	Last month for which data available
		III	IV	I	II	III		
percent change from previous period								
Goods imports	0.02	1.57	4.36	9.59	4.08	-2.21	18.63	Sep
of which: Consumer goods	-2.33	5.43	2.68	9.79	-3.00	-0.96	11.69	Sep
Capital goods	-4.93	-4.28	0.30	11.92	3.82	0.27	14.15	Sep
Intermediates	2.93	2.81	6.56	8.67	6.42	-3.52	22.73	Sep
Goods exports	7.38	0.25	7.55	12.26	2.36	-5.31	20.45	Sep
of which: Manufacturing	7.00	0.26	7.58	11.38	3.22	-5.00	20.74	Sep
of which: High-tech	2.59	3.32	6.01	13.89	2.08	0.90	25.82	Sep
quarterly averages, \$ million								
Trade deficit	199	262	221	196	238	295		Sep
Current account, net	98	-228	52	53	163			Jun
Financial account (excl. foreign exchange reserves) <sup>c</sup>	-154	1,168	-8	-1,673	-922			Jun
Nonresidents' direct investment <sup>c</sup>	918	530	719	579	624			Jun
Nonresidents' portfolio investment <sup>c</sup>	573	1,064	1,555	2,378	934			Jun
Residents' direct and portfolio investment abroad <sup>c</sup>	879	512	2,226	3,286	441			Jun
Net foreign debt (percent of GDP) <sup>c</sup>	-4.33	-4.7	-4.35	-7.02	-8.04			Jun
Bank of Israel reserves, end-period <sup>c</sup>	25,788	24,767	25,788	26,162	25,712	25,840		Sep

<sup>a</sup> Seasonally adjusted. Foreign trade data do not include ships, aircraft, diamonds, or fuel.

<sup>b</sup> Compared with April–September 2003.

<sup>c</sup> Unadjusted data.

SOURCE: Central Bureau of Statistics.

deficits of the old pension funds. This marks the conclusion of another phase in the pension-industry reform that began a year ago. In this phase, special managers were appointed for the funds, a pension law was enacted, and all funds were required to adopt a standard set of rules.

## The Balance of Payments

Despite the exit from the recession, the current-account surplus has remained at roughly the 2003 level because the growth is being driven by exports and not by consumption. The current-account surplus was \$0.2 billion in 2004:II (Table 4), similar to the year-earlier quarter. By using the savings and investment account to analyze the current-account deficit in the first half of 2004 as against the year-earlier period, we find that the deficit and the levels of investments and savings resemble those of the year-earlier period. The deficits on goods and services account and the surplus in current transfers narrowed. The deficit on factor-input income account widened slightly relative to the year-earlier quarter.

The trade deficit was higher during the period reviewed than it had been a year earlier (Table 4 and Figure 7). The distribution of trade during the period reviewed as against 2003 (percentages) showed stability with European Union countries, a slight decrease with the United States, and an increase with Asia.<sup>5</sup>

Nondiamond exports of goods surged during the period reviewed relative to the year-earlier period. manufacturing exports increased at all levels of technology intensity, riding upturns in global growth and export prices that began in the third quarter of 2003. Most of the increase traced to high-tech manufacturing exports, which expanded pursuant to the uptrend that began in the third quarter of 2003.

Exports contracted in 2004:III, evidently due to the slackening of global growth and the lengthy port strike. The uptrend in high-tech exports leveled off. The

<sup>5</sup> Data on the distribution of exports and imports should be treated cautiously because some exports and imports are transacted via go-between countries and not in accordance with final destinations.

Table 5. Government Budget Performance vis-à-vis Deficit Target, 2003–2004

	2003	2003		2004			Apr–Sep 2004 <sup>a</sup>	Last month for which data available
		III	IV	I	II	III		
Domestic deficit as percent of GDP	1.9	1.1	2.1	0.3	1.4	0.6	2.7	Sep
	deviation from path <sup>b</sup> (NIS billion)							
Government revenue	–3.9	–5.0	–2.7	0.5	–2.5	2.3	6.1	Sep
Government expenditure	–5.1	–2.5	–2.9	0.1	–2.2	3.2	–2.9	Sep
Domestic deficit	1.3	–2.5	0.2	0.4	–0.3	0.7	–57.3	Sep
Total government deficit (excl. credit extended)	–18.7	–5.4	–8.0	0.1	–7.4	–3.1	–42.7	Sep
	percent change from previous period							
Government tax revenue	–1.8	–2.1	1.1	8.7	4.9	1.5	3.6	Aug
of which: Income tax, net	–8.2	–4.3	–2.3	11.6	2.7	–3.2	–0.1	Aug
VAT, gross	2.3	–0.8	2.3	3.4	6.1	4.1	5.1	Sep
Government expenditure	2.6	2.4	–0.6	–2.2	–5.2	–4.5	–4.9	Sep
National Insurance allowances	–5.1	–3.7	–11.2	–6.5	–7.6	–6.9	–7.9	Jul
of which: Unemployment benefit	–31.3	–24.8	–25.9	–7.8	–16.2	–20.1	–17.0	Jul
Income support	–18.9	–20.2	–25.8	–15.9	–19.8	–3.0	–16.3	Jul
National Insurance contributions received from public	3.4	–0.4	–4.4	2.7	0.0	1.1	–0.1	Aug

<sup>a</sup> Compared with April–September 2003.

<sup>b</sup> The path was determined on the basis of a deficit of 3 percent of GDP in 2003, and 4 percent of GDP in 2004.

SOURCE: Ministry of Finance.

slowdown in this regard is compatible with the trend in volumes of trade between Israel and its trading partners (as shown in Figure 8).

Imports of goods (excluding diamonds, fuel, ships, and aircraft) increased considerably between the year-earlier period and the period reviewed. Growth was evident in all types of imports: raw materials, capital goods, and goods for current consumption. The increases in raw-materials and capital-goods imports were reflected in an upturn in the industrial output index; the upturn in imports of current-consumption goods was manifested in more vigorous consumption. Imports of goods declined in 2004:III as capital-goods imports leveled off and raw-materials imports contracted, indicating expectations of a growth slowdown in the third and fourth quarters.

The terms of trade worsened in 2004:II—after three quarters of improvement—due to the upturn in energy prices. In contrast, the terms-of-trade index (excluding ships, aircraft, diamonds, and energy) rose by 0.3 percent. Export prices rose at all levels of technology intensity, mainly in high-tech but also in traditional and mixed, and were 7.6 percent higher in 2004:II than on 2003 average. Import prices were 5.8 percent higher, mostly due to increases in the prices of energy and factor inputs.

Imports and exports of services were at similar levels to each other in 2004:II as in the previous two quarters. Increases in exports of software, R&D, and inbound tourism services were balanced by a considerable upturn in imports of tourism services. The vigorous expansion in exports of software and R&D services,<sup>6</sup> relative to the year-earlier quarter, traced to the increase in global growth; the growth of tourism services exports was due to improved domestic security. Imports of services increased over the year-earlier quarter mainly due to a strong upturn in imports of tourism services that evidently reflects the domestic economic improvement and an increase in the prices of domestic tourism services relative to the 2003 average.

Resident external investments increased in the first half of 2004 relative to 2003. Portfolio investments expanded due to vigorous investment in shares and bonds in 2004:I. Resident investments in foreign shares declined in the second quarter, despite the reform that would equalize

<sup>6</sup> We do not have a breakdown of exports of software and R&D services, which are included in “other services.” We believe that software and R&D account for most of the increase in exports of “other services.”

the rates of taxation on foreign and Israeli shares, and did so perceptibly in July–August relative to May–June. Despite low real short-term and long-term interest rates in the second and third quarters and rate increases in the US, resident investments in foreign bonds continued to decline steeply, evidently because investors were able to earn higher yields in Israel relative to the dollar interest rate. Direct external investments of the nonbanking private sector surpassed the 2003 average in January–July 2004 due to one large acquisition—of Sicor, Ltd., by Teva Pharmaceuticals, Ltd.)—in January 2004.

Foreign investment increased in the first half of 2004 as against 2003 (Table 4 and Figure 9). Investments in emerging-market economies (among which Israel is included) expanded in 2003 and continued to climb this year. The increase in Israel was composed entirely of portfolio investment, as foreign direct investment fell from \$0.92 billion on quarterly average in 2003 to only \$0.6 billion per quarter during the period reviewed.

Foreign reserves were \$25.8 billion at the end of the period reviewed, down 1.2 percent from the beginning of the period. The surplus external debt increased by 8 percent of GDP, in continuation of the trend observed in previous quarters.

## General Government

Pursuant to the 2003 economic recovery plan that aimed to reduce government expenditure, measures were taken during the period reviewed to stimulate employment and demand by lowering the tax burden. Taxes on low- and middle-income earners were reduced and the program to induce single parents to join the labor force remained in effect. The 2005 budget, passed by the Government, continues to reflect the policy of reducing expenditure

and taxes and is compatible with the goal of meeting the deficit target. There is some uncertainty, however, about whether the Knesset will pass the budget. Although the debt/GDP ratio rose during the period reviewed, Israel's risk premium remained low.

In view of economic growth in January–March and the increase in tax revenues, the Government decided to lower the rate of Value Added Tax by 1 percentage point in March and to cut personal and corporate income-tax rates in July. The improvement in activity, especially in the first quarter, offset the effects of the tax cuts<sup>7</sup> on tax revenues, so that total tax revenues after the cuts fell only slightly short of the original revenue forecast. With this in mind and in view of budget expenditure in the first nine months of the year, the deficit target of 4 percent of GDP is expected to be attained. The **domestic deficit**<sup>8</sup> (not including issue of credit) was NIS 8.1 billion in January–September 2004 as against NIS 19.3 billion in January–September 2003 (and an average of NIS 8.1 billion in 2001 and 2002, when the deficit was 4 percent of GDP).

**Government expenditure** since the beginning of the year was NIS 6.5 billion smaller than the level that would represent full performance of the expenditure side of the budget. Spending began to decrease in 2003:IV and continued to do so in the first nine months of 2004, especially in the second quarter (Table 5). The underperformance of government expenditure was reflected, among other things, in paltry transfers to municipal authorities, where continuing payroll default resulted in manifestations that included a strike in early September (see box 2).

<sup>7</sup> See the table of events at the end of this survey.

<sup>8</sup> The domestic deficit is the parameter chosen for examination due to the seasonal volatility of the external deficit.

## BOX 2

### Balancing Grants and the Municipal Government Crisis

The municipal authorities' financial crisis deepened during the period reviewed as many authorities tumbled into lengthy payroll default. According to reports presented to Labor Court by the Center for Local Government in October, at the behest of the Court, the authorities owed NIS 400 million in back wages at the end of August. (The Ministry of the Interior estimated the debt at a lower level.) In the middle of September, the Histadrut protested the arrears by declaring a wide-ranging strike, in the aftermath of which the Labor Court ruled that the Government should ensure the payment of most employees' back wages within one week of the day of its decision. The Court also stated that the remaining wage debt (mainly to employees of a group of particularly mismanaged municipal authorities that refused to prepare rehabilitation plans) should be paid

## Ministry of the Interior Grants to Local Authorities

	2002	2003	2004	
	Actual	Actual	Original budget <sup>a</sup>	Amended budget <sup>b</sup>
	(NIS million, current prices)			
Total general grants to local authorities	4,338	3,583	2,411	3,549
Balancing grants	4,082	3,364	2,186	3,314
of which: Recovery programs	337	270	215	682
Balancing grants not part of recovery programs	3,745	3,094	1,971	2,632

<sup>a</sup> Before the additions and across-the-board cut decided upon by the government in February 2004.

<sup>b</sup> Including the additions and across-the-board cut decided upon by the government in February 2004.

SOURCE: Ministry of Finance.

off by the end of October. Finally, it was decided that the Histadrut would participate in negotiations with municipal authorities and government ministries toward an agreement for the implementation of municipal rehabilitation plans that would set local finances on stable footing. In early 2004, the Government decided to provide much of the funding for the rehabilitation plans from its budget.

The financial deterioration of many municipal authorities, especially those populated by socioeconomically weak groups, began in the middle of 2003 when the Government suddenly slashed the “balancing grants” that it forwards to municipal authorities. Later, the Government and the Knesset reduced the balancing grants by another NIS 1.2 billion in the 2004 budget, leaving the grants 44 percent smaller than their 2002 level (Table 1). The cutbacks dealt an especially severe blow to authorities that rank low on the Central Bureau of Statistics’ scale of socioeconomic clusters (1–3), since balancing grants account for about one-fourth of these authorities’ revenues as against less than 4 percent of revenues of authorities in the five highest clusters. After the 2004 budget was approved, the Government acknowledged that the cutback had been too deep and decided (in February 2004) to restore the balancing-grant budget to its 2003 level (i.e., after the first round of cutbacks). However, only NIS 660 million was restored to the budget line for current balancing grants, leaving these grants 30 percent smaller than the sum disbursed in 2002. The remainder—NIS 470 million—was transferred to a budget line for “recovery plans” and is released only to municipal authorities that adopt a budget-adjustment plan approved by the ministries of the Interior and Finance and use the money to pay for it.

By tracking budget performance during 2004, we find that—beyond the steep cutback in the balancing grants—actual transfers from the government budget to municipal authorities were even smaller than the reduced sum worked out in February (Table 1). As of September 13, 2004—after about two-thirds of the budget year had passed—the Government had forwarded only NIS 1.2 billion to municipal authorities in balancing grants that were not linked to recovery plans, only 46 percent of the sum budgeted in this line. As Table 2 also shows, the sum transferred was slightly less than two-thirds of the original sum budgeted at the beginning of the year, not including the increases that the Government decided to give in February. Furthermore, the transfer of the two-thirds of the total balancing-grant budget that had not been contingent on the recovery plans would have increased the transfers to municipal authorities by NIS 470 million by the

## Actual Transfer of Balancing Grants to Local Authorities up to 13 September 2004

	NIS million	Percentage of original budget	Percentage of amended budget
Total balancing grants	1,427	65.3	43.1
of which: Recovery programs	214	99.7	31.5
Balancing grants not part of recovery programs	1,213	63.7	46.0

SOURCE: Based on Ministry of Finance data.

beginning of September—a sum greater than the total cumulative wage debt to that time. Finally, Table 2 shows that total transfers on account of recovery plans resembled the sum initially budgeted, before the Government decision, whereas comparing the transfers on this line with the budget *including* the increases approved in February points to a low rate of execution.

Payouts of National Insurance benefits continued to decline significantly during the period reviewed. Unemployment-compensation expenditure decreased by 17 percent relative to the year-earlier period even though the number of jobless increased. This is the result of legislative changes, tougher enforcement, and the increase in the depth of unemployment, which made more and more jobless persons ineligible for unemployment compensation. Income-maintenance benefits also continued to decline relative to the year-earlier period, although the rate of decrease slowed markedly in 2004:III because of the cutback in benefits in June 2003.

**Government tax revenues** surged in 2004:I relative to the year-earlier quarter but slackened in the second and third quarters. Most of the decline was in income tax, evidently due to legislative changes and, in particular, the tax cut for low- and medium-income earners that went into effect at the beginning of the third quarter. Additionally, the number of employees earning less than half the national average wage and paying little income tax due to their low marginal rates increased significantly, and the number of employees earning more than half of the national average wage declined perceptibly. VAT revenues, which usually march in tandem with private consumption, were relatively low in 2004:I relative to the year-earlier quarter due to the reversion of the VAT rate to 17 percent in March 2003.

According to Research Department estimates, the Government will probably meet its 2004 deficit target but the revenue outlook in the 2005 budget is overoptimistic in the sum of NIS 4 billion. However, since an NIS 2 billion underperformance of the external budget is expected in 2004, a reserve exists—for the time being—that can be applied toward the deficit target. Thus, if the budget as presented by the Government is approved, the Government will probably be able to meet the 2005 deficit target of 3 percent as against 4 percent this year. This calculation does not take account of disengagement expenditure. The public debt/GDP ratio is expected to rise in 2004 and level off in 2005. The decline in Israel's risk premium in the second and third quarters of 2003 far exceeded the average decrease in emerging-market economies. Since then, the premium has remained at this low rate in view of the continuing

decline in the domestic deficit/GDP ratio in 2004:III (Figure 9) and the belief that the Government will narrow its debt/GDP ratio by continuing to cut the deficit and meet its fiscal targets.

## Global Developments

The global economic recovery solidified during the period reviewed. In September, the IMF raised its 2004 global growth outlook to 5 percent<sup>9</sup> as against 3.9 percent in 2003 (Table 6). In view of the upturn in oil prices, global growth has been slackening since 2004:II, especially in the US, Japan, and China. The National Accounts data for the second quarter were mixed. The growth slowdown was evidently manifested in the third-quarter decline in global stock indexes; the NASDAQ index, for example, fell by 7.3 percent.

Global growth stimulated demand for (unprocessed) goods and, in turn, led to an increase in their prices. Oil prices climbed steeply due to a combination of stronger demand, especially starting in 2004:II, and supply problems in some oil-exporting countries.

The US has continued to lead the growth process in advanced countries. According to the IMF outlook, the advanced countries will grow in 2004 by 3.6 percent and the US by 4.3 percent. Growth in the US was based on rising labor productivity despite a 0.75 percentage point rise in the interest rate due to an increase in inflation pressures, but interest remained low nonetheless. In the second quarter, US growth was only 3 percent, short of expectations, and the increase in employment slowed.

The European Union achieved a growth rate of only 0.4 percent in 2003 but launched a recovery in 2004:I that gathered momentum in 2004:II. The EU growth outlook, however, remains relatively sluggish due to the EU's dependency on external demand. Demand within the EU, foremost in Germany, remained relatively weak. Emerging-market economies and developing countries continued to recover impressively despite the upturn in oil prices. In China and India, this also occurred due to IT improvement.

<sup>9</sup> IMF *World Economic Outlook*, September 2004.

Table 6. Indicators of Economic Development in Advanced and Developing Countries,<sup>a</sup> and Forecast for 2005<sup>b</sup>

	2002	2003	2004 Estimate	2005 Forecast
World GDP	3.0	3.9	5.0	4.3
Advanced countries	1.6	2.1	3.6	2.9
Developing countries	4.8	6.1	6.6	5.9
World trade	3.3	5.1	8.8	7.2
Advanced countries				
Imports	2.6	3.7	7.6	5.6
Exports	2.2	2.6	8.1	6.3
Developing countries				
Imports	6.0	11.1	12.8	11.9
Exports	6.6	10.9	10.8	10.6
Inflation (CPI)				
Advanced countries	1.5	1.8	2.1	2.1
Developing countries	6.0	6.1	6.0	5.5
Prices of unprocessed goods (US\$)				
Oil <sup>c</sup>	2.5	15.8	28.9	
Other	0.6	7.1	16.8	-3.9
Short-term interest <sup>d</sup> (%)				
Dollar deposits	1.9	1.2	1.6	3.4
Euro deposits	3.3	2.4	2.4	3.1
Unemployment rate in advanced countries	6.4	6.6	6.3	6.1

<sup>a</sup> According to "World Economic Outlook," Israel is classified as an advanced country.

<sup>b</sup> Annual rate of change, percent, except for unemployment and interest rates.

<sup>c</sup> Average price per barrel in 2003 was \$28.89.

<sup>d</sup> Six-month Libor rate.

SOURCE: "World Economic Outlook" (IMF), September 2004.

## Prices, Monetary Policy, and Financial Capital Markets

The Consumer Price Index rose by 1.3 percent during the period reviewed<sup>10</sup> (Table 7 and Figure 10) and "core inflation"—the CPI net of housing and seasonal and price-

controlled components—was 1.9 percent. The CPI increase was not spread evenly across the two quarters; a 1.5 percent increase in 2004:II, due to the April CPI, was followed by a 0.2 percent dip in 2004:III. Core inflation was 1.8 percent in the second quarter and 0.2 percent in the third. The second-quarter increase focused on tradable goods and was evidently precipitated by appreciation of the dollar and the five-currency basket against the NIS in 2004:I and seasonal increases in clothing and footwear. Prices of electricity and fuel for transport increased due to surge in global oil prices. In the third quarter, the CPI declined due to (1) a seasonal

<sup>10</sup> In this chapter, rates of change are not in annual terms unless explicitly stated as being such.

Table 7. Selected Price Indices,<sup>a</sup> 2003–2004

	2003	2003		2004			Apr–Sep 2004	Last month for which data available
		III	IV	I	II	III		
CPI	–1.9	–3.9	–1.6	–0.4	6.2	–0.8	2.6	Sep
CPI excl. housing, fruit and vegetables	–0.6	–5.0	–0.8	0.0	8.5	–1.9	3.2	Sep
CPI excl. housing, fruit and vegetables, price-controlled goods, clothing and footwear	–0.4	–1.0	–4.2	2.6	7.2	0.7	3.9	Sep
Index of housing prices	–6.7	5.3	–5.8	0.0	5.8	0.4	3.1	Sep
Wholesale price index	3.3	2.3	4.9	9.2	11.1	2.4	6.7	Sep
NIS/\$ exchange rate	–6.4	8.2	–6.3	10.4	1.2	–1.7	–0.3	Sep
NIS/currency-basket rate	–0.5	3.6	7.3	11.5	–0.5	–1.7	–1.1	Sep

<sup>a</sup> Annual rates of change during period, compared with previous period, percent.

SOURCE: Central Bureau of Statistics.

downturn in clothing and footwear prices and (2) a gentle increase in the prices of nontradable goods.

Oil prices soared by 53 percent between the beginning of 2004 and the end of the third quarter and by 37 percent during the period reviewed. Data processing by the Research Department shows that this factor contributed about 1 percentage point to the CPI increase during the year and 0.7 percentage point during the period reviewed.

Gross inflation expectations to twelve months ahead, as derived from the capital market, were 1.85 percent during the period reviewed, within the inflation target range. In June–July, expectations fell to 1.4 percent on average—evidently due to low CPIs and appreciation of the dollar and the currency basket—and returned to the middle of the inflation target range in August and September. Expectations to lengthier terms of up to three years were also within the target; the average level of expectations to longer terms still exceeds the target.

Price stability was abetted by the absence of tension in the forex market in view of the credibility of fiscal policy and the restoration of budget discipline during 2003. Due to the output gap (the gap between potential and actual GDP), the increase in activity was not accompanied by inflation pressure. The restoration of budget discipline, coupled by a decline in the perception of risk in regard to the government debt, was reflected in market stability and a decline in government bond yields during 2003. The average yield to maturity of a ten-year indexed bond fell from 4.8 percent in 2003 to 3.9 percent in 2004:I and 3.8 percent in 2004:III (Table 9). During the period

reviewed, the real yield curve for 5–9-year government bonds declined gently and steadily due to the decline in short-term yields (Figure 14).

In view of the market stability and the leveling off of long-term yields after a decline, the Bank of Israel has left the key rate at a low 4.1 percent since April, even though the US federal funds rate was raised by 0.75 percentage points in July–September, narrowing the US–Israel interest spread to a mere 2.35 percentage points in September. It is believed that low interest at this time is consistent with the maintenance of price stability.

The yield to maturity of Treasury bills leveled off in tandem with the end of the rate-cutting process at the end of 2004:I. In the second quarter, the public expressed its expectations of a rate increase by means of relatively high yields to maturity of Treasury bills to a term of more than half a year and relatively low yields to maturity on shorter-term Treasury bills. The Treasury-bill curve flattened out somewhat in the third quarter, indicating that the public now expected a gentler rate hike, spread over a longer term, than it had expected in the second quarter (Figure 14).

The share of liquid assets increased perceptibly during the period reviewed (Table 8) as money supply (the M1 aggregate) expanded by 23.5 percent in current annual terms. This rate of increase, the highest observed in recent years, traces to the low nominal interest rate and the economic recovery. The imposition of capital-gains tax made investment less advantageous and contributed to the faster growth of M1 than of M2, which includes deposits (Figure 12).

**Table 8. Monetary Aggregates and Nondirected Bank Credit<sup>a</sup>, 2003–2004**  
(annual terms, percent)

	2003 Average	2003		2004			Cumulative change over previous 12 months	Apr–Sep 2004	Last month for which data available
		III	IV	I	II	III			
Rates of change		Change from preceding quarter						During period	
M1 <sup>b</sup>	0.5	9.7	10.5	32.1	24.2	21.6	22.8	23.5	Sep
M2 <sup>c</sup>	1.7	6.0	8.4	3.6	–0.4	7.0	4.2	6.5	Sep
M3 <sup>d</sup>	2.2	3.2	5.0	7.0	4.2	4.9	4.9	6.1	Sep
Nondirected bank credit	1.7	–3.7	0.1	7.4	1.8	–1.8	1.6	–0.4	Sep
Unindexed local-currency credit	7.1	3.0	–1.6	8.5	7.0	3.7	5.7	5.1	Sep
CPI-indexed credit	–1.1	–7.8	–5.1	16.4	–3.4	–4.1	0.3	–4.0	Sep
Credit in and indexed to foreign currency	–0.9	–6.4	10.5	–5.7	2.5	–6.1	–2.0	–2.7	Sep

<sup>a</sup> Some of the data for 2004:III are based on preliminary figures.

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

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

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

SOURCE: Bank of Israel.

**Table 9. Interest Rates, Yields, and the Share-Price Index, 2003–2004**  
(percent)

	2003	2003		2004			Apr–Sep 2004 average	Last month for which data available
		III	IV	I	II	III		
Nominal interest								
Marginal interest on monetary loan	7.8	7.3	5.8	4.6	4.2	4.2	4.2	Sep
SRO deposits	6.2	5.7	4.4	3.4	3.1	3.1	3.1	Jul
Nondirected local-currency credit	10.6	10.2	8.9	7.9	7.4	7.3	7.4	Jul
3-month Eurodollar	1.1	1.0	1.0	1.0	1.2	1.6	1.4	Sep
Yield to maturity on:								
Treasury bills	7.0	6.5	5.4	4.8	5.0	4.8	4.9	Sep
Real yield on 10-year bonds	4.8	4.6	4.2	4.1	4.3	4.3	4.3	Sep
Real yield on 5-year bonds	4.9	4.5	4.2	3.8	3.9	3.8	3.8	Sep
Expected inflation (gross)	2.7	2.7	2.2	1.8	2.2	2.2	2.2	Sep
General Share-Price Index (change)	55.7	–3.5	18.2	9.2	5.8	–9.7	–4.5	Sep

SOURCE: Bank of Israel.

Table 10. Borrowing by Households and Businesses, 2003 and 2004  
(NIS billion)

	2003		2004	
	Jan-Jun	Jul-Dec	Jan-Jun	III
Credit from banks in Israel <sup>a</sup>	-3.6	4.3	7.2	-4.9
Direct credit from abroad <sup>b</sup>	-4.4	1.7	6.1	0.4
Capital raised on the stock exchange (shares and convertible bonds) <sup>c</sup>	0.8	2.6	5.2	1.0
Capital raised via bonds on the Tel Aviv Stock Exchange <sup>c</sup>	5.3	5.0	13.0	
Venture capital <sup>d</sup>	2.2	2.3	3.0	2.0
Capital raised on stock exchanges abroad <sup>e</sup>	0.7	3.8	9.5	2.4
Total	1.0	19.7	44.0	

<sup>a</sup> Bank of Israel data. Credit is calculated as the difference between credit balances at two points in time. Does not include credit given by mortgage bonds.

<sup>b</sup> Credit is calculated as the difference between credit balances at two points in time.

<sup>c</sup> From the table "Capital Raised by Type of Security, 1993–2004", Tel Aviv Stock Exchange. The data include issues of shares, options and convertible bonds, but do not include basket certificates, which do not constitute a source of financing for companies activities. Capital raised via bonds does not include structured bond issues, and is based on an estimate for 2004:II. Data for 2004:III are not yet available.

<sup>d</sup> Israel Venture Association (IVA) and publications of the Israel Venture Capital (IVC) Research Center.

<sup>e</sup> Data from the Foreign Exchange Activity Department, Bank of Israel.

Households and firms acquired sources vigorously during the period reviewed due to a perceptible uptrend in nonbanking credit. Sources of finance increased by NIS 19.7 billion in the second half of 2003 and by another NIS 44 billion in the first half of 2004 (see Table 12). There was a salient increase in capital and bond issues on the Tel Aviv Stock Exchange and abroad in the first half of 2004 and, in the main, in the first quarter. Concurrently, firms' financing difficulties, as measured by the Bank of Israel Survey of Companies, diminished. All types of companies, from small establishments (employing fewer than twenty workers) up to medium and large enterprises (employing more than 100 workers), found it much easier to solve their financing problems from 2003:II on.

**The General Share Price Index** declined by 4.3 percent during the period reviewed, slightly less than the decrease in the NASDAQ index (4.9 percent). The index behaved unevenly, rising by 5.8 percent 2004:II and losing 9.6 percent in 2004:III amidst a sizable increase in trading volumes. The third-quarter decrease evidently reflects a slackening of growth expectations. The Tel-Tech index, which among other things also reflects expectations of growth in IT, lost 8.6 percent during this time after a considerable increase in 2003. This may reflect the slowing of IT growth in view of falling expectations in regard to global growth.

## Events in January–September 2004

Month	Date	Event	Details
<b>January</b>	1	Income-tax brackets and credit points are adjusted downward.	By 1.95 percent, as part of an annual adjustment.
	5	The Finance Ministry and the Histadrut conclude an accord that brings 100 days of disruptions in general government to an end.	The accord includes the following decisions: <ul style="list-style-type: none"> <li>a. No unilateral layoffs in general government in 2004.</li> <li>b. Deferral or repeal of several structural changes in public administration that were proposed by the Finance Ministry.</li> <li>c. Revision of some principles of the rescue plan for old pension funds.</li> </ul>
	7	The state budget is approved at NIS 255 billion.	
	8	The Knesset passes retirement-age legislation.	The retirement age will be raised gradually by 4 months per year until it reaches 64 for women and 67 for men.
	25	The state's holdings in Zim, Ltd., are sold.	For NIS 125 million.
<b>February</b>	1	Changes in child allowances, set forth by the 2003 economic plan,	<ul style="list-style-type: none"> <li>a. The allowance is cut by NIS 24 per child.</li> <li>b. A mechanism to reduce the allowance for children born before June 1, 2003 is established.</li> <li>c. The benefit for each child born after June 1, 2003 is set at a flat rate of NIS 144.</li> </ul>
	1–18	Municipal authorities are shut down due to failure to pay wages. (The 15 largest authorities do not take part in the strike.)	Under the agreement signed on Feb. 18, the blow to municipal authorities is eased and some of the cutback in balancing grants is repealed.
	11	A 1 percentage point reduction of VAT, to go into effect on March 1, is announced, and purchase taxes on some electrical appliances are lowered at once.	For example, taxes on refrigerators are reduced by NIS 900, on home ovens by NIS 400, on washing machines by NIS 360, and on TV sets by NIS 500.
	25	The Government approves NIS 4.5 billion in budget adjustments.	
	25	An agreement for the restructuring of Mekorot, Ltd., is signed.	Water-delivery services (monopolistic) are separated from operations in competitive fields.
<b>March</b>	1	The tax cuts announced in February go into effect.	<ul style="list-style-type: none"> <li>a. VAT is reduced from 18 percent to 17 percent.</li> <li>b. Controlled prices of milk and eggs are reduced by 1 percent.</li> <li>c. Customs on basic foods are abolished.</li> </ul>
<b>April</b>	4	Finance Ministry announces a series of tax changes.	<ul style="list-style-type: none"> <li>a. Corporate tax will be lowered from 36 percent to 30 percent over the next 5 years.</li> <li>b. Taxation of low- and medium-income earners will be reduced and the NIS 7,500–NIS 11,040 tax bracket (monthly gross wage) will be raised.</li> <li>c. Purchase tax on construction inputs will be abolished.</li> </ul>

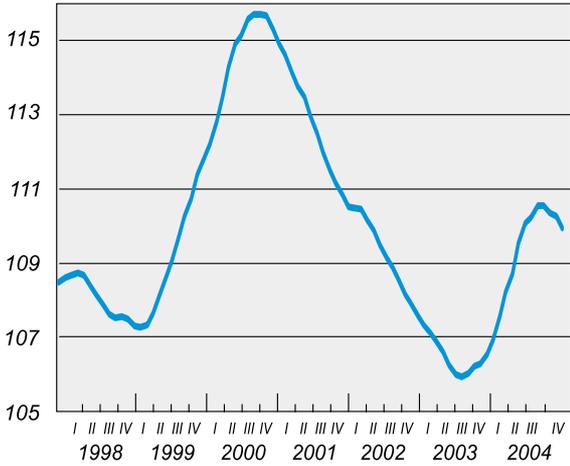
Month	Date	Event	Details
<b>April</b>	4	The Ministerial Committee for Social and Economic Affairs approves amendments to the Encouragement of Capital Investments Law.	<ul style="list-style-type: none"> <li>a. Responsibility for the tax-benefit track will be handed over to the Income Tax authorities.</li> <li>b. Two tax-benefit tracks are added: for investments in National Priority Areas and for large investments.</li> <li>c. A criterion is added in the grants track: recipient firms must make at least 25 percent of their sales as exports.</li> </ul>
	15	The Ministerial Committee for Legislation approves a draft amendment to the labor disputes law that limits the right to strike.	
<b>May</b>	4	Regulations concerning the modus operandi of the railroad corporation in development, land, and subsidization are set forth..	<ul style="list-style-type: none"> <li>a. According to the agreement, development expenditure will be performed from the budget. The budget expenditure in 2004 is estimated at NIS 1.9 billion.</li> </ul>
<b>June</b>	29	The Knesset approves the Minister of Finance's proposal to lower personal income-tax rates for low- and medium-income earners and to reduce the rate of corporate tax.	<ul style="list-style-type: none"> <li>a. Corporate tax will fall gradually from 36 percent to 30 percent over the next five years. The budget cost of each 1 percent cut is NIS 400 million per year.</li> <li>b. As of July 1, 2004, the tax on low- and medium-income earners will be lowered. The budget cost of these measures is NIS 1.3 billion per full tax year and half this amount in 2004.</li> <li>c. Purchase tax on construction inputs is abolished. The extension is to October 30, 2004.</li> </ul>
	30	The Encouragement of Capital Investments Law is extended in its current form.	
<b>July</b>	16	Moody's Investors Service raises the stability outlook of Israel's banking system from Negative to Stable.	
	25	The Government authorizes the entry of market makers in the bond market.	
<b>August</b>	1	The Credit Data Law goes into effect.	The purpose of the law is to give providers of credit more information and a picture of customers' credit history, thereby making it easier for them to decide whether and what terms to issue credit.
	4	The Knesset passes legislation that will gradually introduce competition in postal services starting in 2006.	By 2009, 70 percent of the market will be open to competition. The Postal Authority will become a government corporation.
	5	The port strike ends as the state and port labor conclude an agreement of principles.	
<b>Sept.</b>	2-3	In early September 2004, three Histadrut-owned pension funds	The proceeds (NIS 1.05 billion) will be used to draw down the deficits of the old pension funds.

## Events in January–September 2004 (cont.)

Month	Date	Event	Details
<b>Sept.</b>	2–3 (cont.)	(established after 1995)—New Mivtahim, New Makefet, and Meitavit—are sold to private entities.	This marks the conclusion of another phase in the pension-industry reform that began a year earlier. In this phase, special managers were appointed for the funds, a pension law was enacted, and all funds were required to adopt a standard set of rules.
	8	A report on the reform designed to enhance competition in the banking industry and the capital market is presented to the Minister of Finance, who will make it public shortly before the Government meeting where the proposed reforms will be debated.	
	21	A one-day general strike is declared due to municipal wage defaults.	Labor Court’s decision links wage payments to recovery plans and orders a end to the strike.
	22	A memorandum of understanding between the State and City Pass, Ltd., for financing of the Jerusalem light-rail system, is presented.	

דיאגרמה 1 Figure 1

המדד המשולב למצב המשק\*, 1998 עד 2004  
(מדד ממוצע 1994 = 100)  
State-of-the-economy index\*, 1998-2004  
(Average 1994=100)



\* מעודכן עד ספטמבר 2004. Updated to September 2004.

דיאגרמה 2 Figure 2

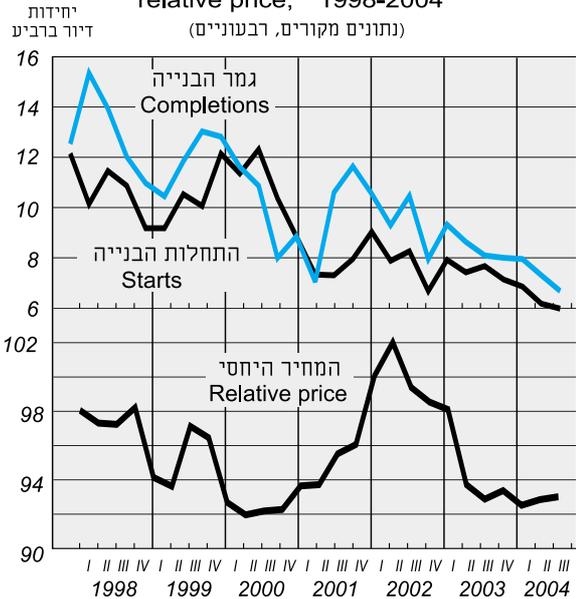
הייצור התעשייתי\* (מדד, ממוצע 1994=100) והמסחר  
הקמעוני המאורגן (מדד, ממוצע 2002=100),  
1998 עד 2004  
Manufacturing production\* (index, average  
1994=100) and large-scale retail trade  
(index, average 2002=100),  
1998-2004



\* Manufacturing production data updated to August 2004. הייצור התעשייתי מעודכן לאוגוסט 2004.

דיאגרמה 3 Figure 3

מספר ההתחלות וגמר הבנייה\* והמחיר היחסי  
של הדיוור\*\*, 1998 עד 2004  
Housing units: starts and completions,\* and  
relative price,\*\* 1998-2004

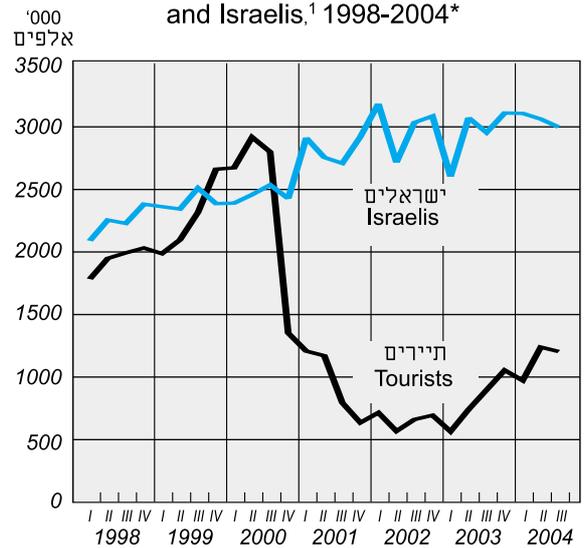


\* הנתונים מקוריים, מעודכן עד יולי 2004. Original data, updated to June 2004.

\*\* מעודכן לספטמבר 2004. במדד המחירים. \*\* Relative to CPI, updated to September 2004.

דיאגרמה 4 Figure 4

ענף המלונאות - לינות תיירים וישראלים<sup>1</sup>,  
1998 עד 2004\*  
The hotel industry: bed nights of tourists  
and Israelis,<sup>1</sup> 1998-2004\*

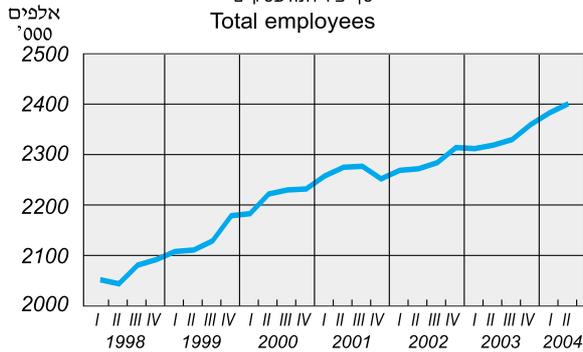


1) בניכוי עונתיות. \* מעודכן עד ספטמבר 2004. Seasonally adjusted. Updated to September 2004.

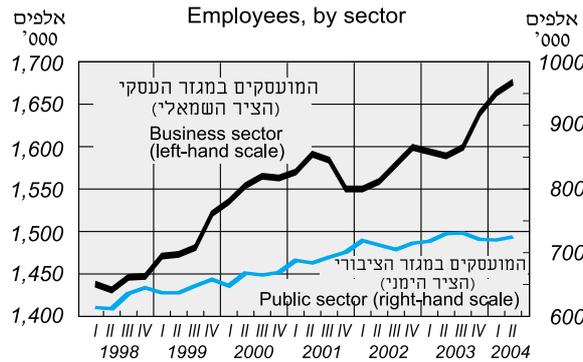
דיאגרמה 5 Figure 5

שוק העבודה<sup>1</sup>, 1998 עד 2004\*  
The Labor Market<sup>1</sup>, 1998-2004\*

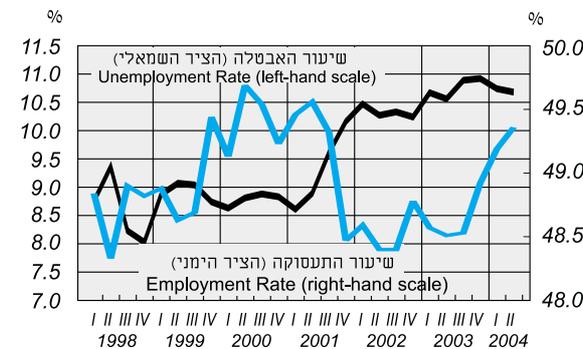
סך כל המועסקים  
Total employees



המועסקים במגזר העסקי והציבורי  
Employees, by sector



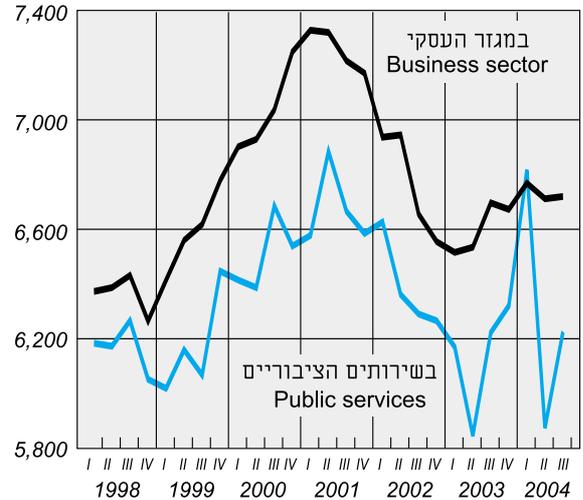
שיעורי האבטלה והתעסוקה  
Unemployment and employment rates



1) Seasonally adjusted. \* מעודכן ליוני 2004.  
\* מעודכן ליוני 2004.

דיאגרמה 6 Figure 6

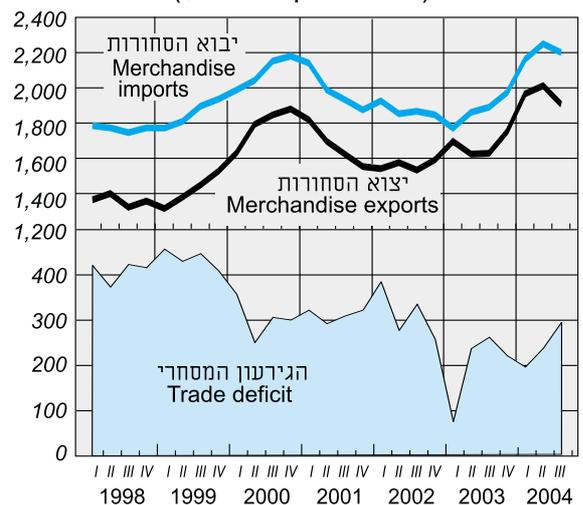
השכר הריאלי למשרת שכיר\*, 1998 עד 2004  
(ש"ח, במחירי 2001)  
Real wage per employee post\*, 1998-2004  
(NIS, 2001 prices)



\* מעודכן ליולי 2004.  
\* Updated to July 2004.  
בניכוי עונתיות. Seasonally adjusted.

דיאגרמה 7 Figure 7

סחר החוץ<sup>1</sup>, 1998 עד 2004\*  
(מיליוני דולרים לחודש)  
Foreign trade<sup>1</sup>, 1998-2004\*  
(\$ million per month)

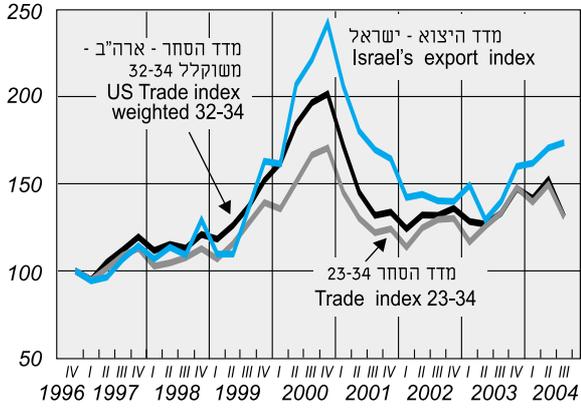


\* מעודכן לספטמבר 2004. \* Updated to September 2004.  
1) ללא אניות ומטוסים, יהלומים ודלק. (1) Excluding ships, aircraft, diamonds, and fuel.  
נתונים מנכ"י עונתיות. Seasonally adjusted.

דיאגרמה 8 Figure 8

היצוא מישראל\* והסחר של ארה"ב\* - רכיבים אלקטרוניים, ציוד תקשורת אלקטרוני, ציוד לבקרה ולפיקוח וציוד מדעי, 1996 עד 2004

Israel's exports\* and US Trade\* : electronic components, electronic communications equipment, and scientific and monitoring equipment, 1996-2004



\* Updated to September 2004. \* מעודכן לספטמבר 2004.

דיאגרמה 9 Figure 9

ההכנסות וההוצאות השוטפות של הממשלה, \*1998 עד 2004 (מיליארדי ש"ח, ממוצע חודשי נע של 12 חודשים, באחוזי תוצר)

Government cash flows, 1998-2004\* (NIS billion, 12-month moving average, percent of GDP)



\* Updated to September 2004. \* מעודכן לספטמבר 2004.

דיאגרמה 10 Figure 10

האינפלציה ב-12 החודשים האחרונים ויעד האינפלציה, \*1998 עד 2004

Inflation in previous 12 months and the inflation target, 1998-2004\*

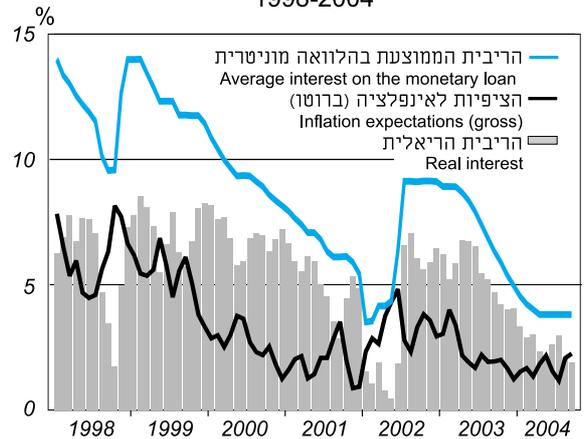


\* Updated to September 2004. \* מעודכן לספטמבר 2004.

דיאגרמה 11 Figure 11

הריבית והציפיות לאינפלציה, \*1998 עד 2004

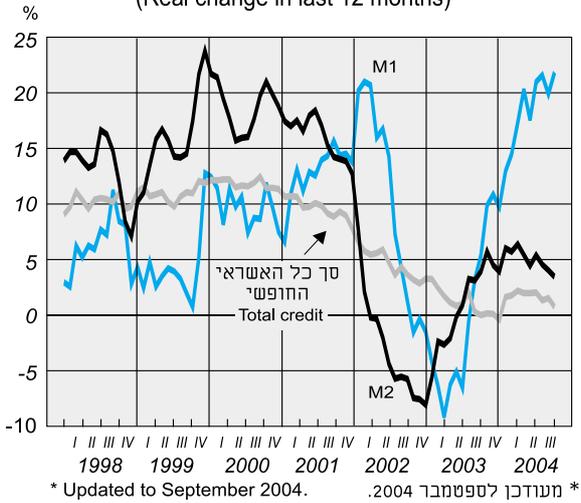
Interest and inflation expectations, 1998-2004\*



\* Updated to September 2004. \* מעודכן לספטמבר 2004.

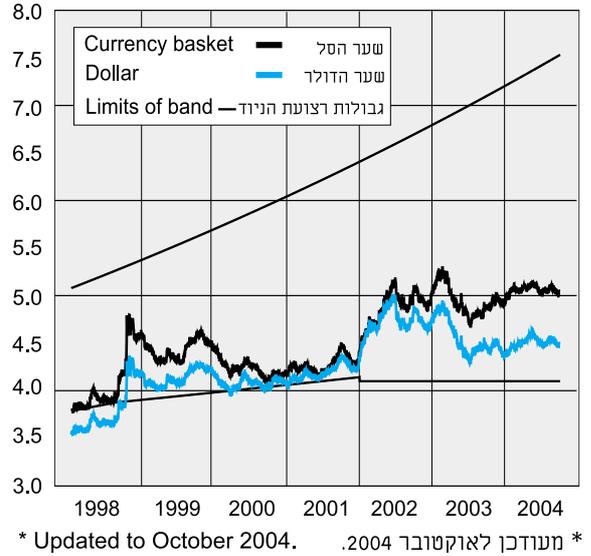
דיאגרמה Figure 12

המיצרפים הכספיים והאשראי, 1998 עד 2004\*  
(השינוי הריאלי ב-12 החודשים האחרונים)  
Monetary aggregates and credit, 1998-2004\*  
(Real change in last 12 months)



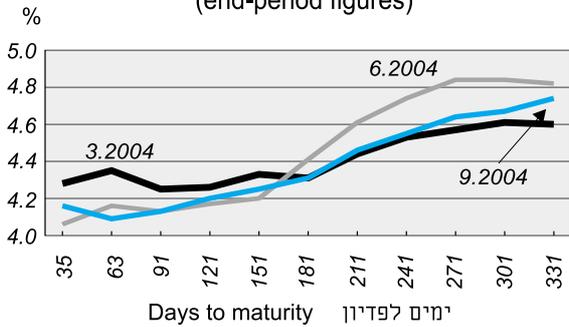
דיאגרמה Figure 13

שער החליפין של השקל לעומת סל המטבעות והדולר (ש"ח),  
1998 עד 2004\*  
The NIS exchange rate against the currency basket and the dollar,  
1998-2004\*



דיאגרמה Figure 14

עקום תשואות המק"ם, מארס עד ספטמבר 2004  
(נתונים לסוף תקופה)  
Yield on Treasury bills, March-September 2004  
(end-period figures)



עקום התשואות של איגרות החוב הצמודות למדד,  
מארס עד ספטמבר 2004  
(ברוטו, נתונים ממוצעים)  
Yield on CPI-indexed Treasury bonds,  
March-September 2004  
(gross, average figures)

