

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS

THE DOMINANT feature of 1972 was the sustained rapid expansion of the economy (the national product was up 10 percent in real terms), even though all reserves of idle factors of production had been fully tapped since 1970, and the accompanying excess demand for the domestic product. The excess demand led to inflationary trends, such as growing demand pressure in the labor market and the mounting of prices by 13–15 percent on an annual average, which came on top of a similar rise in 1971 and a slightly more moderate one in 1970.

The continued swelling of demand was fueled by the rapid monetary expansion; the latter resulted from the increased capital import—notably loans and unilateral transfers—which occurred despite the absorptive measures taken by the Government (through its budget) and the Bank of Israel. Nevertheless, it seems that the incremental liquidity of the economy was not reflected solely in the demand for goods and services, but was partly diverted to the share and real estate markets. Monetary expansion began to slacken during the second half of 1972, and this trend gained momentum in the early months of 1973. Despite this deceleration, the cumulative effect of the liquidity surpluses and the heightening of inflationary expectations (induced by the renegotiation of collective wage agreements in the second half of 1972 and the rise in import prices in the world markets) pushed the domestic price level up at an accelerated rate toward the end of 1972 and the beginning of 1973.

Total resource use expanded much more slowly in the year reviewed—by 6.7 percent as against 11.4 percent in 1971. This was due entirely to the stability of imports, which edged up only 1 percent at constant prices. The standstill in imports despite the expansion of the gross national product can be partly ascribed to special factors—namely the contraction of ship and aircraft acquisitions and of direct overseas defense procurements. Other contributory factors were the drawing-down of stocks of imported goods built up in previous years and some substitution of local for foreign products after the latter had become dearer because of the imposition of an import levy in August 1970, the devaluation of the Israeli pound in August 1971, and the rise in foreign prices.

Though the national product expanded at about the same rate as in 1971, there was a striking change in the destination of the product increment. In 1971 exports accounted for 43 percent of the additional GNP, public consumption for 16 percent, and private consumption and investment for some 20 percent each. In 1972 the weights of the last two uses increased considerably—that of private

Table I-1
MAIN ECONOMIC INDICATORS, 1961-72
(percent annual increase or decrease [-])

	Average 1961-65	1966	1967	1968	1969	1970	1971	1972
Resources and uses								
(at constant prices)								
Total domestic uses								
Gross national product ^a	10.5	-0.8	3.7	16.6	14.5	11.4	8.5	5.2
GNP per employed	10.0	1.4	2.5	14.7	12.0	8.3	10.2	10.3
Private consumption	5.0	2.0	7.2	4.7	7.1	5.5	5.2	3.5
Private consumption per capita	10.3	3.1	1.5	11.3	10.0	3.1	5.1	8.7
Public consumption	6.1	0.5	-1.7	7.6	7.2	0.3	2.0	5.2
Gross investment	10.6	8.3	36.1	8.9	16.9	27.2	2.5	-3.6
	11.3	-16.1	-22.0	48.2	24.4	13.4	23.3	8.4
Balance of payments,^b excl. trade with administered areas (in dollars)								
Imports	12.0	3.8	10.6	24.5	20.8	21.1	16.1	4.8
Exports	15.6	16.6	6.5	21.7	11.7	7.6	33.3	16.8
Import surplus	8.8	-14.4	18.4	29.0	35.6	39.7	-2.1	-12.5
External debt	13.7	7.7	17.9	22.2	11.7	23.4	30.8	19.0
Foreign exchange reserves ^c	27.7	-3.5	13.7	-7.2	-46.0	6.6	59.2	86.0
Population and employment								
Average population	3.9	2.6	3.3	3.4	2.6	2.8	3.0	3.3
Number of employed	4.8	-0.6	-4.3	9.0	3.8	1.8	3.5	5.0
Unemployment rate (as a percent of civilian labor force)— absolute figures	3.6	7.4	10.4	6.1	4.5	3.8	3.5	2.7
Prices and national income (nominal)								
Average monthly earnings per employee post ^d	13.6	19.1	0.4	3.2	6.1	9.0	16.4	14.4
Hourly earnings ^e	14.0 ^f	16.0	7.7	-2.9	2.2	15.8	15.8	15.4
GNP prices	8.0	8.3	1.4	2.8	2.9	9.4	13.7	12.5
Import prices ^g	9.7	2.5	1.7	12.9	6.2	4.2	14.9	21.2
Consumer price index (annual average)	7.4	8.0	1.6	2.1	2.5	6.1	12.0	12.9
National income	18.8	9.0	4.0	18.7	15.0	17.7	25.5	23.7
Disposable private income ^h	18.4	7.8	8.4	15.3	16.1	10.3	23.0	26.9
Finance (annual average)								
Money base ⁱ	18.9	5.1	22.8	22.6	4.0	9.0	34.6	47.5
Money supply	17.6	7.3	20.3	19.0	7.1	5.0	22.4	30.1
Other liquid assets of the public ^j	32.5	20.7	26.7	32.6	23.9	23.3	29.8	27.6
Bank credit to the public and bill brokerage credit	19.6	22.9	19.0	12.4	17.4	18.3	24.1	17.4

^a Valued at the effective rate of exchange.

^b Goods and services (imports c.i.f. and exports f.o.b.).

^c Net foreign currency balances in the Bank of Israel at the end of the year.

^d Israeli employee posts, including part-time and supplemental work. Since 1969 a new series based on National Insurance Institute data, which includes *inter alia* East Jerusalem.

^e Wages and salaries per man-hour, including fringe benefits, per employee post (including workers from the administered areas).

^f Average for the years 1962-65.

^g Including changes in foreign prices and in the effective exchange rate of the Israeli pound.

^h Gross disposable private income from domestic sources, net of compulsory loans.

ⁱ Currency in circulation with the public, plus total liquid assets of the banking institutions.

^j Time deposits in Israeli and foreign currency, saving scheme deposits, bill brokerage, and the Government Short-Term Loan.

consumption more than doubled to reach 46 percent, while the weight of investment (particularly in construction) moved up to 37 percent; the share of exports, on the other hand, fell to 23 percent, while that of public consumption was actually negative, since this use declined in absolute terms in 1972.

Together with the continued uptrend in the national product, there was a further growth of demand for labor, which was met by an increased supply of both Israeli workers (partly due to the larger immigration) and of workers from the administered areas. The expansion of employment was accompanied by a decline in the unemployment rate to an all-time low and a rise in wage and salary payments. The wage data cited in this report probably do not fully reflect the pressures in the labor market and the influence of the wage agreements signed in the final months of 1972 and the early part of 1973.

Employment was up 6.6 percent, after advancing 4.8 percent in 1971. This appreciable increase is only partly explained by the growth of the working-age population; it also reflects the adjustment of supply to the stronger demand for labor: the labor force participation rate rose, chiefly among women, and there was an increase in the number of man-hours worked per employed person and a decline in the number of unemployed job-seekers. The swelling demand for labor was also met thanks to the much greater supply of workers from the administered areas employed in Israel, which was accompanied by the contraction of employment and the raising of wages in the areas themselves. The areas contributed 27 percent of the incremental labor force employed in Israel during 1972.

Despite the much larger labor input in the year reviewed, there did not seem to be any easing of demand pressure in the labor market. This is borne out by the decline in the unemployment rate from 3.5 percent in 1971 to a record low of 2.7 percent, and by the high proportion of unfilled job vacancies. The number of unfilled openings, which in 1970 was smaller than the number of job-seekers for whom placements were not found, increased rapidly, and after slight fluctuations in the ratio between the two in the course of 1972, by the last quarter there were 267 unfilled vacancies for every 100 unplaced job-seekers.

The excess demand for labor was only partly reflected by the rise in average wages and salaries during 1972. The renegotiation of wage agreements for 1972-73 was protracted in some branches until the end of 1972, and sometimes even until the beginning of 1973; consequently, the increases awarded were not yet mirrored by the data for the end of the year reviewed, particularly in the case of the public sector. Actual compensation (wages and salaries plus fringe benefits) per employee man-hour went up 15-16 percent; this represents a real rise of 2-3 percent, about the same as in 1971.¹

¹ The rise in measured earnings is affected by changes in the composition of the employed labor force. The increase in the proportion of workers from the administered areas and of women—groups which earn less than the national average—shaved off about 1 percent from the level of hourly wages. In other words, were it not for these changes, the rise would have come to 16-17 percent.

This far exceeded the 10 percent increase in basic wages and the cost-of-living allowance increment stipulated in the framework agreement concluded at the beginning of the year. Average hourly earnings for the economy as a whole lagged slightly behind the growth of nominal GNP per man-hour. This would seem to support the conclusion that in the last two years the wage and salary hikes were not an independent factor in the inflation. But in comparing GNP per man-hour with hourly earnings account must be taken of the retroactive pay increases awarded in the collective wage agreements signed toward the end of 1972 and the beginning of 1973.

The buildup of inflationary pressures in the Israeli economy is reflected by the rapid mounting of prices since mid-1970, as indicated by the various indexes. The consumer price index climbed 12.4 percent during 1972, with the curve ascending more steeply toward the end of the year; during the first four months of 1973 it moved up by a seasonally adjusted 9.3 percent, or nearly 2.4 percent a month.

The price increases reflected, first and foremost, the existence of excess demand, which was fueled by the rapid growth of the money supply and the economy's liquidity. On the one hand, the excess demand directly pulled up prices in some sectors—notably construction, where dwelling prices soared 30 percent, and control-free personal services, which went up nearly 15 percent. On the other hand, it led to a stronger demand for labor and a consequent tightness in this market, which in turn pushed up wages. These extra labor costs were passed on to the customer, with the price hikes also taking into account the pay increases expected in the wake of the new wage agreements.

Besides the intensified demand-pull on prices, the rising cost of imports also exerted upward pressure in some spheres. Import prices averaged 21 percent higher in 1972, after having risen 15 percent the year before. These increases reflect the import levy imposed in August 1970, the devaluation of the Israeli pound in August 1971, and the higher prices charged for numerous import goods in the international market. Finally, it should be noted that in the case of many products whose price is influenced by the Government, either through the imposition of controls or the payment of subsidies, the advance slowed in the year reviewed.

The existence of excess demand pressure was only partly reflected in the balance of payments for 1972. The uptrend in exports slowed in dollar terms from 33 percent in 1971 to 17 percent; at constant prices, the deceleration was proportionally the same—from 24 to 12 percent. A detailed examination of the figures shows that special factors were partly responsible for the slowdown in some of the commodity and service items, while another part was due to the growth of demand in the domestic market. The influence of this market was strongest in the case of the wide range of industrial products sold both locally and abroad: here growth slackened in spite of the heavier foreign demand for these products in comparison with the two preceding years. On the

other hand, there was a notable gain in sales of diamonds (a distinctly export-oriented product), whose development is primarily a function of changes in foreign demand.

The expansion of gross domestic capital formation slumped from 23 percent in 1971 to 8 percent (at constant prices). However, owing to a change in its composition—a sharp cutback in ships and aircraft and an acceleration in dwelling and nondwelling investment—the influence of this final use on the level of economic activity was greater in 1972 than in the previous year. Private sector investment exclusive of ships and aircraft (which exhibit sharp year-to-year fluctuations) expanded at approximately the same rate in the last two years, similarly to the development of the gross national product.

Public sector investment (not counting ships and aircraft) was up 29 percent, compared with 9 percent in 1971. The biggest increases were in irrigation, electric power, and land transportation.

The vigorous uptrend in residential construction carried over through 1972, when the increase in the value of new construction put in place came to 25.4 percent, as against 21.3 percent in 1971. The volume of starts reached a record 60,000 units, while 47,500 units were completed. Whereas completions were more or less in line with the long-run trend in the demand for homes for immediate occupancy, the volume of starts far exceeded such demand. The much larger supply of housing in the year reviewed led to some weakening of the formidable pressures in this market, as attested by the expanded stock of unsold units held by contractors, some slackening in the upward movement of prices (which, however, still remained fairly rapid), and a slight cutback in privately financed building starts. In publicly financed construction (including private building controlled by the Government) there was a further sizable expansion of starts in 1972.

Part of the upward thrust in the level of economic activity came from the accelerated growth of private consumption, which began in the second half of 1971. On an annual average, the increase was 8.7 percent, or 5.2 percent per capita, compared with per capita rises of 0.3 percent in 1970 and 2 percent in 1971.

The more rapid expansion of private consumption reflects the slower increase in revenue from compulsory payments, in comparison with the two preceding years as well as with the growth of private income. This enabled private consumption to expand at the same rate as the gross national product in 1972, but it still did not go up as fast as disposable private income. As a result, the uptrend in the rate of private sector saving, evident since the economy emerged from the recession of 1966–67, was sustained in the year reviewed.

The growth of savings stands out even more if account is taken of the larger capital gains accruing to the private sector in 1972 as a result of the appreciation of assets linked to foreign currencies and of other assets. Even though such

capital gains are not included in current income, they nevertheless affect consumption spending.

At this stage, no adequate explanation can be given of the further rise in the rate of private saving during the past two years, which has brought it up to a much higher level than during the boom of the early 1960s. Nevertheless, several factors can be pointed out. First, the fluctuations in disposable private income and real income per capita were much sharper than before, and this apparently resulted in a slower adjustment of consumption to the higher income level. Secondly, the rates of return rose steeply on most types of saving—notably investment in shares and housing (the increase in the latter was not accompanied by a corresponding growth of mortgage loans), contributions to social insurance funds, and purchases of value-linked bonds. The continued uptrend in the rate of private saving over the past three years suggests that the value-linkage arrangements introduced in the economy tend to check the growth of consumption normally accompanying the sharpening of inflation and the concomitant expectation of a further erosion of the currency. Finally, the rising level of business profits during the postrecession period has undoubtedly resulted in a greater volume of business saving, which, owing to the lack of separate data, is lumped under the head of private sector saving. According to preliminary signs, the growth of business saving was exceptionally strong in 1972.

On the other hand, the better saving performance of households failed to dampen their aggregate demand by the full amount of their savings: part of the contractionary effect of their saving was offset by the stepped-up purchase of housing, which contributed to the expansion of activity in the construction sector. It should be noted, however, that financial saving, which does not increase demand, grew appreciably in 1972. The continued existence of demand pressures in the economy indicates that the higher rate of private saving was not sufficient to offset the demand surpluses of the public sector and the sectors under its control.

In contrast to the acceleration of private consumption, there was a 3.6 percent decrease in public consumption, after a sluggish rise in 1971. The virtual levelling off of public consumption stands out when compared with its enormous expansion during the years 1967–70. But whereas in 1971 the stability was due to a contraction of direct defense imports while domestic spending rose 11 percent (noncivilian spending by 15.3 percent and civilian spending by 5.1 per cent), in 1972 both components fell off. Total domestic public consumption inched down 1.1 percent (noncivilian consumption declined 7.3 percent, while civilian consumption increased 7.3 percent). The reduction of public consumption therefore contributed to the easing of pressure on the national product and to the trimming of the balance of payments deficit on current account.

The slow expansion of imports—by only 5 percent in current dollar terms—led to the contraction of the current deficit, even though export growth also lost vigor in the year surveyed. After reaching a record \$ 1,288 million in 1970, the

current deficit was whittled down by \$ 20 million in 1971 and by a further \$ 165 million in 1972 to stand at \$ 1,103 million. But whereas in 1971 the improvement can be credited mainly to a notable gain in exports, in the year reviewed the deficit was reduced despite the slackening of export growth. The deceleration of imports in 1972 may be ascribed to a number of special factors: a further cutback in defense imports, a sharp drop in the ships and aircraft item, the drawing-down of stocks of raw materials imported in previous years, and apparently also some import substitution.

In long-term capital imports the strong uptrend of the two preceding years carried over through 1972: after standing at \$ 600–650 million in 1968–69, the figure jumped by \$ 300 million in the year reviewed to reach \$ 1,780 million. The 1972 increment consisted entirely of unilateral transfers, which reached \$ 1,054 million—a sum almost equal to the entire current deficit. Investments from abroad doubled during the year to total \$ 141 million, while foreign long-term loans (which in previous years had been the chief source of the incremental capital imports) were down by some \$ 60 million. After soaring \$ 808 million in 1971, the country's long- and medium-term foreign currency liabilities rose by \$ 651 million in 1971 to stand at \$ 4,081 million at year's end. But this increase was accompanied by similar growth in the economy's foreign currency reserves, which nearly doubled; consequently, for the first time in many years there was no increase in Israel's net foreign liabilities.

The greatly expanded volume of long-term capital imports must be viewed in conjunction with the boom prevailing in the Israeli economy ever since its emergence from the recession of 1967. Other factors stimulating capital imports are the ceasefire (which has actually been observed since August 1970), the increased stream of immigrants from the affluent countries, and the Government's efforts to raise capital abroad after the heavy drain on foreign exchange reserves in 1969.

But the large-scale import of capital since the devaluation in August 1971 probably must also be attributed to the desire to capitalize on the boom and the high rates of return in Israel's securities and real estate markets, especially since the liberalization of foreign currency control in mid-1968, which guaranteed the right of repatriation for most types of investment made by new immigrants.

Foreign currency accumulation was the main source of the rapid monetary expansion in 1972, which, while it was somewhat slower than in the previous year, still greatly outpaced the growth of real economic activity. The money supply went up 28.7 percent during 1972, after having grown by 28.2 percent the year before. Less-liquid assets—namely time deposits, the Short-Term Loan, and foreign currency deposits of the public—expanded more slowly in 1972—by 19.5 percent as against 34.7 percent in 1971.

The large amount of liquidity pumped into the economy since the second half of 1970 has been one of the major causes of the sharper demand pressure, which has pushed up prices of local products more than warranted by the increased

cost of imports. However, the liquidity infusion since the 1971 devaluation has been accompanied by a mounting demand for value-linked financial assets, real estate, and durable goods. This is reflected in the larger holdings of money in relation to the national product, a development explained by the greater proportion of securities transactions within the total volume of business transacted in the economy. This trend blunted the impact of the incremental capital imports on GNP prices and on the balance of payments deficit on current account.

While the growth of foreign currency reserves at the Bank of Israel was partly connected with transfers of personal restitution receipts, which were held in the form of foreign currency deposits, even after allowing for the sterilization of these deposits, the inflationary effect of the foreign currency accumulation during 1972 was so strong as to necessitate the adoption of contractionary fiscal measures by the Government and a restrictive monetary policy by the Bank of Israel.

The total amount of money absorbed during the year through the Government budget was IL 735 million, while the Bank of Israel drained off a record IL 780 million by raising liquidity ratios, increasing the participation of commercial banks in the funds providing directed credit, and its operations in the open market.

During the first half of 1972 foreign currency conversion was so great that, despite the absorptive measures introduced, the rapid monetary expansion persisted. Attempts to stem it began to bear fruit only in the second half of the year, when foreign currency accumulation began to flag. But the slower expansion of the money base during the second half of the year reviewed was not fully reflected by a slackening of the growth of the money supply and other liquid assets of the public. This is because the banking institutions greatly stepped up their lending to the public, thereby sharply depleting the free reserves built up from the middle of 1971 and even running liquidity deficits, which grew further in the first quarter of 1973. It was only in the early part of 1973 that the expansion of the public's total liquid asset holdings (the money supply and other liquid assets) began to decelerate noticeably.

While some of the liquidity infusion generated by the increased capital import was intended from the start for financial investment, the absorption of liquidity through the sale of linked Government bonds and the growth of Pazak and Tamam foreign currency deposits and time deposits in Israeli currency was undoubtedly also connected with the monetary policy implemented by the Government and the Bank of Israel, which shored up the interest rates paid to savers and borrowers despite the heavy liquidity infusion. A drop in these interest rates might have led to the shrinkage of financial savings and a stronger demand for bank credit.

One outcome of the livelier demand for linked bonds in 1972 was a big increase in Government receipts from its own bond issues and in financial institution deposits with the Treasury of the proceeds of their bond issues. These

receipts made it possible to expand subsidized long-term credit (most of which was granted by financial institutions), besides reducing the Government's debt to the Bank of Israel by more than originally planned.

The overall influence of the public sector on aggregate domestic demand, as measured by the sector's demand surplus,² was roughly the same in the past two years. During this period—when the economy reached a state of full employment—the demand surplus rose to IL 3,800–4,000 million; this compares with an average of IL 2,000–IL 2,500 million during the immediate postrecession period, when there were still considerable idle factors of production, and only IL 300–IL 400 million in 1965–66. The picture is not significantly altered if the public sector's overseas purchases are deducted: its domestic demand surplus totalled IL 1,100–IL 1,200 million per annum in 1971–72, as contrasted with IL 750–IL 900 million during the years when the economy was pulling out of the slump, and with a supply surplus in 1965–66. The sizable public sector demand surplus accentuated the inflationary pressures generated by the growth of private consumption and investment and by the rapid monetary expansion during a period of full and even overemployment. The absorptive measures embodied in the Government's budget helped to ease these pressures.

Public sector tax revenue was up 25.8 percent in 1972, after jumping 38.1 percent the year before. If compulsory loans are treated as taxes, the deceleration was even greater—from 42.5 percent in 1971 to 24.5 percent. The slacker growth of tax revenue was due chiefly to the trimming of direct and indirect tax rates, which had been raised in both 1970 and 1971. The sector's payments increased more slowly in 1972 than in the two preceding years. The deceleration encompassed both the sector's consumption spending and its transfer and subsidy payments to other sectors, while purchases on capital account were much greater than in 1971.

In the sector's financial transactions there was a striking increase in domestic credit receipts (excluding compulsory loans)—from IL 545 million in 1971 to IL 1,437 million in 1972. There was virtually no change in the credit outflow. The absorption of credit from the public during 1972 is mainly explained by the boom in the bond and share markets. This led to a faster expansion of subsidized long-term credit to the various economic sectors, which was reflected not in the amount of credit granted directly by the Government but in the volume of credit granted through financial institutions in accordance with Government instructions.

The total deficit of the public sector, which was financed by foreign receipts and bank credit, reached IL 2,975 million—some IL 736 million less than in 1971. There was a marked change in the financing of this deficit: in 1972 it

² The demand surplus is defined as total current expenditure plus purchases on capital account, less income from domestic sources. The domestic demand surplus is the demand surplus less the public sector's purchases abroad. Liquidity absorption is defined as the domestic demand surplus less the sector's net credit receipts from domestic sources.

was covered almost completely by unilateral transfers and loans from abroad, while the Government's liabilities to the banking system increased by only IL 25 million.

The expansionary influence directly exerted by the public sector on the economy's liquidity (i.e. the sector's deficit net of its purchases abroad) was due entirely to the large-scale infusion by the local authorities; the Government itself actually mopped up considerable money from the public. The local authorities greatly stepped up their operations during the last two years, and largely financed this by borrowing from the banking system. The total amount of liquidity pumped into the economy by the public sector was only IL 119 million in 1972, as contrasted with IL 1,133 million in 1971 and IL 975 million in 1970. Though this was an appreciable decrease, in view of the cumulative effect of the big liquidity infusions of the two preceding years, the rapid monetary expansion in 1972, and the sizable demand surpluses of other sectors, an even larger absorption might have been expected.

To sum up, despite the sharpening of the inflation in 1972, there were some positive developments. For the second consecutive year, there was an improvement in the current account of Israel's balance of payments, accompanied by a rise in the share of the current deficit covered by unilateral transfers and an appreciable buildup of foreign currency reserves. The economy continued to expand vigorously, at an annual rate of approximately 10 percent at constant prices, and the unemployment rate fell to an all-time low—even below that of previous boom periods. While the improvement in the balance of payments was to some extent due to special factors—such as the contraction of defense procurements abroad, a smaller investment in ships and aircraft, and the utilization of stocks imported in previous years (factors which cannot be expected to operate with the same intensity in the future)—as well as the rise in import prices, it may also be credited to the economic policy implemented in recent years, notably the raising of the profitability of exports relative to domestic marketing and, to a lesser extent, the deliberate raising of import prices.

However, the accumulation of foreign currency balances—in itself a positive feature—sharpened the inflationary trends that began to appear in 1970 (when the economy approached a full-employment situation) and grew stronger during the next two years. The heavy liquidity infusion and the rapid advance of prices (which in the final months of 1972 and the beginning of 1973 reached an annual rate of 20 percent), as well as the steep pay increases awarded in the wage agreements signed since the second half of 1972 (which are not yet reflected in the data on actual wage and salary expenditures) are liable to gravely impair the ability of Israeli goods to compete in foreign markets. For even though most of these markets are themselves subject to internal inflationary pressures, prices have been rising there much more slowly than in Israel.

The acceleration of the price-wage spiral in the face of the absorptive measures introduced by the Government and the Bank of Israel, which have slowed the

expansion of the money supply and liquidity in the economy, may herald the peak of the inflationary process, in which prices and wages have been released from the restraints imposed upon them during the two preceding years. Perseverance with a restrictive monetary policy and the cutting of public sector spending at a time when wages and prices are rising may lead to the siphoning-off of much of the liquidity injected into the economy in earlier years, thus assuring the continuation of economic growth under full-employment conditions and a further improvement in the balance of payments.

At the same time, however, the expectation of the public—producers, consumers, and employees alike—that the price rise will persist is sharpening the demand for another round of pay increases and the stepping-up of credit for financing consumption and production, which in turn will heighten still more the upward pressure on prices and the call for a renewed infusion of liquidity.

The premature easing of the policy of restraint—either in the monetary sphere or with respect to Government spending, prices, or wages—will strengthen the public's belief that it is about to witness another twist in the price-wage spiral, thereby adding fuel to the already heated demand in the economy. The continued mounting of inflationary pressures will lead to an accelerated growth of private consumption, stimulate imports, and diminish the competitiveness of Israel's exports in foreign markets. Such a development is liable to retard the growth of the economy and bring on unemployment.