

CHAPTER I

MAIN ECONOMIC DEVELOPMENTS

ECONOMIC GROWTH slowed down in 1969 following an exceptionally strong advance the year before, the first full year of recovery from the recession. Gross national product increased by 11 percent at constant prices, compared with over 15 percent in 1968; employment and the utilization of production capacity also continued upward, but at a much slower pace than in the previous year. Despite the deceleration of economic growth in 1969, it was still relatively high, similar to that of the boom period of the early sixties. Although in the course of the year reviewed full employment was attained, wages and prices remained comparatively stable. Imports expanded at a lower rate than in 1968; however, the growth of exports fell off sharply, with the result that the import surplus rose to a substantial \$ 894 million, continuing the rapid upswing begun in 1967. Since capital imports held steady, foreign currency reserves declined sharply, with net balances totalling only \$ 382 million at year's end. The external debt reached approximately \$ 2,100 million, 59 percent more than at the end of 1966.

In 1968 the upsurge of economic activity was associated with a number of special factors working to stimulate demand. The growth of economic activity outpaced the increase in the economy's productive capacity, a development made possible by the existence of a large reserve of idle factors of production. During the year reviewed the impact of some of these factors waned as the economy approached a state of full employment, and this was apparently the principal reason for the comparative stability throughout the year. Other factors were a slowing of monetary expansion, a tight money market, and higher interest rates, all of which helped to restrain demand. The final uses that slowed down most were exports and investment (both of which had contributed heavily to the rapid growth of demand in 1968). Since the direct expansionary influence of public sector operations was on about the same scale as in 1968, it did not tend to accelerate the rate of economic growth, as in the two preceding years.

Despite a slower increase in disposable private income, private consumption continued upward at the same rate as in 1968; this depressed the rate of private saving and counterbalanced to some extent the impact of the factors moderating the growth of economic activity.

Exports of goods and services at constant prices advanced only 5 percent in 1969, compared with 27 percent the year before. They accounted for some 9 percent of total incremental demand, as contrasted with 25 percent in 1968.

Gross capital formation expanded by 15 percent, after soaring 46 percent in 1968. Inventories and fixed nondwelling investment rose more sluggishly in the year reviewed, while dwelling investment went up at a stronger rate. As a result

Table I-1
MAIN ECONOMIC INDICATORS, 1961-69
(percentages)

	Annual increase or decrease (-)					Average 1966-69
	Average 1961-65	1966	1967	1968	1969	
Resources and uses						
(at constant prices)						
Total domestic uses	10.5	-0.8	3.7	17.8	12.2	8.2
Gross national product	10.3	1.1	2.0	15.4	10.9	7.4
GNP per capita	6.2	-1.5	-1.2	11.6	8.2	4.4
Private consumption	10.3	3.1	1.4	12.0	11.7	7.1
Private consumption per capita	6.1	0.5	-1.7	8.3	9.0	4.0
Public consumption	10.6	8.3	36.1	14.9	11.3	17.7
Gross investment	11.3	-16.1	-22.0	45.9	15.1	5.7
Balance of payments (\$)						
Imports ^a	12.0	3.8	12.4	29.5	15.3	15.5
Exports ^a	15.6	16.5	8.9	26.3	9.9	15.4
Import surplus ^a	8.8	-14.5	19.3	35.3	24.4	16.1
Long- and medium-term capital imports	5.8	-14.7	73.5	-15.7	0	10.8
Foreign exchange reserves ^b	25.6	-3.4	15.1	-7.3	-37.9	-8.4
Population and employment						
Average population	3.9	2.6	3.2	3.4	2.5	2.9
Number of employed	4.8	-0.6	-4.3	9.0	3.8	2.0
Daily average of unemployed	-11.0 ^c	126.8	58.0	-56.3	-54.5	18.5
Prices and national income						
(nominal)						
Average monthly wages per employee	13.6	19.1	0.4	3.2	4.6	6.8
Hourly wages	13.3	19.8	3.3	-0.3	3.2	6.5
GNP prices	8.0	8.0	0.7	2.2	3.5	3.6
Consumer price index (annual average)	7.4	8.0	1.6	2.1	2.5	3.6
National income	18.8	9.0	4.1	18.3	12.8	11.1
National income per capita	14.3	6.2	0.9	14.4	10.0	8.0
Finance						
Money supply (annual average)	17.6	7.3	20.3	19.0	7.1	13.4
Bank credit to the public and bill brokerage credit (annual average) ^d	19.6	22.9	19.0	12.4	17.6	18.0

^a Goods and services; imports valued on a c.i.f. basis, and exports f.o.b.

^b Foreign currency balances in the Bank of Israel at the end of the year.

^c In 1963-65 only.

^d In 1961-63 bank credit only.

of the slower expansion of exports and capital formation and the continued rapid uptrend in private consumption, the weight of the last item within incremental final uses rose from 29 percent in 1968 to 48 percent.

Consumption per capita increased by 9 percent, exceeding the 6 percent average for the years 1960–65. In durable goods there was an especially striking rise of nearly 40 percent.

Employment went up by approximately 4 percent in 1969, thereby largely eliminating the last vestiges of unemployment. Moreover, the number of hours worked per employed continued upward and more workers were employed from the administered areas, augmenting the supply of unskilled labor. Despite the elimination of unemployment, there was only a moderate rise in average wages per employee and in hourly wages—4.6 and 3.2 percent respectively. However, it should be noted that the existing labor agreements did not call for any revision of basic wage rates, and no cost-of-living allowance increment was paid during the year. As a result, hourly earnings in public and business services remained virtually unchanged; in construction and industry, on the other hand, the level went up by 8 and 4.5 percent respectively. In the latter sectors demand for labor exceeded the national average, and wage drift was comparatively rapid, particularly in the case of skilled workers.

Prices rose at a somewhat higher rate than in the two preceding years: the consumer price index went up by 2.5 percent on an annual average, compared with 2.1 percent in 1968 and 1.6 percent in 1967. That the general price level held relatively steady even though the economy was approaching a state of full employment is explained by the more sluggish growth of demand, the much larger import surplus, the freezing of prices under Government control, and a notable improvement in productivity. Average product per man-hour increased by 6.5 percent, thus averting a cost-push on prices because of the rise in wages. However, while the general price level remained stable, there were some relatively steep increases. This applies in particular to services free of Government control, which climbed 5.7 percent in 1969, whereas the prices of services and goods largely subject to Government control remained practically unchanged. In addition, there was an above-average rise in investment prices, especially in the case of housing.

The expansion of economic activity was reflected by a 15 percent increase in imports, though this was substantially below the 29 percent figure recorded in 1968. Import prices went up by some 5 percent, so that the quantitative increase was approximately 10 percent. Commodity imports expanded somewhat faster than services. Expectations of devaluation and higher taxes induced a large speculative import of certain items, particularly durable goods and rough diamonds. On the other hand, the structural change in incremental final uses (the decline in the weight of exports and investments with a high import component) tended to stem the growth of imports. The increase of some 15 percent in defense imports led to an accelerated expansion of service imports. All told,

imports of goods and services at constant prices rose a little more slowly than the gross national product.

Export proceeds were up 10 percent in 1969, while in real terms the growth of overseas sales came to only 5 percent, as contrasted with an exceptionally strong 26 percent in 1968. There was a 15 percent gain in proceeds from commodity exports, but services yielded only 4 percent more than in 1968. Agricultural exports advanced only slightly, as in 1968. The expansion of industrial exports sagged appreciably, mainly because of a much smaller growth in the case of diamonds. Excluding diamonds, industrial exports gained 18 percent, compared with 26 percent in 1968. There was a striking deceleration in overseas sales by the defense and building materials industries, as well as in potash and refined petroleum products. On the other hand, citrus products were far above their 1968 level, as were a long list of other industrial products. Services accounted for most of the decline in the export growth rate, rising only 4 percent as against 32 percent in 1968. Nearly all items were affected, but especially tourism and passenger transportation, which fell off in absolute terms.

As a result of the above foreign trade developments, the adverse balance in the country's goods and services account went up by \$ 176 million, from \$ 718 million in 1968 to \$ 894 million.¹ Approximately \$ 40 million of the increment can be attributed to higher import prices.

Since capital imports remained about the same as in 1968 and short-term foreign debt repayments increased, the country's foreign currency reserves dwindled rapidly. Liquid reserves fell by \$ 250 million; minus foreign bank deposits with the Bank of Israel, the decline reached \$ 280 million, and at year's end net reserves stood at \$ 382 million.

The shrinkage of foreign currency reserves had far-reaching repercussions on the rate of monetary expansion. Together with the contractionary influence of the growth of Pazak and Tamam deposits, it offset the stimulative effect of the much heavier Bank of Israel lending to the Government for financing its deficit budget, as well as of the larger volume of Bank of Israel rediscounts and loans to the public. Liquid assets of banking institutions fell by IL 60 million. This reduced their capacity to expand ordinary credit; despite heavy demand, such credit increased by a relatively slow 8.5 percent. Total credit to the public, including bill brokerage and Bank of Israel rediscounts, was up 17.5 percent from 1968.

The money supply expanded by only 2.5 percent in the course of 1969 and by 7 percent on an annual average—low rates compared with previous years. The growth of other financial assets held by the public likewise slowed down. Total monetary expansion amounted to 14 percent in 1969, as against 22 percent the year before.

¹ These data include trade with the administered areas. Excluding the areas, the current deficit increased from \$ 527 million in 1967 to \$ 748 million in 1968 and \$ 944 million in 1969, and the trade gap from \$ 459 million in 1968 to \$ 563 million in 1969.

Together with the lower rate of growth, there was a structural change in the increment: a switch from unlinked financial assets to linked assets, which was connected with expectations of devaluation and a general price increase. There was an exceptionally strong expansion of Pazak and Tamam foreign currency deposits, which are linked to the exchange rate, as well as of approved saving schemes, linked to the consumer price index.

The tightness in the money market, first noticeable in the last quarter of 1968, carried over through 1969, being reflected by a rise of free-market interest rates, the incurring of large liquidity deficits by commercial banks, the growth of bill brokerage business, and a higher circulation velocity of the money supply.

Bank of Israel policy was designed to ensure the continuation of a tight money situation and thereby restrain the growth of domestic demand. Owing to the decline in the liquid assets of banking institutions and the stability of the money supply, the central bank did not have to resort to further absorptive measures. Its policy during the year was largely of a regulatory nature, designed to prevent crises.

Despite a huge increase of IL 1,080 million in revenue from taxes and other transfer receipts, the public sector's demand surplus held fairly steady in the year reviewed, since its purchases went up to about the same extent. Security outlays, transfer payments, and interest expenditure increased conspicuously. In addition, the public sector lent approximately IL 220 million net to the rest of the economy. To finance the demand surplus and credit outflow, it received IL 1,250 million in loans and advances from the Bank of Israel, IL 270 million in credit from banking institutions, and IL 960 million in unilateral transfers and credit from abroad. Total financing from the banking system and overseas sources reached approximately IL 2,480 million in 1969, compared with IL 2,210 million in the preceding year.

Analysis of public sector operations during the last two years reveals that the heavier borrowing from the banking system and overseas sources did not increase the sector's expansionary effect on domestic economic activity, but resulted in larger imports. By contrast, in 1967 the big increase in the sector's expansionary influence was largely instrumental in reviving the economy. However, in that year it occurred against the background of large-scale unemployment, while in 1969 there was virtually full employment.

Public sector dissaving totalled IL 1,720 million in 1969, thus remaining at the high level of 1968. Gross private sector saving out of income from all sources increased moderately. Since the growth of private consumption outstripped that of private incomes, the rate of gross private saving edged down from 29 to 27 percent, which was still higher than in the early sixties. In 1968, on the other hand, consumption lagged behind the rise in domestic income and unilateral transfers from abroad, so that the saving rate moved up.

Though no data are available to break down private saving into its component elements, there are signs that the much heavier investment by households

and businesses in 1968 was wholly financed by savings, and that there was even some left over for investment in financial assets. In contrast to this, in the year reviewed the small savings increment was insufficient to finance the additional investment, even though the latter expanded more slowly; as a consequence, the combined household and business sector had to seek financing from other sources.

Economic growth, as already noted, was sustained in the year reviewed, but at a more sluggish pace than during the last months of 1967 and in 1968. To be sure, in 1969 the gross national product expanded by 11 percent on an annual average, but the rise in end-year levels was lower. The slower trend apparently carried over into the early months of 1970. The sagging economic growth rate can be partly attributed to the weakening of the special factors stimulating the economy during the early stages of recovery from the recession, but in part it can also be ascribed to the slower expansion of commodity and service exports.

The developments in 1969, which resulted in a much larger import surplus, the depletion of foreign exchange reserves, and a rise in the external debt, underline the central problem facing the economy: the inability to finance a mounting import surplus over time from unilateral transfers and long-term loans from abroad.

Continued economic expansion and the prevention of large-scale unemployment, which of necessity involve a further rise in imports, are conditional on a much stronger growth of exports and an increase in their weight in domestic production. This would boost the economy's foreign currency income and enable it to maintain relatively high levels of employment and economic activity, though not as high as during boom periods. However, this transition to economic expansion sustained largely by exports can be realized only gradually, and entails keeping the country's goods sufficiently competitive in foreign markets. Meanwhile, until the requisite productive factors are diverted to export production, it will be necessary to mobilize capital abroad on an even greater scale. These efforts have to be directed to reversing the slowdown in the growth of exports and to restraining domestic demand, thereby leading to a smaller expansion of imports and the diversion of productive factors to export.