

Recent Economic Developments 128

May - August 2010

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Part 1: Review of Recent Economic Developments, May to August 2010*

Main Developments

In the review period, from May to August 2010, the Israeli economy continued its recovery, alongside signs that some of the world's major economies were recovering slower. The recovery was reflected in a rise in the State-of-the-Economy Index of 4.4 percent (in annual terms, Figure 1.1). The continued growth in demand throughout most of the review period contributed to the accelerated growth of GDP in the second quarter by 4.6 percent (and of the business-sector gross product by 5.3 percent),¹ as well as to the continued growth of imports. The rapid growth of private consumption and exports, and the beginning of the recovery of investments in fixed assets, point to the progress of the economy in extricating itself from the recession. The moderation of concerns about the trickling of the debt crisis in Greece to other countries in the Euro Bloc, in the wake of the establishment of an assistance fund for European countries that have encountered financial difficulties, has, in the review period, partially restored confidence in the markets. This development is reflected in curbing the decreases in the public's asset portfolio, in halting the increases in the risk indices of the markets, in a slight depreciation of the nominal effective exchange rate, and in a recovery, to some

extent, of global demand. Against this background, and in light of the continuing improvement in domestic economic activity, the level of uses continued to grow in the review period beyond their level on the eve of the crisis.

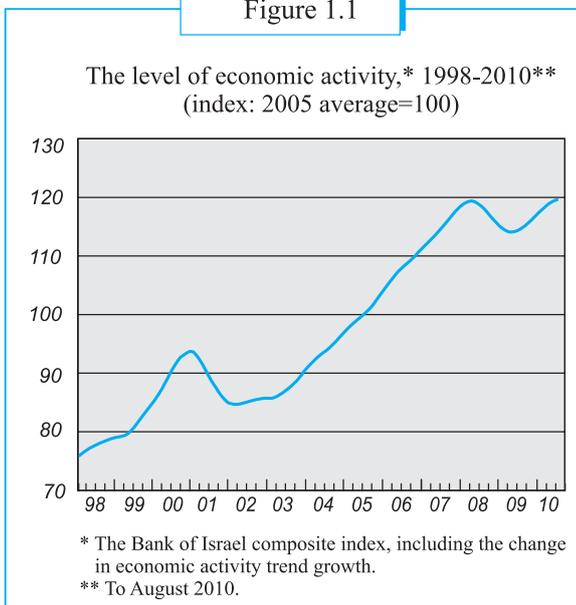
The continuing expansion of domestic economic activity encompassed most of the industrial branches in the economy, and significantly improved the employment situation. The number of employees grew substantially, the employment rate among the population of working age returned to the level on the eve of the crisis, and the unemployment rate in the labor force fell to 6.2 percent, a historically low figure. Part of this growth, however, is a result of the conversion of many full-time to part-time jobs. Also noticeable is that the growth rate in the number of employees in certain industries, especially manufacturing, a large part of whose activity is dependent on global developments, continues to be low.

In the review period the current-account surplus in the balance of payments grew, thanks to improvements in the export of tourism and transportation services. The dollar value of the export of goods and the import of goods grew moderately, with the result that the trade deficit remained almost unchanged. Taking 2010 as a whole, the level of exports in dollars remained fixed, with a decrease in the export of mixed high-tech and mixed traditional industries in the review period. In the financial account the capital export surplus grew as a result of a sharp decline of foreign direct investments and investments in securities in Israel, against the background of the uncertainty in the markets at the beginning of the review period.

The recovery in the market was also reflected in an increase in tax revenues—albeit at a moderate rate relative to the second half of 2009—in the wake of the reduction in gross VAT receipts on domestic manufacture. At the same time, tax revenues remained significantly higher than the state-budget forecast, and therefore the domestic deficit was low relative to the seasonal course consistent with the deficit ceiling determined in the budget. On the basis of these figures, and on the assumption that the budget will be almost fully implemented, it can be said that the debt/GDP ratio of the economy has risen at a low rate by international standards.

The prices environment in the review period was characterized to some extent by price increases, particularly the continuing rise of the housing-price index and the effects of seasonal factors. At the same time, after deducting seasonal influences, the rate of price increases grew only

Figure 1.1



* Based on data available by 10 October 2010.

¹ National accounting data are in annual terms, and relate to the second quarter of 2010.

slightly, and inflation over the past twelve months remained around the middle of the inflation target. Prices of financial assets recorded a mixed trend in light of changes in the level of uncertainty in the markets. As opposed to these, privately-owned-housing prices continued to rise at a rapid rate, despite the rise in monetary interest in the review quarter, and the new policy steps adopted with regard to mortgages.² Price rises are also affected by inflation expectations, which are around the upper limit of the inflation target.

The Bank of Israel interest rate continued to increase gradually. The interest for May to July was kept at 1.5 percent, the interest for August was raised to 1.75 percent.³ Furthermore, the Bank of Israel continued to purchase foreign currency.

Concern about the trickling of the debt crisis to other countries in the euro bloc lessened during the review period, in the wake of the announcement by the European Union of the establishment of an assistance fund. At the same time, the difficulty of using fiscal and monetary policy to revitalize the economies that were affected by the crisis and return them to a growth course, together with the increasing need for fiscal adjustments in order to reduce government debts, the implementation of which has only recently begun, continue to cloud the growth prospects of developed economies worldwide.

Real aggregate activity⁴

The corrected estimates of the national accounts for the second quarter of 2010 (Table 1.1) point to continuing GDP growth at a slightly higher rate than prevailed until now since the crisis: GDP rose by 4.6 percent, and the business-sector gross product by 5.3 percent. The growth encompassed all sources and uses in the second quarter. However, while GDP and private consumption were only slightly affected and rapidly returned to their pre-crisis levels, exports, imports, and investments in fixed assets at fixed prices are still about 5 percent lower than on the eve of the crisis.

² The Supervisor of Banks instructed the banks to examine their housing credit risk management, and to make additional provisions for housing loans with high loan-to-value ratios. The directive came into force on July 1.

³ The interest rate for September (outside the scope of this review) was increased to 2 percent.

⁴ The national accounts data in the review as a whole are in annual terms after deducting seasonality. Export and import figures relate to the export of goods and services excluding diamonds, and the import of goods and services excluding security equipment, ships, aircraft, and diamonds.

The growth rate of private consumption (9 percent) was relatively high in the second quarter, a result of the rapid growth in the consumption of durables (64.5 percent in annual terms), and the continuing growth in the consumption of current goods (4.6 percent)—a development that attests to a feeling of optimism among consumers. The dissipation of concern about the trickling of the debt crisis to other countries in the euro bloc during the period, checked the decline in the public's asset portfolio (Figure 1.15) and the rise in the risk indices of the markets.⁵ Even though there is still considerable uncertainty about the continuation of the recovery worldwide, the positive domestic figures and the improvement in employment reflect optimism, as expressed in the consumers' confidence index. Even though the index moderated slightly at the start of the review period, it still remains high.

The rise in investment in fixed assets continued for the second consecutive quarter (reaching 13.1 percent), following continuous declines since the start of the crisis. This rise was spearheaded by a rise in investment in various industries (12.2 percent), especially the growth of investment in machinery and equipment (12.8 percent), and of investment in intangible assets (50.2 percent). This development is a result of a positive prediction of continuing activity in the various industrial branches, a prediction that intensified towards the end of the period, as was evident in the decreased risk premiums of the business sector (Figure 1.14). Despite this, uncertainty regarding global developments raises questions about the possibility of the further expansion of investments in the coming period—as emerges from the companies survey, the survey of industrial expectations, and the Purchasing Managers Index—and is already reflected in moderation of the rate of import of investment products during the review period. Furthermore, the growth of investment in residential building (17.8 percent) has continued and even accelerated in the second quarter, a trend that began even before the crisis and intensified in light of the low mortgage interest. As opposed to this, the decline of investment in non-residential building, which began at the beginning of 2008, has continued. Note that despite the growth of investment in fixed assets, gross domestic investment has decreased as a result of the fall in inventory, which is a volatile component.

The rate of growth of exports of goods and services increased, while the rate of growth of imports of goods and services moderated somewhat, against the background of the partial return of global demand to a growth course (the Triple Trade Index, Figure 1.11), and the curbing of the

⁵ The rise in the risk indices, as reflected in the standard deviation derived from stock options in the economy, and the risk premiums of the business sector (Figure 1.14).

appreciation reflected by the real effective exchange rate (Figure 1.16). The developments in exports and imports of goods and services was a result of the 29.6 percent growth in goods exports and the 11.5 percent increase in goods imports, whereas services exports increased by only 5.9 percent, services imports did not rise at all, and both were still 16 percent lower than on the eve of the crisis.

Public consumption, which rose significantly since the beginning of 2009, decreased during the review period (by 1 percent), while civilian consumption rose by 3.7 percent.

Product prices—exports, imports, private and public consumption—rose during the review period, and the fall in investment prices was checked, a phenomenon that is consistent with the trend of continuing growth in the economy. The trade conditions index (export prices divided by import prices (excluding diamonds)) points to stability in recent quarters and an improvement relative to the trade conditions prevailing on the eve of the crisis.

Real industria⁶ activity

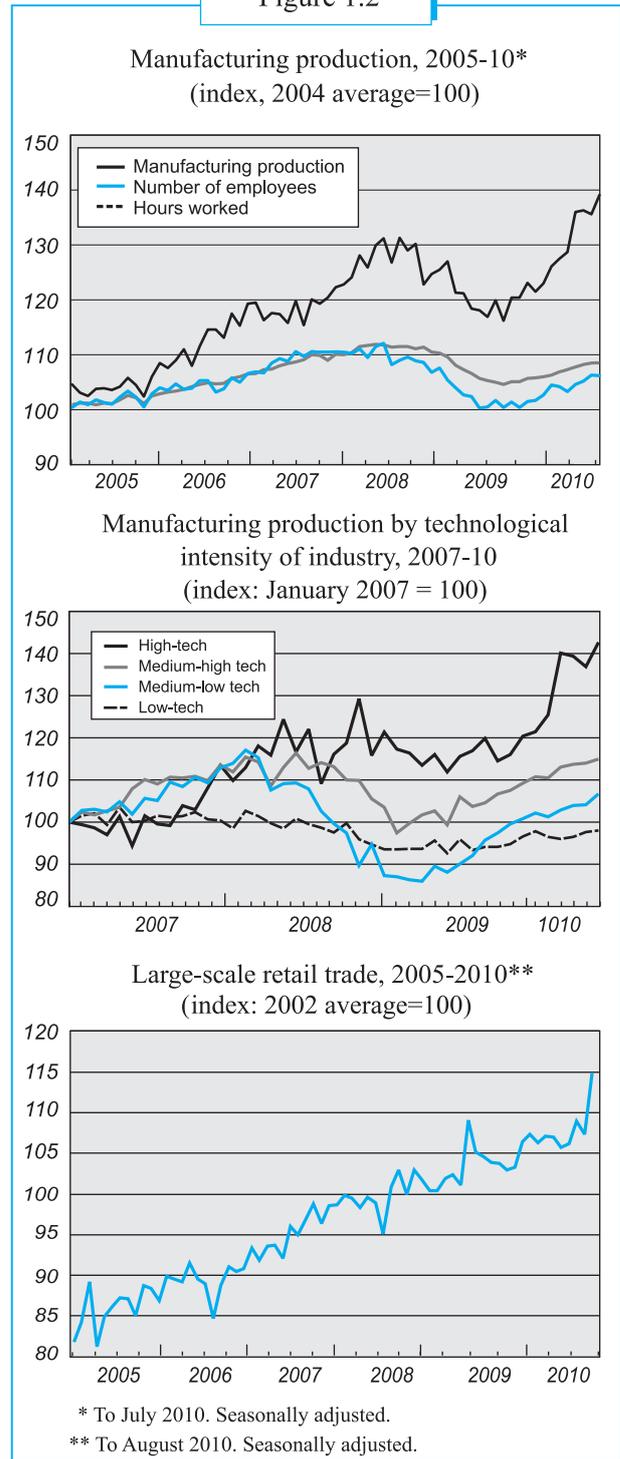
The industrial recovery continued. The industries whose employment was adversely affect by the crisis, and have not yet overcome the arrears are wholesale and retail trading, construction, and particularly manufacturing—even though according to the revenue indices (in trading industries), the production (in the manufacturing industries), and the investments (in the construction industry), there is evidence of an almost complete recovery to pre-crisis levels.

The rate of expansion of manufacturing increased (37 percent—Figure 1.2), alongside more moderate expansion of the manufacturing revenue (17.6 percent). At the same time, employment in manufacturing industries remained low. The growth of production in manufacturing industries continued in accordance with the recovery course of each industry: industries in which technological intensity was higher, and that were less affected by the crisis,⁷ continued to recover more rapidly in the review period (high-tech by 37 percent, mixed high-tech and mixed traditional each by 11 percent, and traditional by 2 percent). The growth in activity of the manufacturing industries is expected to moderate in the wake of the fall in sales abroad, and the continuing uncertainty that surrounds international developments, as emerges from the findings of the industrial expectations survey, the Purchasing Managers Index, and the companies survey. This

⁶ The real activity figures by industry are in annual terms after deducting seasonality (Table 1.2), and relate to the mostly period from May to July.

⁷ The impact on manufacture and exports matched the intensity of the industry: the more advanced the industry, the less severe the impact.

Figure 1.2



assessment is strengthened in view of the moderation of the rate of growth of investment products, and the stabilization of imports of raw materials.

Overall activity in the construction industry also continued to expand: the number of building completions accelerated (145 percent), the number of building starts grew (18 percent), and investments in construction stabilized. This development, however, embodies two contradictory trends—on the one hand a decline in non-residential construction in the wake of the crisis (a decrease in investments of 20.5 percent in the second quarter), despite the beginnings of recovery of investments in industry in general in the past two quarters, and on the other hand, an increase in residential construction (an increase in investments of 17.8 percent in the second quarter). The rise in building starts, as well as the growth in the number of building permits (Figure 1.4), which was accompanied by greater efforts on the part of the Israel Lands Administration and the Ministry of Housing to increase the pace of marketing of the land, are likely to stimulate additional future growth of activity in the industry, signs of which can already be seen in the reports of the construction companies in the companies survey. At the same time, in the review period the growth in supply did not succeed in matching the rise in demand, the result being that prices of privately owned apartments continued to rise (a rise of 4.1 percent from May to July in quarterly terms—Table 1.7).

Figure 1.3

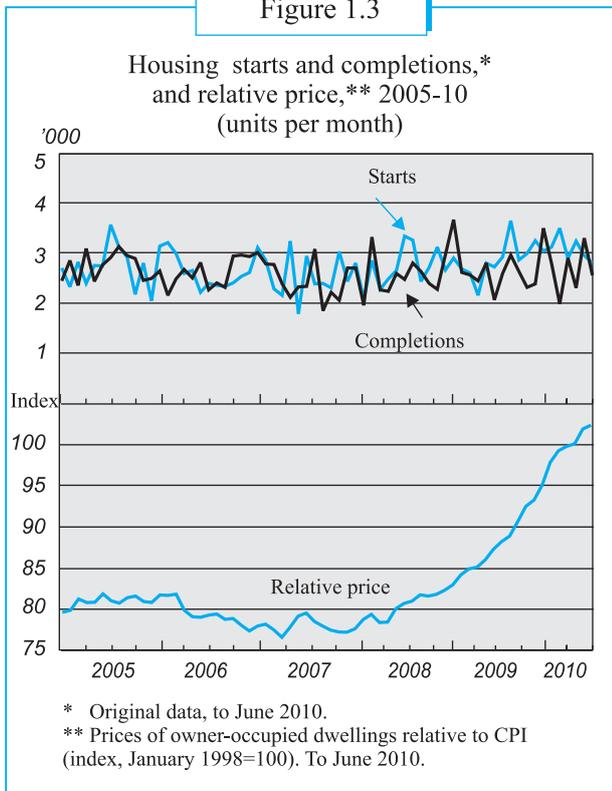
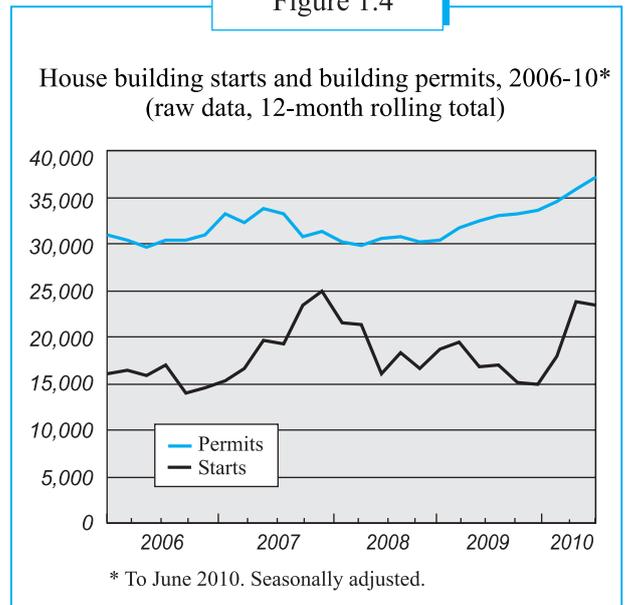
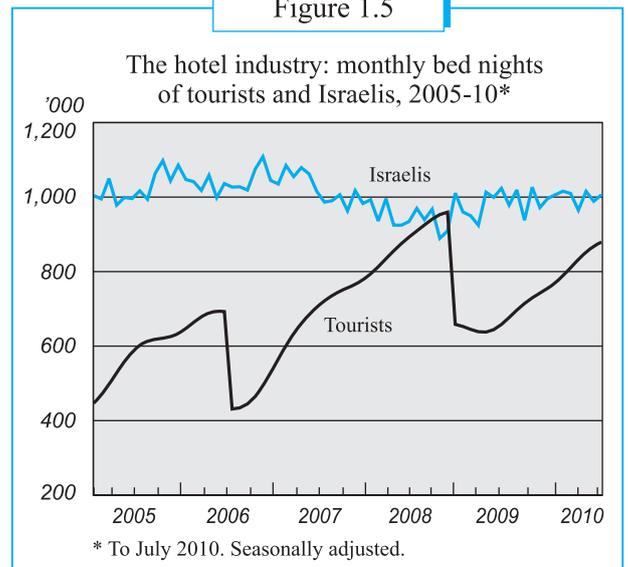


Figure 1.4



Activity in the wholesale and retail trading industries continued to increase, but more moderately. Revenue of the multiple retail stores increased by 4 percent, and the value of credit card purchases increased by 10 percent, with a slight decline in the revenue of the wholesale and retail trading industries. This development—which is supported by positive activity reports from trading companies in the Bank of Israel Companies Survey, and that was reflected in the consumers' confidence index, which remained high, and in private consumption figures for the second quarter—points to an optimistic feeling among consumers. This feeling is

Figure 1.5



also reflected in the activity of the food and accommodation services industry (a rise of 7 percent), even though in the tourism industry the number of bed nights of Israelis remained stable (Figure 1.5). In the other service industries, however, the rate of growth slowed slightly (to 3 percent), despite the increase in services exports, particularly business services (5 percent).

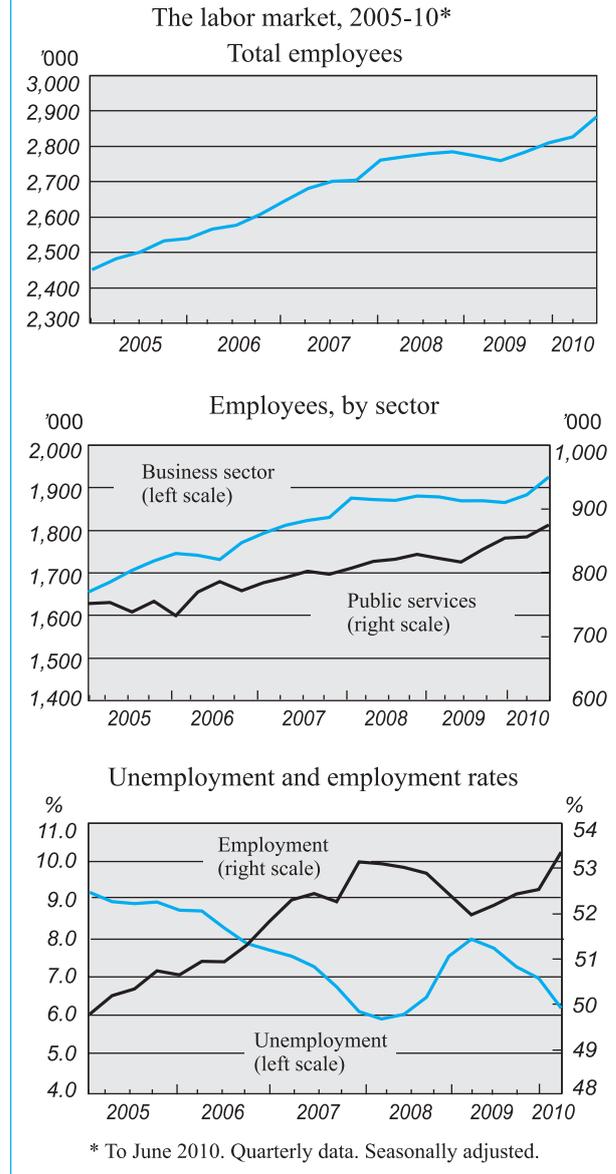
The labor market⁸

The recovery in the labor market continued at a rapid rate in the review period (Figure 1.6). The rate of growth of the number of employees jumped significantly (2 percent), both in the business sector and in the public services. This growth led to a rapid rise in the rate of employees among the working-age population, even slightly exceeding its level on the eve of the crisis (53.3 percent as opposed to 53.1 percent, respectively), as well as a sharp decrease in the rate of unemployment in the labor force (6.2 percent, compared with 5.9 percent on the eve of the crisis); the decrease in the number of work seekers continued. At the same time, the growth in employment was also a function of a rise in the number of part-time jobs (6.5 percent), while the number of full-time jobs fell (by 1 percent). As a result, the number of involuntary⁹ part-time employees increased (6.4 percent), and the number of working hours per employee fell (35.8 as opposed to 36). These developments could partially explain why, despite the sharp rise in the number of employees in the review period, the nominal wage per employee post increased by only 0.5 percent, and the real wage per employee post rose by only 0.1 percent (Figure 1.7). The growth in the number of employees in the second quarter reflects rising employment in most industries during this period, even though in manufacturing, trade, and construction the employment levels are still lower than on the eve of the crisis. Unit labor cost remained almost unchanged in the second quarter (Figure 1.8), a result of the stability of the real product per hour, and of the nominal hourly cost of work. The stability of the real product per hour is a result of the same rates of increase in hours of work of employees and in the real product, while the cost of labor per hour remained stable, because of the relative stability of the nominal wage per employee post. The findings of the employers survey show that the employment balance continued to be positive (the rise in the rate of filling the posts is less than the rise in the rate of discharge of workers), even though it was lower

⁸ National Insurance Institute data (number of salaried jobs, real and nominal salary) related to the months of May to July, while the labor force survey and the employers' survey relate to the second quarter of 2010. All the data are in quarterly terms, after deducting seasonality (Table 1.3).

⁹ Involuntary part-time employees are defined as those who looked for full-time work or additional work, and did not find any.

Figure 1.6



than in the previous quarter. The survey also shows that activity is expected to moderate, apparently as a result of the uncertainty about whether the global recovery from the crisis will continue, even though expectations regarding the recruitment of workers remained positive. The continuing recovery in the labor market is also reflected in the number of unemployed persons per available job (Figure 1.9), which serves as an index of labor market tightness. This index continued to decrease in the second quarter as a result of a fall in the number of unemployed persons, and an increase in the number of available jobs. An analysis of the index by geographical region shows that the index in the Tel Aviv and central region is more stable than in the other regions—even

though in this region the index has not reached the level it was on the eve of the crisis, while in some of the other regions, the recovery was more rapid.

Figure 1.7

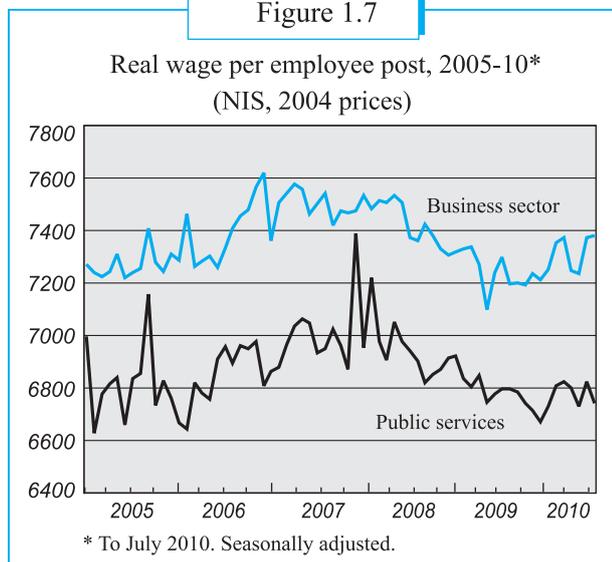


Figure 1.8

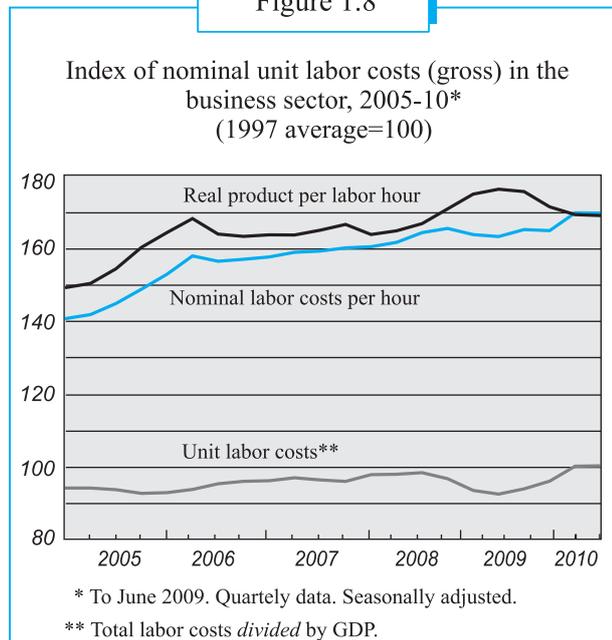
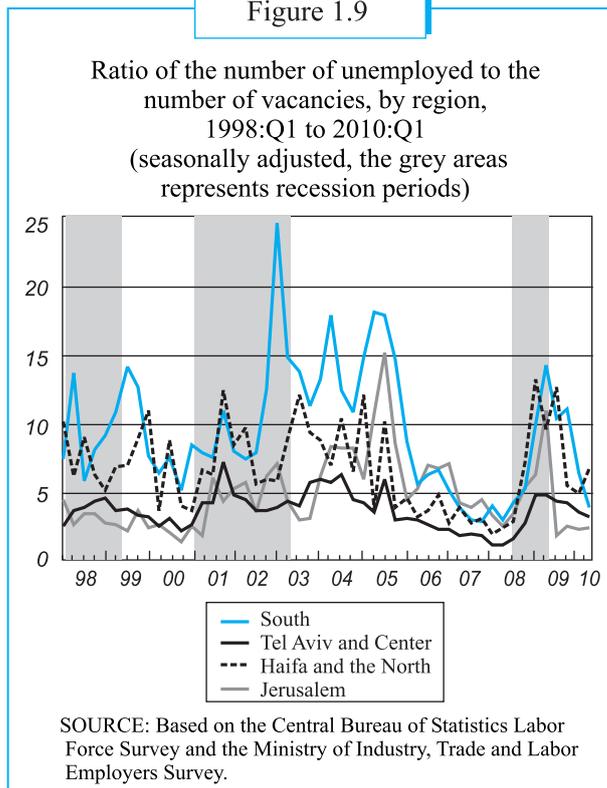


Figure 1.9



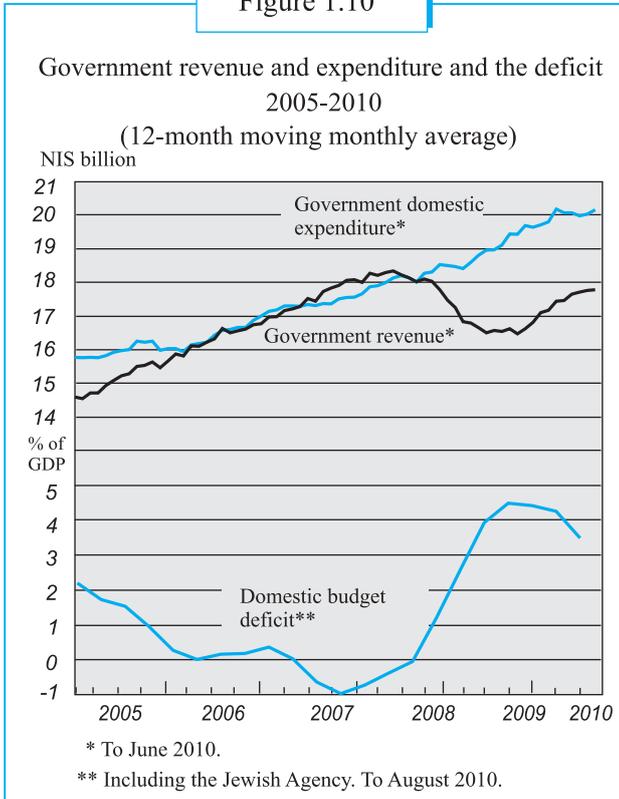
The government

Continuing the recovery trend that characterized the economy in the review period, tax revenues¹⁰ continued to rise, even though at a more moderate rate than in the previous period. This development is mainly a result of moderation in the rate of growth of indirect tax collection (2.8 percent), and especially gross VAT revenues on domestic manufacture. At the same time, tax revenues are still higher than that forecast in the state budget (by NIS 2.6 billion). Domestic expenditure without credit in the review period were lower than the seasonal course of the budget (by NIS 2.1 billion), because of an inflated estimate of interest payments in the forecast (by about NIS 3 billion throughout the year), while the ministries' expenditure approximated full implementation of the budget. From this it follows that the domestic deficit in the review period was NIS 4.6 billion lower than the seasonal course that is consistent with the budget. The overall budgetary deficit (without credit) in the review period was NIS 8.1 billion—lower than the parallel period last year (NIS 10.8 billion), but still higher than that of 2006-2008, years in which there was a budgetary surplus

¹⁰ Tax revenues are presented in fixed prices, after deducting seasonality, legislative amendments, and one-time incomes.

(Table 1.4 and Figure 1.10). Based on developments until now, and on the assumption that the budget will be almost fully implemented, the overall deficit without credit is expected this year to reach from 3.7 to 4 percent of GDP, which is less than the budget forecast.

Figure 1.10



The balance of payments¹¹

The current account surplus grew in the second quarter (by 0.7 billion dollars), a result of growth in the surplus on the services account and the current transfers account, alongside stability in the goods account and the income account. The goods account remained stable (Figure 1.11), including a moderate rise in the dollar value of imports (0.9 percent), largely a result of stabilization of the import of raw materials, and stabilization of the dollar value of exports in the wake of the moderation in the mixed high-tech industries and the mixed traditional industries (a decrease of 3 percent and 11 percent, respectively, Figure 1.12). The services account

¹¹ Balance of payments figures (Table 1.5) and foreign trade figures (Figure 1.11) are presented in current dollars and relate to the second quarter of 2010, and to each of the four months of the period reviewed, respectively. Current account figures are in quarterly terms, after deducing seasonality, and the financial account figures are in quarterly terms and original.

Figure 1.11

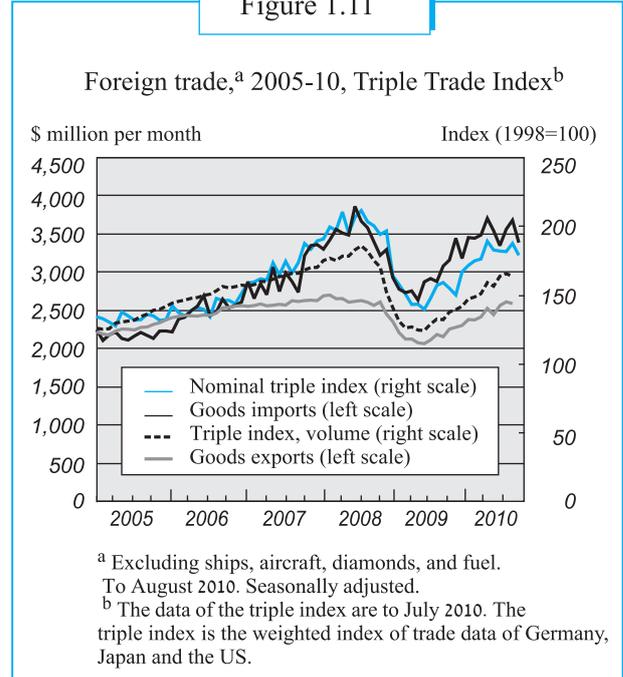
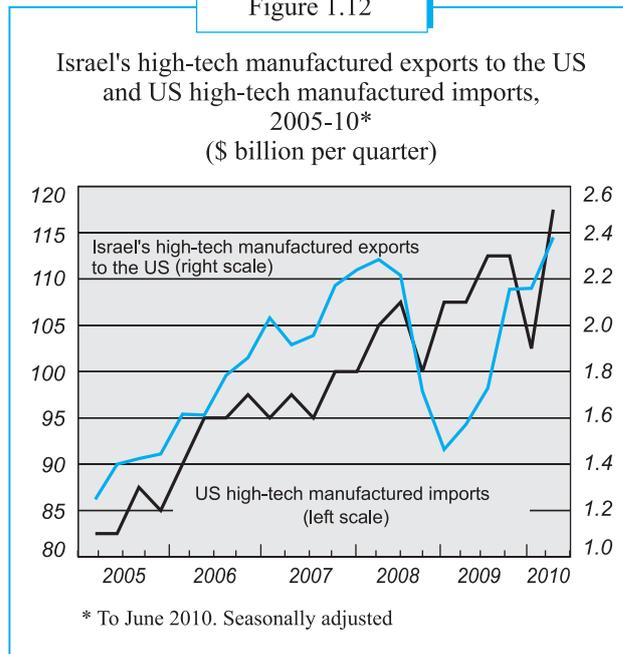


Figure 1.12



rose in the review quarter, a rise that reflected mainly the improvement in the export of tourism and transportation services (12 percent and 18 percent, respectively) in the wake of the significant rise of the shipping of cargoes between foreign ports, and a growth in the number of tourists visiting Israel as the security situation continued to improve. Prominent in the income account was the decrease in income

from direct investments abroad and in Israel, alongside an increase in the income of foreigners from investments in a securities portfolio in Israel, a result of the realization of holdings of Israeli stocks and government bonds.

On the financial account a sharp rise was recorded in the surplus of capital exports (from 2.5 billion dollars to 5.2 billion), which mainly reflected the decrease in investments of foreigners in Israel (both in the securities portfolio and in direct investments), and the continuing growth of foreign currency reserves of 2.6 billion dollars. While direct investments by Israelis abroad began to recover from the crisis, and by the middle of 2010 had reached almost 3 billion dollars—which was about 40 percent lower than the pre-crisis level—the investments of foreign residents in Israel remained low, and even continued to moderate in the review quarter, against the background of the increase in uncertainty in the markets in the first half of the period, and similar to the global trend of direct investments. In addition to this decrease in direct investments of foreigners in Israel, the volume of their investments in securities also fell as a result of the realization of their holdings in stocks and in government bonds.

Inflation and monetary policy

During the review period the CPI rose by 1.7 percent (Table 1.7). At the same time, the growth rate of the index, after deducting seasonality, was characterized by only a slight increase (0.3 percent). Contributing to the increase was a rise in the housing index and the effects of seasonal factors (particularly fruit and vegetables, and clothing and footwear), while the moderated global inflation environment, which led to decreases in commodity and oil prices, and checked the rise in food prices, offset the CPI rise. The inflation rate in the past 12 months (Figure 1.13) was influenced mainly by increases in housing prices (6.1 percent) and transport and communications (2.3 percent), and fell to its lowest level since December¹² 2007, 1.8 percent, which is more or less in the middle of the inflation target. However, the relatively high level of expectations of inflation for the year continued, both on the part of the forecasters and according to the capital market, so that the expected inflation is closer to the upper limit of the inflation target. Asset prices showed a mixed trend in the wake of global developments. At the beginning of the review period, decreases were recorded in the stock market (Figure 1.15) and in the issue of corporate bonds, and a rise

¹² Excluding three months after December 2007, in which it was at the limit of the upper range of the inflation target.

Figure 1.13

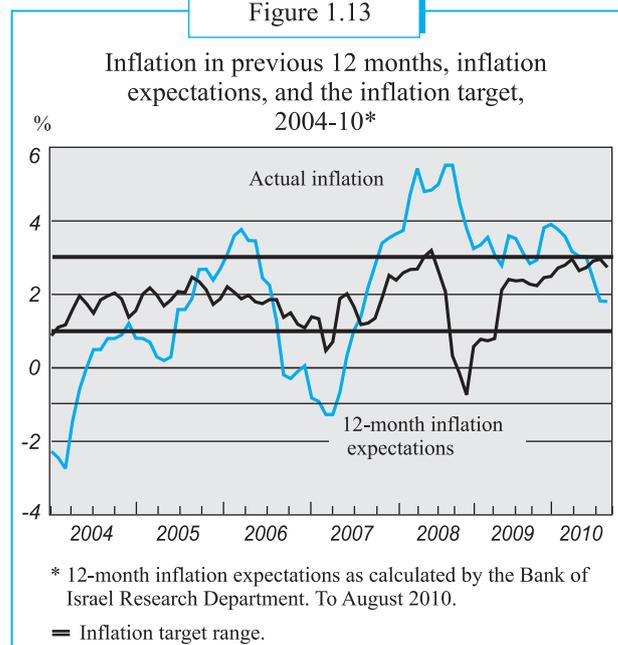
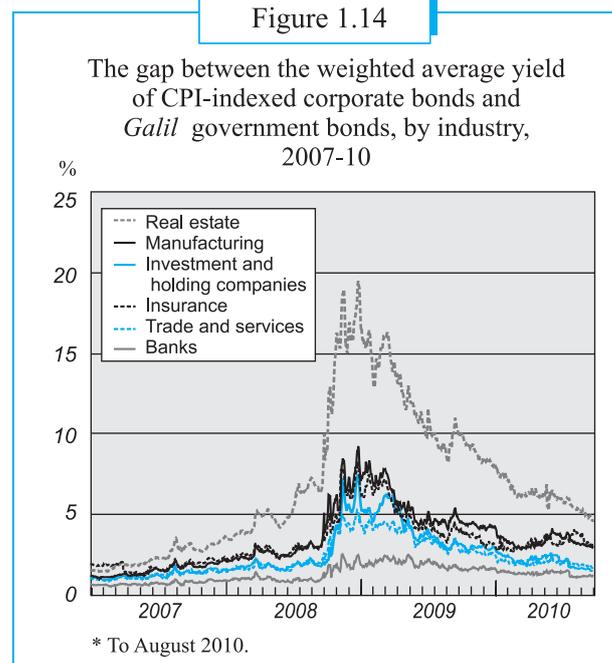


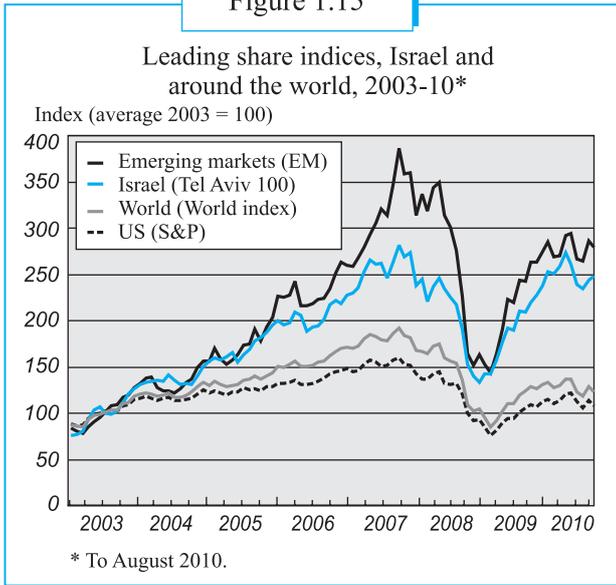
Figure 1.14



in the risk index.¹³ These, however, were checked as concern dissipated about the deepening of the crisis. As opposed to this, prices of privately owned apartments continued to rise

¹³ The rise in the risk indices, as reflected in the standard deviation derived from stock options in the economy and the risk premiums of the business sector (Figure 1.14).

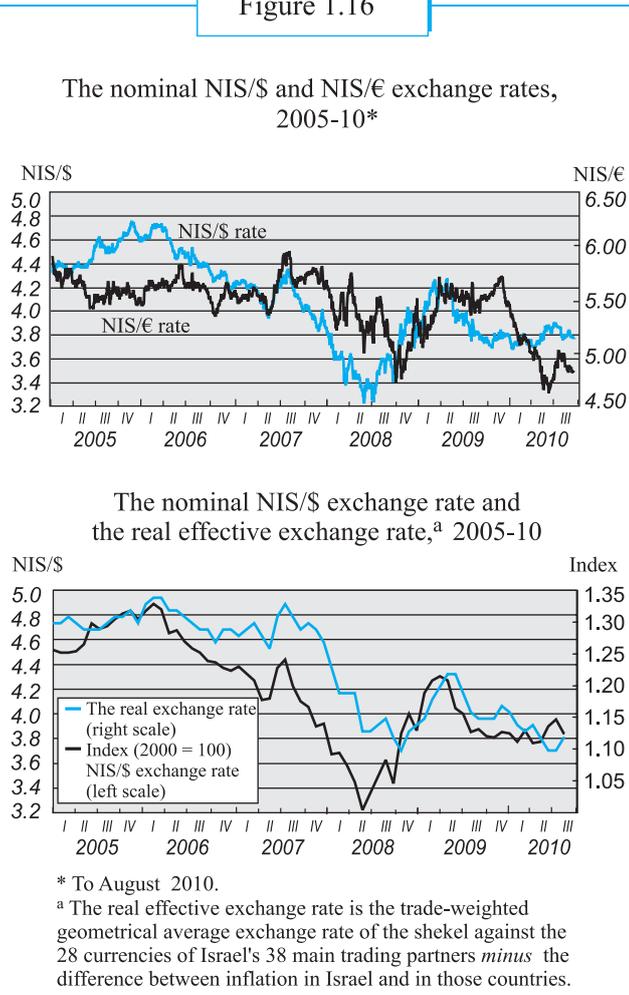
Figure 1.15



during the period at a rapid rate of 4.1 percent, and in the past 12 months by 20 percent, far in excess of the rise in rental prices for the same period (6.3 percent)—and despite new policy measures adopted with regard to mortgages.¹⁴ In light of these developments, the process of the gradual raising of the Bank of Israel interest rate continued in the review period. The interest rate for May to July was kept at 1.5 percent, while the interest rate for August was raised to 1.75 percent.¹⁵

The development of the nominal effective exchange rate was not uniform over the review period. At the beginning of the period the appreciation trend continued, a continuation of the strengthening of the shekel against the currencies of Israel's trading partners since the beginning of 2009. From July, however, this trend was checked, mainly as a result of the recovery of the euro bloc, which was reflected in the depreciation of the nominal exchange rate against the euro (Figure 1.16). Overall the nominal effective exchange rate depreciated over the review period by the moderate rate of 1 percent. The Bank of Israel was active in the foreign currency market: in May the Bank bought 625 million dollars, and in August 600 million dollars.

Figure 1.16



The global economy

The global growth rate moderated in the second quarter (a rise of about 3.5 percent). The growth course over the period was not uniform: at the beginning the danger that threatened the global economy was the trickling of the debt crisis to other countries in the euro bloc, while at the end the major problem of most of the developed countries that were affected by the crisis, primarily the United States, was that their fiscal and monetary policy had not managed to sufficiently resuscitate domestic demand. The difficulties experienced by fiscal and monetary policy in reviving the economies that were affected by the crisis and returning them to a growth course, and the increasing need for fiscal adjustments to reduce the governments' debts, adjustments that only commenced recently, have not managed—with the passing of the euro bloc crisis—to completely alleviate fears of a further recession. On the other hand, a large proportion of the developing countries are enjoying a relatively rapid recovery, spearheaded by the Asian countries.

At the start of the period the euro bloc occupied center stage because of the debt crisis that affected certain European countries and that threatened to spread to other countries, placing in doubt the stability of the euro bloc as a whole. However the provision of an assistance program to Greece

¹⁴ See footnote 2 above.

¹⁵ See footnote 3 above.

and the declaration of the establishment of an assistance fund for countries that find themselves in crises, in return for implementing a consolidation program for reducing the governments' debt, managed to partly alleviate investors' fears that some countries would go insolvent. The state of the euro bloc as a whole improved during the review period—GDP rose by 3.9 percent—but there is still a noticeable gap between countries: in Germany the GDP rose substantially, while in other countries such as Greece and Spain, the severe crisis is still in progress, and unemployment is rife.

The United States economy grew in the second quarter by 1.6 percent, less than the growth forecasts for this quarter. The quarter began with positive expectations of continuation of the recovery, but these dissipated as domestic demand failed to revitalize. There was also optimism at the beginning

of the period about the ability of the fiscal and monetary incentive programs to rehabilitate the economy, against the background of restocking of inventories of manufacturing companies. The expected private consumption, however, did not recover as expected during the period, and production and investments in the business sector moderated. In the labor market as well, there were few signs of recovery. The state of the real estate market is still precarious and is dependent on government support. This can be seen in the rate of home sales that reached a low point in July, following the termination of the assistance program for home buyers.

Against the background of these developments, and concerns of a further global slowdown, the major central banks decided to postpone the raising of interest rates.

Table 1.1 National Accounts, 2009-10
(percentage change in annual terms, at constant prices, seasonally adjusted)

	2009 ^{a,b}	Change from previous quarter					2010/II	
		2009			2010		Year on year change ^b	Last month for which data available
		II	III	IV	I	II		
GDP	0.8	1.1	4.0	4.4	3.8	4.6	4.8	June
Business-sector product	0.1	1.7	3.8	4.3	4.5	5.3	5.2	June
Private consumption	1.7	10.0	6.2	9.2	0.7	9.0	6.1	June
Gross domestic investment	-8.9	-18.4	-2.4	-35.6	72.1	-18.4	-1.5	June
Fixed investment	-5.8	-2.2	8.6	-8.4	15.6	13.1	8.6	June
Goods and services exports	-10.0	-5.1	9.6	30.8	3.7	22.7	15.0	June
excl. diamonds	-12.7	-22.3	41.3	32.8	20.9	29.6	32.8	June
Goods exports ^c	-11.9	63.0	-33.3	64.0	-25.9	5.9	-4.1	June
Services exports ^c	-12.3	-0.4	14.8	7.6	13.0	16.4	13.1	June
Goods and services imports ^e	-14.4	7.9	34.2	9.8	40.1	11.5	23.9	June
excl. diamonds	-11.9	3.8	-10.6	11.3	-8.7	-1.2	-4.4	June
Goods imports ^d	2.5	5.1	-0.8	1.5	1.7	-1.0	2.5	June
Services imports ^d	4.0	6.9	0.9	0.6	-1.7	0.0	1.3	June
Public sector consumption	0.2	2.1	4.6	-2.4	10.7	0.1	3.9	June

^a Compared with previous year.

^b Raw data.

^c New calculation excluding subsidies.

^d New calculation, excluding taxes.

^e Excluding defense imports, ships and aircrafts.

SOURCE: Central Bureau of Statistics and Bank of Israel.

Table 1.2. Indicators of Business Activity, 2009-10
 (percentage change, in annual terms, seasonally adjusted)

	Change from previous quarter						May - August 2010		
	2009 ^{a,b}	2009			2010		Change from previous period	Year on year change ^a	Last month for which data available [*]
		II	III	IV	I	II			
Composite state-of-the-economy index	-2.9	-3.1	1.2	4.3	5.4	5.2	4.4	4.4	August
Unit labor cost	-4.8	-4.1	3.6	4.1	1.9	-1.1	-1.1	2.1	June
Large-scale retail trade	4.2	18.9	-10.0	8.7	4.2	0.5	8.0	4.8	August
Manufacturing production (excl. diamonds)	-6.0	-6.5	2.4	12.4	17.0	29.6	20.6	16.4	July
Index of trade revenue	-1.6	11.4	7.6	13.1	15.8	-2.0	-6.6	6.6	July
Index of trade and services revenue	-2.6	8.2	3.7	13.8	18.4	-1.3	-2.3	7.7	July
Index of services exports	-15.9	49.2	13.8	29.1	-13.3	21.3	4.9	7.7	August
Tourist arrivals	-9.7	88.6	80.7	39.1	5.5	11.8	0.3	19.3	August
	period average, year-on-year change								
Residential construction ^a									
Starts ^a	5.9	3.6	3.9	9.5	16.4	17.3		4.2	June
Completions ^a	6.4	3.4	3.5	7.6	-13.3	11.8		20.6	June
Building permits ^{a,d}	23,468	3,180	3,807	5,422	9,741	2,746			June
Nonresidential construction									
Area of starts ^a	-17.7	-49.5	-34.2	24.4	-13.5	15.8		15.8	June
Survey of companies (net balance, percent) ^c									
Weighted balance of the business sector	-7.8	-10.7	-1.8	17.1	26.2	17.2			June
Output of manufacturing firms	-4.2	-13.6	2.4	24.2	31.4	21.6			June
Sales by trading firms	-7.9	5.1 [^]	-1.4 [^]	24.7	26.7	17.4 [^]			June

* When the last month is August, the period of comparison is four months; when the last month is July, the comparison is quarterly; when the last month is June, the period compared is two months.

[^] Not significant at 10% level.

^a Unadjusted data.

^b Year-on-year.

^c 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.

^d The number confirmed by the Israel Land Administration in the relevant period.

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

Table 1.3. Indicators of Labor Market Developments, 2009-10
(percentage change, seasonally adjusted)

	2010/II ('000)	Percent change from previous quarter					May - August 2010			
		2009			2010		Change from previous period	Year on year change ^a	Last month for which data available*	
		II	III	IV	I	II				
Civilian labor force	3,075.4	0.0	0.6	0.4	0.3	1.2	1.2	2.5	June	
Israeli employees	2,884.4	-0.5	0.9	0.9	0.6	2.0	2.0	4.5	June	
<i>of which:</i> in public services	876.4	-0.7	2.4	2.1	0.2	2.2	2.2	7.1	June	
in business sector	2,015.2	-0.5	0.0	-0.3	1.1	2.5	2.5	3.4	June	
Foreign workers and Palestinians (unadjusted) ^b	276.3	2.9	1.8	-0.6	2.0	-2.9	-2.9	0.2	June	
Average hours worked weekly per Israeli employee	35.8	0.3	1.4	0.8	-1.4	-1.4	-1.4	0.8	June	
Weekly Labor input in business sector (incl. foreign workers and Palestinians)	97,067.7	0.4	1.2	1.7	-0.7	0.1	0.1	3.8	June	
<i>of which:</i> Israelis	84,859.6	0.1	1.2	2.1	-1.0	0.5	0.5	4.6	June	
Weekly labor input in public services (Israelis)	18,391.7	-0.6	5.2	2.7	-2.1	0.7	0.7	8.4	June	
Unemployed	191.0	5.7	-2.3	-5.7	-3.9	-10.0	-10.0	-21.5	June	
Work seekers	189.9	4.6	-1.4	-2.0	-6.6	-1.0	-3.0	-10.5	July	
Claims for unemployment benefit	75.9	14.1	2.4	-5.0	-10.1	-5.1	-5.6	-19.9	August	
Balance of employment ^c		-0.6	-0.3	1.7	2.3	1.2			June	
Vacancies ^a				-10.7	4.1	27.7	29.6	35.1	August	
	NIS	Seasonally adjusted								
Real wage per employee post ^{d,e}		-1.2	0.3	-0.6	1.3	-0.1	0.1	1.1	July	
In public services		-1.0	0.1	-1.3	1.2	-0.1	-0.7	0.0	July	
In business sector		-1.8	0.4	-0.2	1.6	-0.5	0.1	1.7	July	
Nominal wage per employee post ^e	8,210.3	-0.1	1.4	0.4	1.6	0.3	0.5	3.5	July	
In public services	7,813.8	0.2	1.1	-0.6	1.8	0.4	-0.4	2.4	July	
In business sector	8,376.3	-0.9	1.7	0.6	2.0	-0.4	0.4	4.1	July	
		Percent, seasonally adjusted								
Participation rate		56.5	56.6	56.5	56.5	56.9			June	
Employment rate		52.0	52.2	52.4	52.5	53.3			June	
Unemployment rate		8.0	7.8	7.3	7.0	6.2			June	
Depth of unemployment ^f		33.4	34.8	34.4	36.1	36.2			June	

* When the last month is August the period of comparison is four months; when the last month is July the comparison is quarterly; when the last month is June the period compared is two months.

^a Raw data.

^b Due to an error in the method of calculation, the data from January 2008 have been recalculated.

^c Posts filled minus terminations of employment as a percentage of the total number of employees in businesses in the Employers Survey Sample.

^d At 2004 prices.

^e Including foreign workers and Palestinians.

^f Percent of unemployed seeking work for more than six months (unadjusted).

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

Table 1.4. Government Budget Performance, 2009-10

							May - August 2010		
	2009			2010			Change from previous period	Year on year change	Last month for which data available*
	2009 ^a	II	III	IV	I	II			
Domestic deficit as percent of GDP	-3.7	-5.3	-1.3	-7.0	-0.8	-2.3			June
Cumulative deviation from domestic budget path, excl. credit extended ^b	(NIS billion) ^c								
Revenue	3.0	0.8	2.9	3.4	1.9	3.7	1.8	2.9	August
Expenditure	-2.5	2.1	-1.3	1.3	0.5	-1.8	-2.3	-3.8	August
Deficit	5.6	-1.3	4.1	2.1	1.3	5.5	4.1	6.8	August
Total deficit excluding credit	-39.3	-13.5	-4.5	-16.1	-3.4	-6.5			August
	Real year-on-year change (percent)								
Government domestic income excluding credit	-9.0	-10.6	-1.2	0.3	12.7	3.8		3.9	August
Government tax revenue	-5.2	-10.3	-1.6	7.1	9.1	8.7		7.6	July
<i>of which:</i> income tax, net	-12.2	-15.5	-12.2	-0.8	2.0	2.0		7.8	August
VAT, gross	-5.8	-13.1	-0.8	3.4	14.1	14.5		7.8	August
Government expenditure excluding credit	-2.4	-8.9	7.0	-0.4	9.3	-6.7		-0.6	August
National Insurance allowances	7.2	7.0	8.0	7.0	4.3	4.1		4.6	July
<i>of which:</i> Unemployment benefit	59.2	71.2	69.4	48.3	2.3	-26.4		-26.1	July
Income support ^d	0.4	0.9	0.7	3.3	2.0	-2.2		-2.0	July
National insurance contributions received from the public	-1.5	4.4	-1.7	2.6	5.0	10.5		10.2	July

* When the last month is August the period of comparison is four months; when the last month is July the comparison is quarterly; when the last month is June the period compared is two months.

^a Compared with previous year.

^b The path was determined on the basis of the deficit target. The data on change from previous period and year-on-year change are differences.

^c Year-on-year change. Does not refer to the seasonal path.

^d Not including income support in old-age and survivors' pensions.

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

Table 1.5. Foreign Trade, Balance of Payments, and the Reserves, 2009-10
(seasonally adjusted)

	2009 ^{a,b}	(rate of change, percent) ^c					May - August 2010		
		2009			2010		Change from previous period	Year on year change ^b	Last month for which data available
		II	III	IV	I	II			
Trade in goods ^d									
Goods imports	-21.3	-4.7	9.4	3.7	10.6	1.1	1.0	17.5	August
<i>of which:</i> Consumer goods	-7.8	-1.6	9.2	3.4	4.9	0.9	2.2	12.5	August
Capital goods	-25.5	-8.4	10.7	-3.2	8.9	2.0	2.5	5.7	August
Intermediates	-24.3	-4.3	8.9	6.7	13.6	0.9	-0.1	24.9	August
Goods exports	-13.4	1.9	8.2	10.5	5.6	-1.7	-1.4	18.5	August
<i>of which:</i> Manufacturing	-13.9	2.2	8.9	10.1	5.3	-1.4	-0.8	18.6	August
<i>of which:</i> High-tech	4.5	8.9	5.5	5.1	-0.2	7.6	10.2	18.4	August
Balance of payments									
					\$ million				
Goods and services exports	68,077	16,244	16,665	18,947	19,520	20,279			June
Goods and services imports	63,372	15,020	15,862	17,704	18,636	18,988			June
Balance of trade in goods and services account	4,705	1,225	802	1,243	884	1,290			June
Financial account	7,580	1,418	1,237	2,815	1,663	2,313			June
(excl. foreign exchange reserves) ^b	5,714	2,237	6,126	-2,394	927	-2,612			June
<i>of which:</i> Nonresidents' direct investment ^b	3,894	703	1,415	591	306	101			June
Nonresidents' portfolio investment ^a	2,389	185	1,074	469	3,827	201			June
Residents' direct and portfolio investment ^b	8,686	1,371	3,246	3,114	5,400	3,763			June
Bank of Israel reserves, end-period ^b	60,612	50,275	59,964	60,612	62,476	63,096	-0.6	11.0	August
Net foreign debt (percent of GDP) ^{b,c}	-27.0	-25.5	-25.9	-27.2	-24.9	-23.8			June

* When the last month is August the period of comparison is four months; when the last month is July the comparison is quarterly; when the last month is June the period compared is two months.

^a Compared with previous year.

^b Raw data.

^c The change relates to the dollar values of imports and exports.

^d Not including ships, aircraft, diamonds, and fuel.

^e GDP calculated at the end-of-period value of the dollar .

SOURCE: Central Bureau of Statistics.

Table 1.6 Indicators of Economic Development in Advanced and Developing Countries^a
 (Annual change, percent, seasonally adjusted)

			2008	2009	2010	2011
					Projection	Projection
World GDP			2.8	-0.6	4.8	4.2
	Advanced countries		0.2	-3.2	2.7	2.2
	Developing countries		6.0	2.5	7.1	6.4
World trade			2.9	-11.0	11.4	7.0
	Advanced countries	Imports	0.4	-12.7	10.1	5.2
		Exports	1.9	-12.4	11.0	6.0
	Developing countries	Imports	9.0	-8.2	14.3	9.9
		Exports	4.6	-7.8	11.9	9.1
Commodity prices (US\$)	Oil ^c		36.4	-36.3	23.3	3.3
	Nonfuel		7.5	-18.7	16.8	-2.0
Inflation (CPI) in advanced countries	Developing countries		3.4	0.1	1.4	1.3
Short-term interest ^d (%)	Dollar deposits		3.0	1.1	0.6	0.8
	Euro deposits		4.6	1.2	0.8	1.0
Unemployment rate in advanced countries	Advanced countries		5.8	8.0	8.3	8.2

^a According to World Economic Outlook, Israel is classified as an advanced country. The advanced countries include the industrialized countries and some emerging markets.

^b Except for unemployment and interest rates (percent).

^c The average price of a barrel of Brent crude oil in 2009 was \$61.78, excluding freight costs. Estimated price for 2010 is \$76.2, and for 2011, \$78.75.

^d Six-month Libor rate for US dollar deposits, and three-month Libor rate on euro deposits.

SOURCE: World Economic Outlook (IMF), October 2010.

Table 1.7 Selected Price Indices, the Effective Exchange Rate, Nondirected Bank Credit, Interest Rates, Yields, and the Share Price Index, 2009–10
(rates of change, percent)

	(Change from previous quarter)						May - August 2010		
	2009			2010			Change from previous period	Change from May-August 2009	Last month for which data available*
	2009 ^a	II	III	IV	I	II			
	Change during period ^b								
CPI	3.9	2.3	1.3	0.5	-0.9	1.5	1.6	1.8	August
Consumer price index, seasonally adjusted	4.0	1.3	0.8	1.1	0.1	0.5	0.3	1.7	August
Price index of owner-occupied homes ^c	19.9	5.1	5.1	5.3	4.0	4.1	2.9	19.9	June
General share-price index	78.7	18.3	10.3	13.9	10.4	-13.8	-5.3	18.7	August
	Change in period average ^d								
Real effective exchange rate ^e	1.8	4.8	1.5	3.3	-3.5	-8.3	-2.0	-5.8	August
Nominal effective exchange rate	4.3	7.5	4.7	5.5	-2.4	-7.8	-1.0	-5.7	August
Nondirected bank credit	4.3	-0.6	0.3	1.1	0.5	1.8	1.5	3.9	August
Effective interest rate in daily deposit auction	0.8	0.5	0.6	0.8	1.3	1.5	1.6	0.5	August
Yield on 5-year bonds	1.5	1.6	1.5	1.1	1.3	1.1	0.8	1.6	August
Risk premium ^f	52.2	-66.7	-54.3	10.7	-1.0	-4.2	1.6	-20.1	August
	Change during previous 12 months ^g								
CPI	3.3	3.2	3.2	3.6	3.5	2.8		2.3	August

* When the last month is August the period of comparison is four months; when the last month is July the comparison is quarterly; when the last month is June the period compared is two months.

^a Compared with 2008.

^b Last month in period compared with last month of previous period.

^c Not part of the CPI.

^d Quarterly average compared with average of previous quarter.

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

^f As measured by the 5-year credit-default-swap (CDS). Calculated as the difference between the monthly average in the quarter and the monthly average of the previous quarter.

^g Year-on-year change in period average.

SOURCE: Central Bureau of Statistics and Bank of Israel.

Part 2: Broader Review of Selected Issues

The Composition of Israel's Goods Exports, by Geographical Destination

- The share of Israel's exports to Europe in Israel's total exports has fallen recently, while the share to Asian countries and other emerging and developing economies has increased. At the same time, the share of Israel's exports to Asia in Asia's total imports increased.
- In world trade in the last few years the share of imports into Asia in world imports has shown a rising trend, while Europe's and the US's shares have fallen.
- A study shows that if the imports of Israel's trading partners increase by 10 percent, Israel's exports would increase at a similar rate, 9.5 percent.
- Under a scenario of an unbalanced increase in world trade (as occurred in the last few years), with imports into the US and Europe increasing by 7.5 percent while those into Asia and the rest of the world grow by 12.5 percent, Israel's exports would also grow at a similar rate to that shown above, i.e., 9.3 percent.

The composition of Israel's exports by trading area destination¹⁶ has changed in the last few years (see Figure 2.1). The main export destinations in the past were the EU (33 percent), the US (28 percent), and Asia (15 percent) (henceforth, the main trading areas). Since the beginning of 2008, however, a downward trend has been evident in Europe's share of Israel's exports. Thereafter, from the second quarter of 2009, the share of Israel's exports destined for Asia began an upward trend, after many years when that share had remained steady, at about 15 percent.

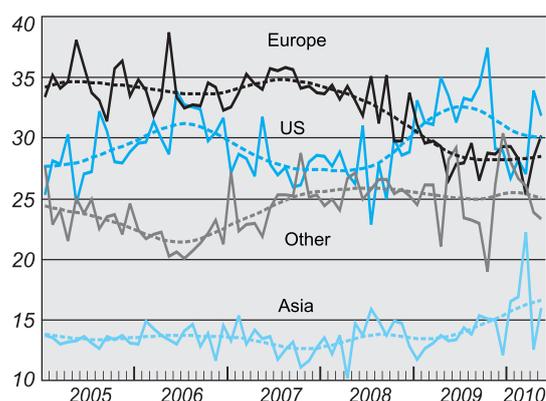
These changes in Israel's exports may derive from the change in the composition of world imports, assuming that the geographical distribution of Israel's exports and that of worldwide imports develop in parallel. Figure 2.2 shows the changes in the shares of the main trading areas in total world

¹⁶ Israel's exports excluding ships, aircraft and diamonds, by country. Countries' data are totaled by the following trading areas: US; Europe—the 27 members of the EU; Asia—India, China, Japan, Hong Kong, Taiwan, Singapore, Thailand, the Philippines and Korea; other—East Europe, West Asia, Central and South America, the Middle East and Africa.

For each area, its external trade was calculated, e.g., the EU's trade includes its trade with other trading areas, but not internal EU trade between member countries, and Asian trade includes Asian countries' trade with other trading areas but not trade among themselves. The reason for this is that internal imports within trading areas is less relevant to the demand for Israel's exports.

Figure 2.1

Composition of Israel's Exports, by Geographical Destination^a, 2005-10^b
(seasonally adjusted, trend data)
(percent)



^a See footnote 16 in the text.

^b Data for February-May 2010 are estimates based on incomplete information.

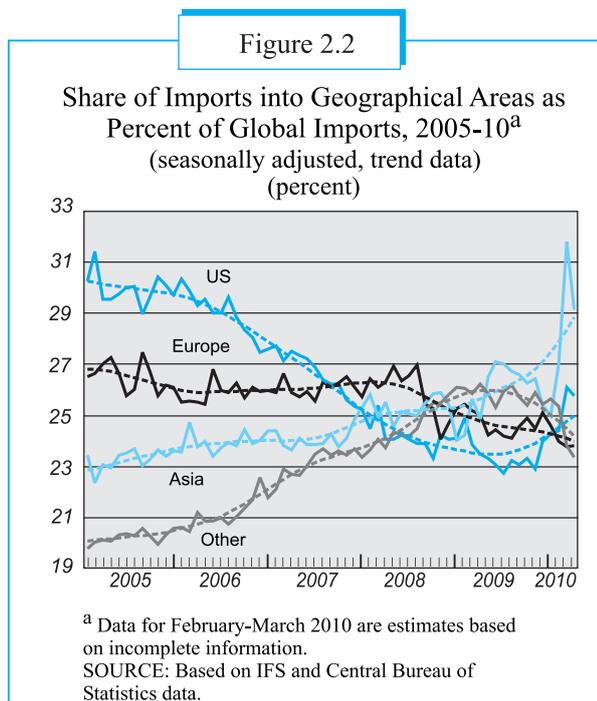
SOURCE: Based on IFS and Central Bureau of Statistics data.

imports between 2005 and the first quarter of 2010. The figure shows that in the period reviewed the share of imports from the US in total world imports declined continuously, while imports from Europe also fell, but more moderately. In contrast, the share of imports from Asia and other countries increased.¹⁷ More recently the picture has changed to some extent: the downward trend in the US share of world trade seems to have halted, and it has been relatively stable since the second half of 2008; the Europe's share of world trade fell at a faster rate from the middle of 2008, compared with a very slow decline from 2005 to mid-2008, while the increase in the share of other countries from 2005 halted in mid-2008, and actually started falling from the second quarter of 2009.

The figures show that the long-term developments in the composition of world imports is different from the composition of Israel's exports. The most prominent differences are the accelerated decrease in the US share of world imports in contrast to the increase in the US share of Israel's exports, and the rapid increase in the share of other countries' in world imports vis-à-vis a slower increase in Israel's exports to them. These developments indicate

¹⁷ The trading areas herein account for about 96 percent of Israel's exports.

an increase in the relative exposure—explained below—of Israel’s exports to the US and a decline in its relative exposure to other economies.



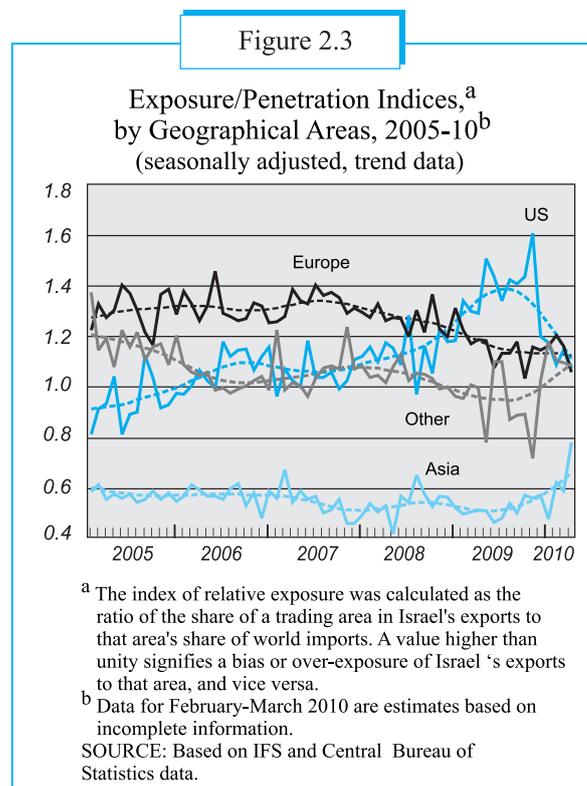
To give expression to Israel’s exposure to the world’s various trading areas, a relative exposure index was calculated. It was constructed as the ratio of the share of a trading area in Israel’s exports to that area’s share of world imports. A ratio higher than unity indicates a bias or excess exposure of Israel’s exports to that trading area, and vice versa. The index also shows Israel’s relative penetration into the various markets around the world. This can be seen by noting that the index is also the ratio of the share of Israel’s exports in that area’s imports to the share of Israel’s total exports in total world imports. If the share of Israel’s exports in the imports of a trading area is greater than the share of Israel’s total exports in total world imports, it means that Israel’s degree of penetration into that trading area is high, and the index will be greater than unity, and vice versa.

For example, The index for the US can be calculated thus:

$$INDEX_{USA} = \frac{\frac{\text{Israel's exports to US}}{\text{Israel total exports}}}{\frac{\text{total US imports}}{\text{total World imports}}} = \frac{\frac{\text{Israel's exports to US}}{\text{total US imports}}}{\frac{\text{Israel total exports}}{\text{total World imports}}}$$

Figure 2.3 shows the indices for the four trading areas over time. Israel’s excess exposure to Europe is evident,

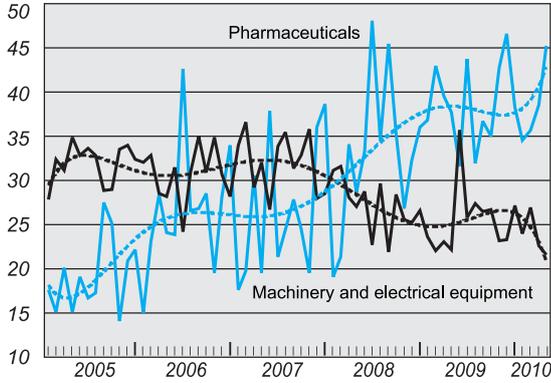
particularly in light of the under-exposure to Asia. The figure shows that at the beginning of the period reviewed there was no deviation in Israel’s exposure to the US. The deviation developed only in the last few years, and was partly due to the opening of a computer processor factory in Israel and the subsequent exports from that factory, which decreased after a while.



The differences between developments in Israel and world wide, expressed by the Israel’s exposure indices to the trading areas, may result from the rapid (or slow) development of a specific export industry, if the industry has different shares in exports to the various trading areas. For example, pharmaceuticals are responsible for a very significant part of Israel’s exports to the US. Our study showed that the share of this industry in exports to the US was more than twice its average share in Israel’s exports. An analysis of Israel’s exports shows that in the last few years Israel’s pharmaceutical exports grew faster than did exports of the other export industries. This is confirmed by the change in the composition of exports to the US which shows the faster rate of increase of the share of pharmaceuticals than of other industries (Figure 2.4). A similar examination of the industry composition of exports to the other trading areas showed no significant change.

Figure 2.4

Israel's Main Exports to the US, by Industry, Share in Total Exports, 2005-10^a (seasonally adjusted, trend data) (percent)



^a Data for February-April 2010 are estimates based on incomplete information. SOURCE: Based on IFS and Central Bureau of Statistics data.

To neutralize the exceptional effect of exports of pharmaceuticals and computer processors on Israel's relative exposure to the trading areas, the indices were calculated excluding those items. The indices are shown in Figure 2.5. It can be seen that the exposure indices (excluding those items) are relatively stable over the years. This means that the composition of Israel's exports by trading area destination adjusts in line with world trade. This reflects the relative flexibility of Israel's exporters to changes in world trade. Recently, increased exposure to Asia and the other markets has been evident, reflected in a rise in the relative exposure index. This means that Asia's share of Israel's exports has risen faster than the share of Asia's imports in world imports.

We think it is too early to determine whether the rise in Asia's relative share of Israel's exports reflects a diversion of trade, and time will tell whether the increase is a permanent one. If the above trend persists, it would apparently indicate that trade has been diverted as a result of a structural change in the target destinations of Israel's exports. Such a structural change was made possible recently by the global crisis and the resulting developments: the very rapid recovery in Asia compared with the moderate recovery of demand in the advanced economies and the expectation of another crisis in Europe made it worthwhile to penetrate into the markets in the East. This was in contrast to the position in the last few years when although demand from Asia grew faster than that from Europe and the US, the geographical composition of Israel's exports developed in line with the geographical composition of world imports. The global crisis in 2008 and concern over another crisis in Europe cast doubts on the continued growth of the advanced economies, and against

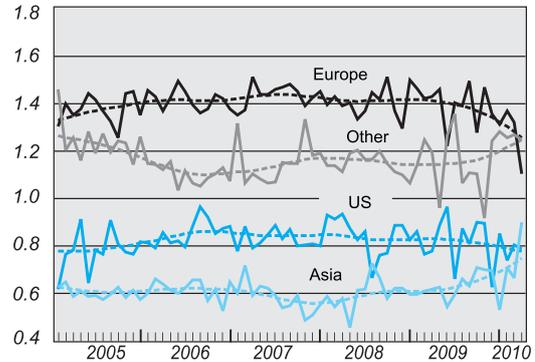
this background, what has been seen in the last few months may be a switch of trade from Europe to Asia.

Israel's exposure to Europe and its under-exposure to Asia vis-à-vis the downward trend in Europe's and the US shares in world trade and Asia's increased share of world trade raise the question of the extent to which changes in world

trade and its composition will affect Israel's exports. We therefore estimated the elasticity of Israel's goods exports by trading area relative to those areas' total goods imports. The estimation shows that Israel's exports are more elastic to changes in demand from Asia (1.15), and less elastic to changes in demand from Europe (0.77) and the US (0.92) (Table 2.1). Hence, assuming that imports of the trading areas increases by 10 percent, Israel's exports would rise at a similar rate, 9.5 percent. An unbalanced increase in world trade, however, with an increase of 7.5 percent in imports into Europe and the US while imports into Asia and the rest of the world rise by 12.5 percent¹⁸ would also lead to an increase in Israel's exports similar to that above, 9.3 percent. This means that whether world growth is balanced, or whether growth in Asia and the emerging market economies outstrips that in the other areas, the resultant growth in Israel's exports would be almost the same.

Figure 2.5

Exposure/Penetration Indices,^a Geographical Areas,^b Excluding Exports of Processors and Pharmaceuticals to the US, 2005-10^c (seasonally adjusted, trend data)



^a The index of relative exposure was calculated as the ratio of the share of a trading area in Israel's exports to that area's share of world imports. A value higher than unity signifies a bias or over-exposure of Israel's exports to that area, and vice versa. ^b The data for Europe and Asia do not include their internal trade. ^c Data for February-March 2010 are estimates based on incomplete information. SOURCE: Based on IFS and Central Bureau of Statistics data.

¹⁸ The gap between the growth of imports into emerging and developing markets on the one hand and imports into advanced economies on the other, estimated at about 5 percentage points, is based in IMF World Economic Outlook, "World Economic and Financial Surveys," April 2010.

Table 2.1
The Effect on Israel's Exports^a of a 10 Percent Increase
in World Trade

	Coefficient	Trading area share of Israel's exports ^b (%)	Balanced increase of 10 per- cent	Unbalanced increase of 10 percent
US	0.77	28.6	30.8	30.2
EU	0.92	29.9	32.7	32.0
Asia	1.15	15.4	17.1	17.6
Other	1.05	26.1	28.9	29.5
Total	0.94	100.0	109.5	109.3

^a See footnote 16 in the text.

^b Average of trend data for 2009 to May 2010.

SOURCE: Based on IMF, IFS and Central Bureau of Statistics data.

Sales by Israel to the Palestinian Economy

- Direct sales by Israeli companies in the manufacturing, electricity and water, agriculture, transport, banking and finance industries to the Palestinian economy in 2008 yielded direct added value of about NIS 1.5 billion, about 0.15 percent of Israel's GDP.
- Direct sales by Israeli manufacturing companies to the Palestinian economy in 2008 yielded direct added value of some NIS 540 million, about 0.6 percent of the industry's total added value, and less than 3,000 employee posts.
- A significant share of the sales consists of the transit of imported goods: in 2008 about 58 percent of Israel's sales to the Palestinian economy were by trading companies, and about 20 percent of those sales were fuel sales.
- Sales to the Palestinian economy constituted less than 2 percent of the sales of total sales of each of the principal industries, except for electricity and water, sales of which were 5 percent of their total sales.

Sales by Israel to the Palestinian economy¹⁹ in 2008 reported to the VAT authorities totaled some \$3.2 billion (about NIS 12 billion), second only to Israel's exports to the US (excluding diamonds) totaling \$11.5 billion, and more than the exports (excluding diamonds) to other important markets, such as Germany or the Netherlands, with exports of about \$2 billion to each. This gives the impression that sales to the Palestinian economy are of great importance to Israel's

¹⁹ Israel's sales to the Palestinian economy do not appear in the figures of Israel's goods trade, as the two economies are under the same customs union. The sales are however expressed in Israel's balance of payments.

economy, but a more detailed analysis of the sales by industry presents a different picture, because a significant share of the sales consists of transit trade of goods imported into Israel, or goods with low added value to Israel's economy.

Evaluating the importance to Israel's economy of these sales can lead to a better understanding of the economic consequences of political and economic policies that effect those sales. Sales to the Palestinian economy increased slightly, and they are expected to continue to grow following the removal of the prohibition, in July 2010, on exports to the Gaza Strip, and as a result of growth in the Palestinian economy—6.8 percent in 2009 (at constant prices). In particular, the development of Palestinian manufacturing industry is likely to boost the demand for Israeli intermediates, machinery, and services. Sales to the Palestinian economy could decline if the latter's boycott of Israeli goods manufactured in Judea and Samaria is extended, even if indirectly or unofficially, to all Israeli manufactured goods, if the customs union is split up, and also if the Palestinians reduce the use made of the Israeli shekel following the issue of a currency of their own.

Data on sales to the Palestinian economy are based mainly on VAT records, categorized by the industry to which the selling company belongs, unlike data of goods exports to other countries, which are based on reports to customs authorities and which are based on the category of the goods sold. The data do not include sales which are not reported to the VAT authorities via invoices designated for Israeli–Palestinian trade, including direct sales of goods to Palestinian households or sales not reported to the VAT authorities at all. The data of sales of agricultural goods are of limited reliability, as they are not liable to VAT, and estimates of those sales are based on other sources. Acting in the opposite direction is the fact that in certain categories those sales are overestimated as they include such goods as fuels sold to the Palestinian Authority but some of which are smuggled back into Israel because of differences in tax rates. The analysis herein is based on data relating to 2008 and not more up-to-date information in order to reduce biases that would arise due to the global crisis.

An analysis of the importance of sales to the Palestinian economy by industry of the exporting companies shows that over half of the reported sales (58 percent) were by trading companies. Those companies' exports to the Palestinians totaled NIS 7 billion (see Table 2.2), of which about NIS 2.4 billion were sales of fuel²⁰—about 20 percent of total

²⁰ These sales data are derived from Paz Ltd and Dor-Alon Ltd financial statements. The Palestinian Authority signed agreements with these two companies that all Palestinian purchases of fuel from Israel will be made via them.

Table 2.2 Sales to the Palestinian economy (PE), by Industry, 2008

	Sales to the Palestinian economy (PE)		Total revenue, by industry (NIS mill)	Sales to PE as share of industry revenue (%)	Attributed to sales to the Palestinian economy	
	Amount (NIS mill)	Percent of total			Added value (NIS mill)	Employee posts
	(I)	(II)			(V)	(VI)
Total sales of goods	10,860.4	90.4				
<i>of which:</i> Agriculture ^a	403.6	3.4	35,410	1.1	165.08	
Manufacturing ^b	1,836.3	15.3	356,634	0.5	538.98	2,787
<i>of which:</i> Food products	785.3	6.5	49,961	1.57	197.17	1,239
Beverages and tobacco products	137.8	1.1	7,483	1.84	73.74	203
Wood and wood products (excl. furniture)	53.5	0.4	2,487	2.15	16.27	129
Paper and printing	174.1	1.4	17,234	1.01	62.94	357
Chemicals and chemical products and oil refining	200.7	1.7	96,895	0.21	51.13	75
Plastic and rubber products	104.8	0.9	17,109	0.61	32.49	144
Non-metallic mineral products	47.4	0.4	9,689	0.49	12.69	59
Basic metals	65.7	0.5	8,256	0.80	12.68	51
Metal products	96.8	0.8	21,913	0.44	36.91	228
Electricity and water	1,421.2	11.8	29,465	4.8	461.90	
Used vehicles	192.6	1.6				
Trade	7,006.7	58.3	429,795	1.6		
<i>of which:</i> Fuel ^c	2,410.0	20.1				
Trade excl. fuels	4,596.7	38.3				
Total services	1,149.1	9.6				
<i>of which:</i> Construction	156.8	1.3	105,521	0.1		
Transport and communications	513.4	4.3	108,667	0.5	209.99	
Banking and insurance	270.3	2.3	28,426	1.0	130.27	
Computing, rental	184.9	1.5	55,174	0.3		
Total excl. diamonds	12,009.5	100.0	1,343,993	0.9		

^a Data on sales to and revenue from the Palestinian economy are based mainly on VAT records, categorized by the industry to which the selling company belongs. The estimate relating to agriculture, which is not liable to VAT, is less reliable.

^b Sales of Israeli manufactured goods via trading companies (industry categories 50-53) are not included in the estimate of sales of Israel's manufacturing industry.

^c Fuel sales data are derived from Paz Ltd and Dor-Alon Ltd financial statements for 2008. According to the Palestinian Central Bureau of Statistics, sales of fuel and mineral products were double the figure shown in this table, and stood at NIS 5.2 billion.

SOURCE: Sales to the Palestinian economy—Central Bureau of Statistics (CBS) processing of VAT data; Coefficients of industry value added—the CBS; Coefficients of value added and output per employe post in manufacturing—Manufacturing Survey (2006).

sales to the Palestinian economy. Non-fuel sales by trading companies totaled NIS 4.6 billion, about 38 percent of the total sales to the Palestinian economy. The data on sales by trading companies to the Palestinian economy do not differentiate between sales of Israeli produced goods and transit trade of goods imported into Israel, but it may be assessed that the latter, whose contribution to Israel's GDP is limited, constitutes a significant share of the total.



Direct sales of the manufacturing industry (NIS 1.8 billion) and the electricity and water industries (NIS 1.4 billion), whose contribution to GDP exceeds that of trading, constituted 15 percent and 12 percent respectively of total reported sales to the Palestinian economy. Sales of the transport and communications industry and of agriculture were relatively modest, about 4.3 percent of total sales to the Palestinian economy. It may reasonable be assumed, however, that those sales figures are biased downward because some of the products are sold by trading companies that are not classified in those industries, and because some other goods and services, such as cellphone services, are sold directly to Palestinian households and are not reported for VAT purposes as transactions with the Palestinian economy.

The limited dependence of Israel's economy on sales to the Palestinian economy can be seen from the low share of those

sales in Israel's total revenue, 0.9 percent, and in the revenue of the agriculture, insurance and banking industries—less than 2 percent. Reported sales of the manufacturing industry to the Palestinian economy were about half a percent of total manufacturing sales (see Column IV in the Table 2.1). Those sales were mainly from the low-tech industries such as food, drink, and wood, paper and metal products, and they accounted for between 1 and 2.5 percent of the revenues of those industries. The main exceptions were the electricity and water industries, with about 5 percent of their sales being to the Palestinian economy. However, it appears that those sales are sometimes a burden to the electricity and water industries in light of their limited capacity.

The direct added value to Israel's manufacturing industry of sales to the Palestinian economy is estimated at about NIS 540 million, about 0.6 percent of the industry's total added value (see Table 2.1, Column V). The total number of employee posts that may be attributed directly to those sales is estimated at less than 3,000. The added value of electricity and water sales is NIS 461 million. The total added value of direct sales of the manufacturing, electricity and water, agriculture, transport, banking and insurance industries to the Palestinian economy is about NIS 1.5 billion, about 0.15 of Israel's GDP in 2008.

It is important to bear in mind that these figures do not include sales of Israeli goods by companies in the trading industry, nor do they include VAT, wages, or employee posts in the providers of ancillary services and sellers of intermediate goods to companies selling to the Palestinian economy. Nevertheless, even if the contribution of Israel's sales to the Palestinian economy is twice that estimated herein, the contribution to Israel's GDP and employment is still not a large one. It should however be taken into account that a decline in these sales would probably have a negative effect on companies in the low-tech, traditional industries—food, drink, wood, electricity, and energy companies. In particular, companies specializing in sales to the Palestinian economy would suffer a negative impact.

Annual Growth Forecast for the Principal Industries

- The Bank of Israel has compiled an annual growth forecast for the principal industries in the current year and next year. This forecast is intended to assess industry developments and to compare them with the development of aggregate business-sector product on the basis of uses.
- According to the forecast, manufacturing product will expand by 7.5 percent and construction product by

4.8 percent in 2010. The growth rates in the principal industries in 2010 were compiled by using a method that makes it possible to forecast annual growth on the basis of monthly data (such as revenue).

- With the exception of the construction industry, a somewhat slower pace of growth is likely in all industries in 2011 relative to the growth estimate for 2010. The forecasting of industry growth rates in 2011 is based on variables that imply information on expected developments, such as variables from the capital market.

Over the years, the Bank of Israel has compiled and published GDP growth forecasts for Israel while forecasting developments in uses. The Research Division at the Bank of Israel recently began to forecast business-sector product by forecasting growth rates in the principal industries. This forecasting is intended to assess industry developments and to compare them with the development of business-sector product and uses (consumption, exports and investment)—a well-known parameter that has been published to date. For the purpose of forecasting for the rest of the year, use is made of year-to-date monthly data on changes in economic activity and in the variables reflecting expectations of future change. However, the forecast for the next year is based mainly on variables that imply information on expected developments. The quality of the forecasts improves in the course of the year due to the updating of monthly data. Here, we will describe the methods employed for forecasting in the principal industries, and will present the growth forecasts for these industries during the rest of the current year and next year. As with macroeconomic forecasts, the realization of this forecast is dependent on assumptions regarding exogenous variables—for example, the assumption regarding the expansion of world trade, which is based on the IMF forecast.

One of the main problems in forecasting product growth in the principal industries is that accurate data on developments in the majority of these industries are published with a three-year lag. Until then, only data based on developments in revenue (or output) are published. Although these provide a good indication of developments in product, in many cases the actual development of such parameters differs from the development of product itself to a considerable extent. Two problems exist: Firstly, the monthly information on revenue received in the course of the year is integrated as an explanatory variable in a model in which the explained variable is not revenue but output. Secondly, the retroactive comparison between the forecast product values and the figure that is published at the end of the year leads to a

difference. This difference derives *inter alia* from the fact that the year-end figure is based on revenue data, and is not final.

When the information on the forecast year (2010) is partial, the growth rates in the principal industries are forecast by using a mixed-frequency data sampling (MIDAS) method, a method that has recently become accepted practice in similar applications.²¹ Using this method makes it possible to connect between the dependent variable, which is measured annually—the output growth rates in each and every industry—and explanatory variables, which are measured at a higher frequency: monthly data on real revenue by principal industries and quarterly data on companies' expectations (by industry) from the Ministry of Industry and Trade's Employers Survey.²² The model thereby utilizes the information obtained from all the updates received in the course of the year, and over time the estimates converge with the estimate based on complete information for the forecast year.

The forecast employing this method is compiled for each of the 11 principal industries, and the change in aggregate business-sector product is calculated according to each industry's weight in business-sector product in the previous year. Due to data limitations, no forecast exists for the electricity and water industry, and it was assumed that this industry will expand in line with the GDP growth rate (on the basis of uses). Table 2.3 details the forecast for 2010.

Forecasting of the growth rates in the principal industries next year (2011) includes separate forecasts for manufacturing, commerce and services (the accommodation services and restaurants, financial services, real estate and business services industries, education services, health and welfare services, and personal services), construction, and transport and communications. In order to obtain a forecast of business-sector product, a regression was run which explains business-sector product from the principal industries side via industries for which separate forecasts were compiled.

²¹ See: Ghysels, E., Santa-Clara, P. and Valkanov, R. (2004), "The MIDAS Touch: Mixed Data Sampling Regression Models", Mimeo, Chapel Hill, N.C.

²² All the explanatory variables are seasonally adjusted. Revenue variables are calculated in terms of monthly rates of change, each month compared with the previous month. Variables relating to expectations are calculated as diffuse indices. In the construction industry the model includes additional explanatory variables—the monthly rates of change in building starts over the previous 20 months. In the finance industry, since the banks' activity is not represented in the revenue indices, monthly changes in aggregate bank credit in real terms were taken into account.

Table 2.3 Industry product forecasts for 2010 (percentage change in annual terms; fixed prices)

	Weight in 2009	Growth forecast
Agriculture	2.4	2.3
Manufacturing	20.8	7.5
Construction	6.6	4.8
Wholesale and retail trade	11.6	5.7
Accommodation services and restaurants	2.9	6.2
Transport and communications	10.9	5.3
Financial services (banking, insurance, etc.)	17.2	4.2
Real estate and business services	23.3	7
Education	1.2	5.8
Health & welfare	2.4	3.8
Personal services	4	6
Electricity and water*	2.9	-
Total business-sector product**		5.7

* In the absence of updated monthly information, it is assumed that the growth rate in the industry is the same as the uses-based GDP growth rate.

** The industries' weight exceeds 100, taking into account imputed bank services, errors and omissions.

The forecasts for the manufacturing and the commerce and services industries were compiled by means of OLS regressions, in which the explained and the forecast variable is the annual rate of change in the indices of manufacturing and of commerce and services activity—industrial production and the revenue of the commerce and services industry respectively. The explanatory variables for forecasting purposes are the IMF forecast of the developed countries' imports—variables that reflect demand for Israel's products and services, data from the Israeli and American capital markets, which are likely to reflect changes in the development of the Israeli economy and the global economy, and expectations of such changes. As expected, these affect the industries' growth (with a positive sign). With the manufacturing industry, information from the Bank of Israel's Companies Survey on expectations for the next quarter was used as well, on the assumption that it implies not only information for the next quarter, but also expectations regarding further developments in the industry. In order to demonstrate the quality of the forecast, Figure 2.7 presents the performance of the forecast for the manufacturing industry: Actual rates of change in the industrial production index are presented for each year alongside the forecast for

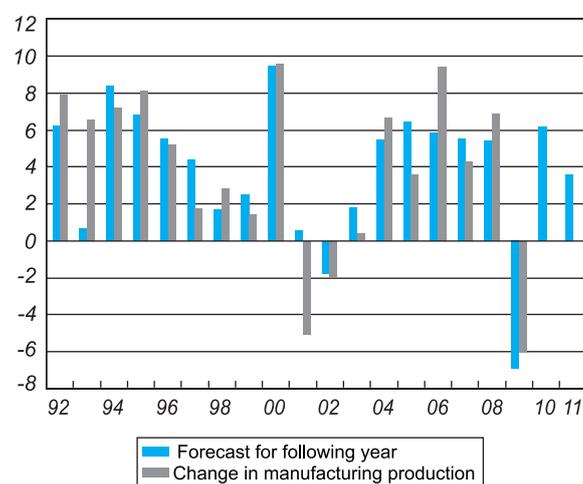
that year, which is based on data that were available until the middle of the previous year.

The forecasts based on the models employed over the years appear reasonable, and succeed in discerning the turning points in the business cycle. Under this model, 4 percent growth in manufacturing product is forecast for 2011.

The explained and the forecast variable in the construction industry is the rate of change in the industry's product. The annual forecast for the construction industry's activity is based on an estimate of the quarterly differences equation

Figure 2.7

**Forecast vis-à-vis Mid-Year Actual
Manufacturing Production 1992-2008,
and Forecasts for 2010 and 2011**



SOURCE: Bank of Israel.

from 1995 and until the first quarter of 2010, with a lag. The equation is based on supply factors—the active construction of residential apartments and non-residential buildings, cement consumption and the number of workers—all with a positive sign—and interest rates, with a negative sign. Although it was necessary to assume the values of part of the variables when compiling the forecast for 2011, it was found that these assumptions are not critical for the results.

The forecast for the transport and communications industry is based on the assumption that the industry is affected by two main factors—its structural development as the result of investments, which reach fruition with a lag, and its close relationship with the activity of the other industries, especially the commerce and services industry. The forecast

for the transport and communications industry is therefore based on investments in the industry as well as forecasting of the development of the commerce and services industry.

The business-sector product growth forecast is based on a weighting of the forecasts for the principal industries by means of a regression, in which the explained variable is product by principal industries and the explanatory variables are series of outputs of the principal industries (such as manufacturing, commerce and services, and construction). The purpose of the regression is to overcome differences between the weighting of the summary of the industries and business-sector product by principal industries. This is because imputed bank services, and errors and omissions are not taken into account, and due to the lack of a forecast for the agricultural and the electricity and water industries.

Table 2.4 describes the findings of the industry forecasts, and presents a comparison between the forecast derived from the principal industries and the uses-derived forecast.

Like the macro forecast, the industries forecast for the current and next year is optimistic. However, a difference exists between the uses forecast for 2010 and the forecast based on a weighting of the industries for which forecasts

were compiled for that year. The forecast from the industries side for 2011 is the same as that from the uses side.

The difference between the uses forecast and the weighting of the industries for which forecasts were compiled may derive from two factors. The most likely factor is the fact that the calculation methods differ: Product by principal industries is calculated at production factor prices, and is estimated in accordance with the development of industry indicators of output (output + imports), while product from the uses side is at market prices, and is based on an attempt to estimate the value added of product. Over time however (approximately three years), the difference between the actual data and the series is not great in most years (Table 2.4) because it is updated retroactively: The principal industries' product is updated on receipt of the results of the industry output surveys with a lag of approximately three years. At the end of the year therefore, a difference may be apparent between product from the industries side—which is a temporary figure based on revenue data—and product from the uses side. In addition, a difference may derive from

Table 2.4 Development of business-sector product and product of the principal industries, 2000 to 2011

	Business-sector product by		Product of the principal industries				
	Uses	Principal industries	Manufacturing	Trade and services	Construction	Transport and communications	Agriculture
2000	11.5	11.2	15.5	14.7	-1.3	4.2	6.6
2001	-1.3	-1.7	-10.7	-1.4	-4.0	0.8	9.1
2002	-2.6	-2.6	-5.9	0.9	1.1	2.9	2.8
2003	2.0	2.4	5.8	-1.0	-4.3	2.9	-7.1
2004	6.7	6.8	3.4	8.6	-7.5	11.3	17.4
2005	6.1	6.2	9.2	7.9	0.8	11.3	7.9
2006	6.4	6.4	11.2	8.3	7.7	2.1	-0.1
2007	5.6	6.2	4.2	8.0	5.3	5.8	-0.3
2008	4.5	4.4	7.4	3.2	2.3	4.4	-5.2
2009	-0.2	-0.2	-5.9	2.2	-1.0	-4.0	0.0
2010 (F)	4.4	5.7	7.5	5.7	4.8	5.3	2.3
2011 (F)	4.4	4.4	4.0	3.6	7.0	5.0	-
2009 weight	-	-	20.8	62.7	6.6	10.9	2.4

Diary of Events: May to August 2010

the lack of a forecast of the electricity and water industry, and from the difficulty in observing the volume of imputed bank services.

May	2	The Governor of the Bank of Israel, Stanley Fischer, has been appointed for a second term.	
	9	The leaders of the euro block decided to establish an emergency fund in an attempt to check the crisis in Europe.	Facing increasing concern about the fate of the euro bloc, leaders of the bloc countries convened for emergency consultations at the European Union headquarters in Brussels, and announced the immediate establishment of a special emergency fund in an attempt to curb the crisis threatening Europe. The European leaders also approved an assistance package of 80 billion dollars for Greece.
	9	The Taxation Authority is promoting an exemption from criminal procedure for foreign-bank-account holders who report on their profits.	The initiative of the Taxation Authority is designed to encourage Israelis holding bank accounts abroad to declare them. If this is done in the designated period, criminal proceedings will not be instigated against them for failure to report and for non-payment of taxes until now.
	10	The budget of the Israel Science Foundation will be doubled to half a billion shekels for advancing higher education.	The annual budget of the Israel Science Foundation, which supports Israeli research, will be increased substantially to more than NIS 500 million. The increase is part of the five-year plan for higher education in Israel, which includes establishing excellence centers to counteract the brain drain, integrating the ultra-Orthodox in academia, and streamlining the universities.
	11	The rescue plan for the euro bloc is finally approved.	The heads of the euro bloc countries announced an assistance package of 750 billion euros, with the aim of stabilizing the euro, calming the markets, and preventing the spread of the Greek crisis.
	13	Dorad will sell electricity to Mekorot.	Mekorot, the national water company, signed a NIS 2.4 billion contract to purchase electricity from the Dorad private power station. Mekorot will purchase electricity for 12 years, at an estimated annual cost of about NIS 200 million.
	13	A company was established to manage the pension clearing houses.	The commissioner of capital markets, insurance and savings, Prof. Oded Sarig, announced the establishment of a company that will set up and manage the clearing house for transferring information and money with regard to pension savings.
	20	The European Union transferred 14.5 billion dollars to Greece.	The first stage of the European rescue program is under way. This is the first payment in the assistance package for Greece.
	21	An agreement was signed between Israel and China for industrial R&D cooperation.	The agreement facilitates industrial R&D cooperation between Israeli and Chinese companies. The Israeli company will receive support of up to 50 percent of R&D costs from the Office of the Chief Scientist in the Ministry of Industry, Trade and Labor.
	24	The post office will start issuing credit cards.	The Israel Postal Company has been accepted as a non-full member of Visa Europe, which enables it to issue Visa credit cards.

	24	The Bank of Israel interest rate for June was left unchanged at 1.5 percent.	
May	25	The Bank of Israel published new directives regarding the development of risks because of housing loans.	The Supervisor of Banks in the Bank of Israel has instructed the banks to reexamine mortgage risks in order to ensure that they are not taking undesirable risks. The banks are also required to create an additional reserve for housing loans given with high loan-to-value ratios. The regulation comes into force on July 1.
	26	The term of office of senior banking personnel will be limited.	In order to refresh the management of the banks more frequently, the Supervisor of Banks decided to limit the term of office of bank chairmen and CEOs to 10 years, or to two consecutive terms of office whose length will be determined by the bank.
	30	The Fitch international rating agency lowered the credit rating of Spain by one level, to AA+.	Fitch justified the move based on assessments that the across-the-board budgetary cuts that Spain declared in order to deal with its deficit, will slow down the country's economic activity and its short-term growth.
June	2	Further write-off of bank debts in the euro bloc.	The European Central Bank warned of a second wave of bad debts of 195 billion euros. This wave will add to the 238 billion euros that the banks on the Continent have been forced to write off since the outbreak of the global economic crisis in 2007.
	4	A new preliminary minimal capital adequacy target was determined.	The Supervisor of Banks announced that every bank should adopt a preliminary minimal capital adequacy target of not less than 7.5 percent, and reach this target by December 31.
	6	Economic measures against Israel in European countries.	Port workers in Sweden boycotted goods from Israel. At the same time, tens of thousands of Europeans demonstrated against the events surrounding the flotilla to Gaza.
	7	Israeli embargo of Turkey.	In addition to the cancellation of charter flights from Israel to holiday destinations in Turkey (as part of a wave of cancellations that began immediately following the events surrounding the flotilla to Gaza), the management of the large workers' committees in Israel decided to exclude Turkish products as holiday gifts for their employees.
	7	The Ministry of Finance presented the growth forecast for the two-year budget.	According to the Ministry of Finance, growth in 2011 and 2012 will be 4 percent and 3.8 percent, respectively. The ministry's updated growth forecast for 2010 is 3.6 percent.
	7	The reduction in vacation pay for teachers and public-sector employees has been postponed.	Udi Nissan, budget director of the Ministry of Finance, and the chairman of the Histadrut labor federation, Ofer Eini, reached an agreement according to which vacation pay for public sector employees would be paid in full for 2010. The reduction would be postponed to 2011.
	7	Banknotes in 2012 will be of different sizes for the benefit of visually impaired people.	The Ministerial Committee on Legislation decided that banknotes and coins will be of different sizes, and with special features for the benefit of blind and visually impaired people.
	8	Approval of free dental treatment for children.	The Knesset passed the plan for providing free dental treatment to children up to age 8, starting on July 1.

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	9	A plan was presented for encouraging hi-tech industry in Israel	At the annual conference of the high-tech industry, the Minister of Finance presented an encouragement plan for the industry. The plan recommends developing R&D centers in Israel, granting tax benefits to scientists returning from abroad, and postponing exits. The state will allocate NIS 200 million to increase institutional investment in high-tech enterprises.
June	9	The first budget for promoting the "Netivei Israel" plan was approved. [Upgrading the road and rail network.]	The Finance Committee approved an immediate budget of NIS 250 million, and an authorization for earmarking NIS 3.5 billion in the 2011-2012 budget.
	14	The volume of real-estate transactions has declined in recent months.	The sale of apartments decreased by about 30 percent in May relative to the previous year, and the prices of second-hand apartments fell by up to 5 percent in the past six months.
	14	The Bank of Israel revealed its official policy regarding the salaries of senior personnel.	According to the Bank of Israel there is no connection between salary and performance. The salary encourages risk-taking, and is given at the expense of the shareholding public.
	15	The allowance for married students in talmudical colleges was revoked.	After discussions that have continued for ten years, the High Court of Justice ruled that government support for married talmudical college students, which is granted by virtue of a clause in the Budget Law, would be revoked.
	15	Supervision of the activity of the credit card companies on the internet will be intensified.	The Bank of Israel is tightening its demands from the credit card companies operating in electronic trading on the internet, in particular with regard to clearing.
	18	The Moody's credit rating agency lowered the rating of Greek bonds from a solid rating (AAA) to the lowest possible rating—junk.	
	18	Turkey has frozen all its military agreements with Israel.	Turkey announced that it is freezing 16 agreements with the Israeli government, including planned transactions worth billions of dollars.
	21	The banks will be required to report on Israeli residents holding high-value assets abroad.	A new regulation of the Bank of Israel requires the banks to report quarterly on Israeli residents holding capital abroad in excess of 20 million dollars (not only liquid capital, but also other financial assets).
	22	The Taxation Authority will cancel tax benefits to members of purchasing groups.	The tax benefits currently enjoyed by the organizers of the groups and their members have been canceled, and these purchasers will be required to pay a similar tax to that paid by people purchasing apartments from a contractor.
	23	The Knesset gave its final approval to a bill enabling the government to present a two-year budget for 2011-2012.	

	27	The United States approves the economic reform.	The reform confers far-reaching authority on regulators, who will be equipped with a variety of means for supervising financial institutions. The authority of the Federal Reserve System, which is the leading body in the supervision of financial institutions, will be widened. A body with an independent budget will be set up to supervise credit and mortgage products, in order to protect consumers. It was decided that henceforth credit transactions must exceed 10 dollars.
June	28	The Bank of Israel supports extending the negative income tax program, unrelated to the Wisconsin Plan.	Until now, the Ministry of Finance has made the extension of the tax conditional on operating the Wisconsin Plan throughout the country. The Bank of Israel, the National Insurance Institute, the Tax Authority, and the Brookdale Institute have published a joint report summarizing the first year of operation of the negative income tax program. The findings of the report show that negative income tax extricated about 4.5 percent of grant recipients from poverty, reduced the poverty gap by about 5 percent, and raised the income of the lower quintile of grant recipients by about 12 percent.
	28	The Bank of Israel interest rate for July was left unchanged at 1.5 percent.	
	29	At the economic summit in Canada, the G20 countries undertook to reduce their budgetary deficits.	Leaders of the 20 largest economies in the world will pursue independent policy for reducing their budgetary deficits, and each country will take steps to reduce the deficit according to its particular needs. The countries also undertook to reduce the budgetary deficit of their countries by half by 2013, and to balance their debt/GDP ratio by 2016.
July	5	The proposal to raise the minimum wage from NIS 3,850 to NIS 4,600 was rejected.	The government decided to reject Amir Peretz's proposal to raise the minimum wage. At the same time the Minister of Finance announced his intention to present for discussion the budget for 2011-2012, which will include a response to the low-earning working population by expanding the negative income tax program that compensates low-wage earners.
	6	New working conditions for employees in the construction industry.	The Minister of Industry, Trade and Labor, Benjamin (Fouad) Ben-Eliezer, signed an extension order to the collective agreement between the Histadrut and the Association of Contractors and Builders in Israel, detailing the working conditions of all employees in the construction and renovation industry. The agreement states that every employee is entitled to a minimum wage of NIS 4,350, and that a construction foreman will earn at least NIS 6,550.
	7	A proposal to reduce VAT was postponed.	According to the state budget proposal of the Ministry of Finance, VAT will remain at 16 percent, and will be reduced to 15.5 percent only in 2013.
	12	It was decided to establish a public committee to deal with the issue of concentration of ownership in the economy.	
	13	Fall in mortgage interest rate.	The average mortgage interest rate fell in the second quarter of the year by 0.31 percent, to a historic low of 2.31 percent.

	14	Moody's lowered the credit rating of Portugal; S&P issued a warning to Britain.	The Moody's credit rating agency lowered the rating of Portugal by two levels. The S&P rating agency reconfirmed Britain's perfect credit rating—AAA—but maintained its negative credit rating forecast. The agency claims that the scale of the British government's debts is higher than what is acceptable among governments with a perfect credit rating.
July	18	The government approved the budget for 2011-2012.	Among the changes in the budget: the defense budget will be reduced by NIS 2.7 billion; the army retirement age will be raised gradually to 50 on average; the Ministry of Industry, Trade and Labor received an addition of millions of shekels; the Ministry of National Infrastructures will have to forego streamlining in the energy field; most of the reforms in the Ministry of Communications were approved.
	18	The government approved the Arrangements Law.	The law contains 67 sections, including: taxation and VAT for purchasing groups, annulment of the Public Housing Law, increasing the supply of housing, protecting and strengthening buildings, changing the budgetary procedures for projects of the Office of the Chief Scientist, reducing the Ministry of Finance's allocation to the National Insurance Institute, and raising the retirement age in the career army.
	19	The Concentration Groups Law is approved.	The Ministerial Committee on Legislation approved the Concentration Groups bill, in terms of which the authority of the antitrust commissioner will be expanded, enabling him to declare an organization a "concentration group" and operate against it.
	21	The Bank of Israel will require the banks to comply with a new parameter—the capital/balance sheet ratio.	Starting in 2012, the Bank of Israel intends to require the banks to comply with a new stability parameter—the capital/balance sheet ratio—and to determine its minimum threshold value. This ratio provides a complementary measure to capital adequacy, the other measure indicating the stability of the banks.
	21	Moody's reduced Ireland's credit rating to Aa2.	
	26	The price of calls abroad from cellular phones will be significantly reduced.	A new regulation will come into force on August 1, which is intended to significantly reduce the cost of phoning abroad from a cellular phone—by around 35 percent.
	26	The Bank of Israel interest rate for August was raised by 0.25 percent to 1.75 percent	
	29	A proposal for reform in the credit card market, the aim being to increase competition and to benefit mainly the owners of small businesses in the periphery.	According to the proposal, any organization that has issued 10 percent or more of all credit cards is a large issuer, and will be obliged to allow other clearers to clear transactions executed by means of its debit cards.
August	5	The price of bread under supervision has risen by 3.55 percent as a result of a sharp rise in wheat prices worldwide.	

	5	Interconnect tariffs to be reduced.	The Ministry of Communications is expected to reduce the interconnect tariffs to 5 agorot by 2014. Interconnect tariffs are expected to decrease by about 80 percent from their current level (25 agorot without VAT).
August	10	The Basel Committee on Banking Supervision published concessions to “Basel 3”	The Basel Committee on Banking Supervision has changed the draft of directives of “Basel 3” in the direction of easing them: concessions from the original demands will be made for capital requirements and liquidity.
	11	The government will provide guarantees for private power stations.	The Finance Committee approved guarantees of NIS 7 billion for power stations run by private electricity producers.
	12	Israeli banks will be required to report to the United States authorities on assets held by United States citizens.	A new regulation of the United States tax authorities will come into effect in 2013. This regulation is part of a revolutionary legislative procedure in the United States that requires financial organizations worldwide to report on activities they undertake for United States citizens. Banks worldwide do not have to comply with this regulation, but the Americans have announced that sanctions will be imposed on banks that do not sign the arrangement, namely, revocation of the tax benefits that have been in force until now. Israel manages 20 billion dollars owned by foreigners, and the banking system fears that the new regulation will lead to an outflow of money.
	16	Old banknotes are being finally removed from circulation.	The Bank of Israel announced that December 31 this year marks the end of the period in which it is possible to convert old banknotes of the A series of the New Sheqel, and 5 agorot coins.
	17	Asylum seekers can open a bank account in Israel without a passport.	The Supervisor of Banks published an update regarding the opening of bank accounts by asylum seekers in Israel. The arrangement will enable asylum seekers and people enjoying temporary humanitarian protection to open bank accounts in Israel, even if they do not have in their possession a passport of their country of origin.
	19	New reform in higher education.	The higher educational system will receive an addition of NIS 7.5 billion over the next six years, as part of the budgetary reform for the universities and the public colleges in Israel. At the heart of the reform is a change in the budgetary model, according to which institutions that publish more quality research will be rewarded accordingly.
	19	Launching of a program to encourage the establishment of financial R&D centers in Israel by multinational companies.	The program includes unprecedented benefits: for the first time the Office of the Chief Scientist will grant the world’s leading foreign banking corporations a NIS 100 million grant for five years. The corporations will enjoy full exemption from royalties, and will not be fined if they leave the country, taking with them the knowledge they have developed.
	20	The government will initiate a NIS 1.8 billion program for developing alternative fuels.	The government intends to invest NIS 1.8 billion in a national program for developing alternative transportation-energy sources. The program includes the establishment of venture capital funds in cooperation with the private sector with the aim of leveraging the government investment.

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	21	A government program to persuade institutional investors to invest in high-tech.	Venture capital funds will be required to invest 90 percent of their money in Israeli companies in order to benefit from the money of the institutional investors. The state will hedge the institutional investors against losses for up to 20 percent of their investment. Implementation of the program is expected to begin within two months.
August	21	The government takes measures to strengthen the connection between academe and industry.	The program for strengthening the connection between academic research and industry in Israel will be budgeted in 2011 for NIS 40 million. The program is intended to encourage applied research in the universities, the research institutes, and the colleges, with the aim of translating the high relative advantage they enjoy in research, into products that Israeli industry will produce.
	23	The government gave its final approval to joining the OECD.	The government ratified the agreement for Israel to join the organization, the final stage in the process of joining.
	23	The Bank of Israel interest rate for September was left unchanged at 1.75 percent.	
	26	S&P lowered Ireland's credit rating by one level to AA-, with a negative forecast.	
	29	The Finance Committee approved the updating of the allowance paid to Holocaust survivors.	The monthly allowance paid to about 20,000 Holocaust survivors and disabled war veterans was updated retroactively from October 2009.
