

CHAPTER III

PRICES

The three-digit inflation which had prevailed in the past few years carried over through 1982. The price level in the various markets stood 2.3–2.4 times higher at the end of the year reviewed than at the end of 1981. The consumer price index, the most conventional measure of inflation, went up 131 percent during 1982, while its annual average level rose 120 percent.

The price advance did not proceed at an even pace during the year: in the first three quarters inflation accelerated, but toward the end of 1982 and beginning of 1983, when anti-inflationary measures were adopted, the rise of prices was slowed down, but the average rate of increase was the same as in the three preceding years.

In recent years the government's policy of subsidizing basic products and services has undergone frequent changes, and this has been a direct cause of the fluctuations in the consumer price index. The policy of controlling prices and the changes in such prices have an opposite, but not simultaneous, effect on the rate of inflation: in contrast to the direct and immediate impact of a revision of controlled prices, the government injection (or absorption) generated by such changes has a lagged effect on the index.¹ It is hard to estimate the length of the lags, and their effect changes with the level of economic activity during the period concerned.

In the course of 1982 controlled prices shot up 143 percent (as against 60 percent last year), and this directly affected the rate of increase in the general price index. The cutting of subsidies in 1982 and its impact on prices this year were to a large extent expected. These expectations arose from the gap which appeared last year between controlled and uncontrolled prices: this led to the swelling of the government's demand surplus, and in its wake to a much larger injection—a policy that cannot be persisted in for any length of time.

The price increases in 1982 were very similar to those in 1980, and were higher than the rates recorded in 1981. The experience of the last few years shows that changes in the policy of subsidizing controlled items influence the swings in the consumer price index, but are unable to alter the basic rate of inflation. This stands out in the light of the relatively stable rate of increase in uncontrolled prices over the past three years.

¹ The weight of controlled items in the consumer price index comes to nearly 20 percent.

Table
SELECTED PRICE
(Percent increase during

| | 1978 | 1979 | 1980 | 1981 | 1982 |
|--|------|------|------|------|------|
| 1. Consumer price index | | | | | |
| General index | 48 | 111 | 133 | 101 | 131 |
| General index, excl. fruit and vegetables | 47 | 114 | 131 | 101 | 132 |
| Housing (20) | 57 | 159 | 107 | 132 | 133 |
| Food (excl. fruit and vegetables) (19) | 39 | 136 | 152 | 62 | 153 |
| Fruit and vegetables (7) | 70 | 79 | 165 | 115 | 124 |
| Household maintenance (10) | 40 | 125 | 143 | 103 | 127 |
| Furniture and household equipment (8) | 47 | 76 | 129 | 98 | 115 |
| Clothing and footwear (6) | 50 | 66 | 130 | 146 | 108 |
| Education, culture, entertainment (9) | 38 | 85 | 129 | 114 | 136 |
| Health (4) | 64 | 94 | 144 | 116 | 137 |
| Transport and posts (13) | 49 | 99 | 128 | 82 | 127 |
| Miscellaneous (4) | 41 | 99 | 132 | 80 | 140 |
| 2. Index of wholesale industrial prices | 47 | 113 | 138 | 105 | 138 |
| 3. Index of input prices | | | | | |
| Residential construction | 58 | 117 | 134 | 109 | 130 |
| Road construction | 66 | 124 | 152 | 122 | 133 |
| Agriculture | 46 | 115 | 150 | 96 | 141 |
| 4. Official exchange rate | | | | | |
| Against the dollar | 24 | 86 | 113 | 107 | 116 |
| Against a foreign currency basket ^a | 33 | 94 | 106 | 82 | 100 |
| 5. Import prices (excl. diamonds) | | | | | |
| In terms of foreign currency basket ^a | | | 16 | 8 | 1 |
| In IS terms | | | 140 | 102 | 97 |

NOTE: Figures in parentheses are the percentage weights of the items in the consumer price index, according to the 1979/80 family expenditure survey.

^a A basket of five currencies: U.S. dollar, German mark, pound sterling, French franc, and Dutch guilder. The increase in import prices is a quarterly average; no data are available on the increase during the quarter.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

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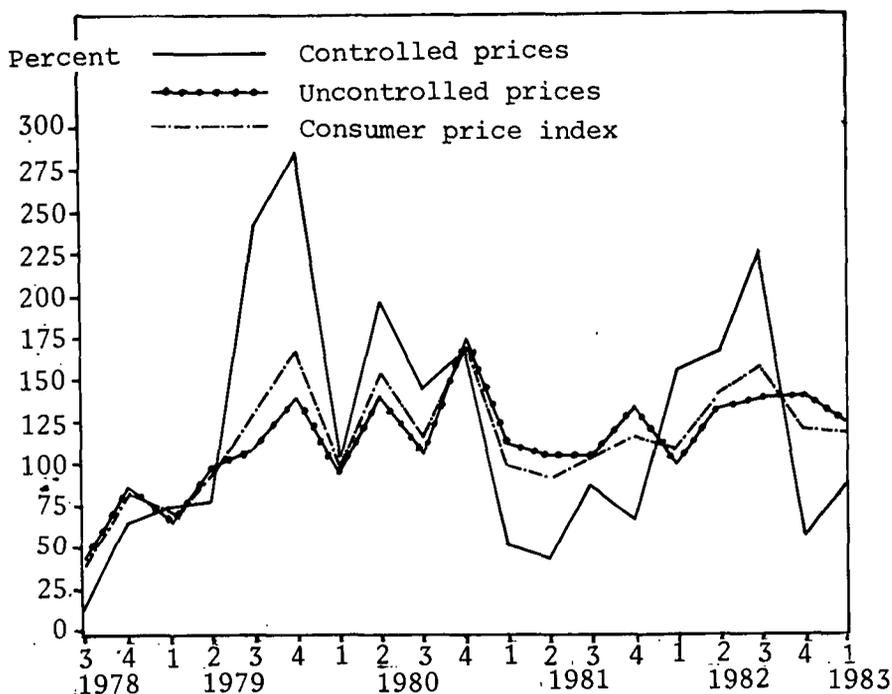
INDEXES, 1978-82

(the period, at annual rates)

| Quarterly data | | | | | | | | | | | | |
|----------------|-----|-----|-----|------|-----|-----|-----|------|-----|-----|-----|------|
| 1980 | | | | 1981 | | | | 1982 | | | | 1983 |
| I | II | III | IV | I | II | III | IV | I | II | III | IV | I |
| 96 | 154 | 116 | 174 | 98 | 91 | 102 | 116 | 109 | 141 | 158 | 120 | 118 |
| 85 | 157 | 122 | 169 | 90 | 107 | 98 | 108 | 114 | 148 | 160 | 110 | 98 |
| 78 | 129 | 81 | 149 | 117 | 145 | 138 | 129 | 155 | 132 | 128 | 118 | 103 |
| 137 | 153 | 159 | 161 | 83 | 29 | 65 | 75 | 154 | 149 | 251 | 85 | 118 |
| 333 | 113 | 47 | 261 | 247 | -58 | 168 | 283 | 56 | 62 | 123 | 349 | 575 |
| 81 | 222 | 106 | 190 | 76 | 172 | 110 | 70 | 129 | 189 | 128 | 75 | 88 |
| 79 | 127 | 154 | 165 | 118 | 81 | 87 | 109 | 83 | 116 | 151 | 115 | 116 |
| 5 | 292 | 47 | 363 | 32 | 425 | 30 | 307 | -7 | 286 | 43 | 261 | 5 |
| 97 | 122 | 169 | 133 | 126 | 100 | 162 | 104 | 80 | 128 | 224 | 133 | 100 |
| 158 | 142 | 107 | 171 | 142 | 118 | 91 | 116 | 134 | 142 | 138 | 134 | 134 |
| 36 | 189 | 149 | 174 | 67 | 83 | 98 | 80 | 141 | 121 | 190 | 71 | 93 |
| 136 | 127 | 150 | 118 | 93 | 67 | 82 | 79 | 83 | 142 | 213 | 141 | 163 |
| 116 | 141 | 129 | 169 | 124 | 95 | 101 | 101 | 131 | 148 | 184 | 97 | 113 |
| 89 | 197 | 109 | 155 | 140 | 138 | 129 | 47 | 132 | 151 | 152 | 92 | 109 |
| 97 | 156 | 157 | 209 | 153 | 109 | 156 | 80 | 125 | 132 | 184 | 99 | 138 |
| 135 | 178 | 121 | 170 | 111 | 94 | 76 | 105 | 149 | 163 | 142 | 109 | 97 |
| 89 | 106 | 100 | 166 | 91 | 201 | 75 | 82 | 128 | 149 | 112 | 80 | 91 |
| 51 | 166 | 92 | 133 | 55 | 110 | 63 | 107 | 86 | 132 | 96 | 90 | 67 |
| 49 | -4 | 2 | 22 | 32 | 23 | -10 | -9 | 6 | -10 | 8 | 2 | |
| 194 | 96 | 119 | 163 | 139 | 129 | 55 | 97 | 95 | 97 | 123 | 77 | |

Figure III-1

**MOVEMENT OF CONSUMER PRICES: GENERAL INDEX, CONTROLLED PRICES,
AND UNCONTROLLED PRICES, 1978-83**
(Percent quarterly increase, at annual rates)



A measurement of the annual average rates of inflation also reveals a stable picture. The price deflator for the gross national product at market prices went up 127, 127, and 122 percent in 1980, 1981, and 1982 respectively, while the deflator for the private sector product at market prices rose by 134, 121, and 122 percent respectively.²

As regards relative prices,³ this year witnessed a sharp drop in both import and export prices. In the case of imports this reflected a continuation of the downturn in its relative price, a result of the policy of lowering customs duties and other taxes on imports. This trend became more pronounced in the year reviewed owing to the abating of world inflation and the depreciation of the sheqel at a lower rate than the rise in domestic prices. The weakening of export prices reflected both the slackening of world demand and Israel's currency depreciation policy this year. The relative price of public consumption continued upward, owing to a rise in real wages in the

² These changes in the two indexes relate to annual average levels; no data were available on the movement of the indexes in the course of the year.

³ These are measured in relation to the deflator for total uses in the economy. The relative prices of imports and exports are also discussed in Chapter VII.

public sector and the increased cost of noncivilian consumption. No distinct trend was discernible in the relative prices of private consumption and investment.

The price advances this year occurred against the backdrop of constricting developments in the economy's real activity: on the one hand, GNP was stagnant and the labor market continued to be weak, a trend that has prevailed for the past few years. On the other hand, domestic uses (private and public consumption and investment) expanded faster than the average rate for the past five years (the development of uses is described in Chapter II).

The growth of domestic uses and the stagnation of the product were consistent with the increase in the import surplus. Were it not for the drop in the relative price of imports and the diversion of domestic demands to the foreign sector, inflation probably would have been higher in 1982 than it actually was, and the product somewhat larger.

The construction industry, one of the leading sectors in the economy, continued to be sluggish in 1982, and the relative price of dwellings fell further during the year. Nominal wages per employee post in the business sector rose a little faster than prices, but the reduction of the sector's labor input resulted in a 3 percent growth of wages per hour worked, and hence in a real increase in the cost of labor. This created inflationary pressure from the costs side.

From a long-range point of view, inflation is always accompanied by a nominal monetary expansion. This originates in the government's fiscal policy (injections engendered by the government's demand surplus), the Bank of Israel's policy in the credit and financial assets markets, and balance of payments developments.

The government demand surplus shrank in 1982, after expanding greatly in 1981, and returned to its level of 1980. This was accompanied by an increase in the amount of government credit granted for development purposes. Since the demand surplus declined to about the same extent as net long- and medium-term borrowing from the public, there was no change in the government injection this year. The average level of outstanding bank credit fell 8 percent in real terms, but there was a 3 percent increase in the course of the year (December levels). All the growth took place in the final quarter, and was offset in the first four months of 1983. This year's increase in the private sector's current account deficit was financed mostly by capital imports and only to a minor extent by the purchase of foreign currency from the Bank of Israel. These purchases siphoned out IS23.3 billion in 1982, as against IS13 billion last year (this is discussed in detail in Chapter VIII).

The growth of the public's financial asset holdings accelerated this year in nominal terms, and the real increase came to 27 percent. Liquid financial assets, including bank shares, grew by 12 percent. In the light of these developments, 1982 can be characterized as a year of monetary expansion.

The relationship between an injection and the price level finds expression after some time-lag. Since the length of the lag varies, it is difficult to pinpoint this relationship at every point in time. Broadly, it can be said that the principal long-term factor that influenced inflation in 1982 was the monetary expansion in previous years, especially the exceptionally large injection in the second half of 1981, and not the injection in 1982.

Table III-2
SELECTED PRICE INDEXES, 1970-82
 (Percent annual average change)

| | Average | | | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|-----------|-----------|-----------|------|------|------|------|------|
| | 1970-1973 | 1974-1978 | 1979-1982 | | | | | |
| Consumer price index | 13 | 39 | 112 | 51 | 78 | 131 | 117 | 120 |
| Wholesale price index of industrial output ^a | 11 | 43 | 116 | 53 | 79 | 135 | 123 | 126 |
| Index of agricultural input prices ^b | 13 | 43 | 117 | 51 | 78 | 144 | 119 | 128 |
| Index of housing construction input prices | 16 | 38 | 116 | 57 | 87 | 128 | 132 | 117 |
| Index of road construction input prices | 14 | 47 | 128 | 75 | 92 | 145 | 147 | 127 |
| Exchange rate against the dollar ^c | 5 | 34 | 96 | 62 | 47 | 102 | 122 | 112 |

^a Until 1978 excludes printing and publishing.

^b Excludes agricultural services.

^c The official exchange rate of the sheqel until October 1977 and the representative rate thereafter.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

The high inflationary expectations continued to influence the behavior of economic units, and hence also the actual rate of inflation, despite the more sluggish level of economic activity this year.

The public's expectations were formed in the light of all the domestic developments, not only in the current but also in previous years. The cooling of inflation in 1981 was achieved thanks largely to the direct price control measures adopted. Subsidies were raised this year, and this resulted in an extraordinarily large government demand surplus, which had a contrasting effect on the public's expectations. Thus there is no reason to assume that the high level of expectations changed toward the end of 1982.

In the year reviewed the government conducted a policy that brought its demand surplus down to the 1980 level by stiffening taxes proportionately more than the growth of public spending (this policy is described in detail in Chapter V).⁴ Against this background, in the final part of year new policy measures were introduced which

⁴ The contraction of the government demand surplus was accompanied by a smaller long-term borrowing from the public, and so the liquidity injection during the year did not decrease to the same extent as the demand surplus (see the discussion in Chapter V). It is also possible that in the short run the stiffening of taxes heightened pressure on prices from the costs side. The tax hikes were partly at the expense of saving and not merely consumption, and consequently they did not fully counter the inflationary influence of the heavier government spending.

were supposed to work on a broad front—on import prices, controlled prices, interest rates, and wages. This policy was intended to coordinate and synchronize numerous factors that influence the consumer price index in the short run, thereby making it possible to tone down inflation without triggering sharp swings in relative prices. In the final quarter of 1982 and first quarter of 1983 the spiraling of prices slackened compared with the preceding quarters, but inflation remained at its average level of recent years. This is borne out by a comparison with the corresponding quarters of the previous year and by the continued surging of uncontrolled prices.

Table III-A1
CHANGE IN PRICE DEFLATORS FOR RESOURCES AND USES, 1970-82
 (Percent annual average increase)

| | Average | | | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 | 1980 | 1981 | 1982 |
|--|---------------|---------------|---------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|--------------|--------------|
| | 1970- 1973 | 1974- 1978 | 1979- 1982 | | | | | | | | | |
| Gross national product | 14.0 | 39.7 | 114.3 | 34.4 | 39.3 | 27.0 | 43.6 | 54.0 | 80.8 | 126.9 | 127.3 | 122.1 |
| Imports, excl. direct defense imports ^a | 14.9 | 46.9 | 107.1 | 44.6 | 41.5 | 32.7 | 40.9 | 74.7 | 71.2 | 135.4 | 115.8 | 106.0 |
| Private consumption | 13.5 | 39.4 | 110.0 | 38.0 | 40.6 | 28.6 | 36.0 | 54.0 | 77.1 | 128.6 | 118.9 | 115.6 |
| Public consumption, excl. direct defense imports | 15.7 | 41.6 | 119.1 | 36.1 | 38.8 | 30.2 | 48.4 | 54.3 | 94.4 | 125.7 | 133.3 | 122.9 |
| Gross domestic investment | 16.4 | 43.3 | 114.1 | 42.1 | 34.0 | 25.7 | 40.5 | 74.2 | 72.6 | 132.6 | 134.0 | 117.1 |
| Total domestic uses, excl. direct defense imports ^a | 14.7 | 40.6 | 112.7 | 38.4 | 38.5 | 28.3 | 39.8 | 58.1 | 79.6 | 128.8 | 125.0 | 117.6 |
| Exports, at domestic prices | 13.2 | 46.4 | 107.2 | 35.7 | 45.7 | 30.1 | 50.2 | 70.1 | 74.2 | 128.7 | 118.4 | 107.6 |
| Total uses, excl. direct defense imports ^a | 14.4 | 24.1 | 111.3 | 37.9 | 40.0 | 28.7 | 42.6 | 61.5 | 77.8 | 129.4 | 123.0 | 115.0 |

^a Until 1977 excludes ships and aircraft.

SOURCE: Central Bureau of Statistics.

Table III-A2
MONETARY INDICATORS OF INFLATION, 1974-82

| Year | Rate of inflation | Percent increase in liquid assets ^a | Weight of narrow monetary base in total liquid asset base ^b (%) | Real money balances ^c | Injection into liquid asset base relative to narrow monetary base ^d |
|------|-------------------|--|--|----------------------------------|--|
| 1974 | 56 | 44 | 25 | 100.0 | 30 |
| 1975 | 24 | 17 | 24 | 98.5 | 6 |
| 1976 | 38 | 20 | 24 | 90.1 | 16 |
| 1977 | 43 | 58 | 28 | 88.4 | 41 |
| 1978 | 48 | 58 | 21 | 86.5 | 77 |
| 1979 | 111 | 83 | 16 | 53.4 | 75 |
| 1980 | 133 | 148 | 12 | 45.3 | 92 |
| 1981 | 101 | 90 | 11 | 40.1 | 53 |
| 1982 | 131 | 132 | 11 | 36.6 | 52 |

^a Percent annual increase in the money supply, time deposits and negotiable certificates of deposit, bonds, and Patam (local residents' foreign currency deposits).

^b The ratio between the narrow monetary base and the liquid asset base (annual averages).

^c Base: 1974=100.

^d The injection into the liquid asset base is defined as the government's domestic demand surplus, less long-term borrowing from the public, plus Bank of Israel rediscounts and other factors, less purchases of foreign currency by the private sector, less the increase in the liquid asset base due to the growth of the economy. An injection of this magnitude is not inflationary. The ratio between this variable and the monetary base is calculated as a moving three-year average in order to smooth deviant changes over the years and to reflect the lagged effect of the monetary variables on prices.

Table III-A3
CHANGE IN CONSUMER PRICES: GENERAL INDEX, CONTROLLED PRICES, AND UNCONTROLLED PRICES, 1979-82
 (Percent increase during the period, at annual rates)

| | Quarterly data | | | | | | | | | | | | | | | | |
|----------------------------------|----------------|------|------|------|------|-----|-----|-----|------|-----|-----|-----|------|-----|-----|-----|------|
| | 1979 | 1980 | 1981 | 1982 | 1980 | | | | 1981 | | | | 1982 | | | | 1983 |
| | | | | | I | II | III | IV | I | II | III | IV | I | II | III | IV | I |
| Controlled prices ^a | 153 | 150 | 60 | 143 | 88 | 203 | 143 | 169 | 50 | 43 | 86 | 65 | 156 | 167 | 228 | 56 | 88 |
| Uncontrolled prices ^b | 101 | 128 | 114 | 128 | 95 | 141 | 107 | 176 | 112 | 105 | 105 | 134 | 100 | 134 | 140 | 141 | 125 |
| Consumer price index | 114 | 133 | 101 | 131 | 96 | 154 | 116 | 174 | 98 | 91 | 102 | 116 | 109 | 141 | 158 | 120 | 118 |

^a The index of controlled prices comprises the following items: bread, flour, eggs, frozen beef and poultry, edible oils and margarine, milk and milk products, property tax, municipal rates, electricity, water, fuel for domestic use, school fees (kindergarten, elementary, and secondary), cigarettes and other tobacco products, public urban and interurban transport, postal and telephone services. The weight of these items in the consumer price index is approximately 20 percent.

^b The index of uncontrolled prices comprises all consumer price index items not included in note a.

Table III-A4
UNCERTAINTY INDEXES OF INFLATION, 1970-82
 (Base: 1975-78=100)

| Period | Average monthly change in CPI (%) | Index of change in CPI over time ^a | Index of change in relative prices ^b |
|---------|---|--|--|
| 1970-72 | 1.09 | 56 | 89 |
| 1975-78 | 2.67 | 100 | 100 |
| 1979-82 | 6.48 | 105 | 137 |
| 1974 | 3.71 | 171 | 126 |
| 1979 | 6.24 | 107 | 136 |
| 1980 | 7.05 | 111 | 141 |
| 1981 | 5.84 | 113 | 147 |
| 1982 | 6.79 | 80 | 127 |

^a Calculated as the standard deviation of the monthly rates of change in the consumer price index around the annual average rates of change.

^b Calculated as the standard deviation of the monthly rates of change in the consumer price index items (according to their weights in the index) around the monthly rate of change in the index. The annual figure is an average of 12 monthly observations.

Table III-A5
INDEX OF DWELLING PRICES, 1976-82^a
(Average October 1975 to March 1976=100)

| Year and month | Index of dwelling prices | Relative to consumer price index | Relative to index of construction input prices |
|----------------|--------------------------|----------------------------------|--|
| 1976 January | 100.0 | 1.000 | 1.000 |
| April | 101.4 | .944 | .942 |
| July | 102.7 | .879 | .867 |
| October | 105.7 | .832 | .845 |
| 1977 January | 107.6 | .794 | .830 |
| April | 108.6 | .760 | .788 |
| July | 110.0 | .718 | .727 |
| October | 116.2 | .673 | .696 |
| 1978 January | 129.3 | .662 | .700 |
| April | 156.1 | .725 | .853 |
| July | 191.3 | .817 | .897 |
| October | 240.5 | .926 | .900 |
| 1979 January | 313.0 | 1.058 | 1.057 |
| April | 403.7 | 1.175 | 1.144 |
| July | 497.4 | 1.220 | 1.116 |
| October | 587.4 | 1.166 | 1.077 |
| 1980 January | 663.8 | 1.059 | 1.019 |
| April | 753.4 | .972 | .942 |
| July | 896.6 | 1.108 | .891 |
| October | 1,118.0 | .946 | .898 |
| 1981 January | 1,456.8 | .990 | .937 |
| April | 1,905.4 | 1.077 | .982 |
| July | 2,387.5 | 1.151 | .997 |
| October | 2,917.5 | 1.180 | 1.043 |
| 1982 January | 3,465.9 | 1.154 | 1.057 |
| April | 4,145.3 | 1.129 | 1.031 |
| July | 5,140.1 | 1.125 | 1.009 |
| October | 6,430.3 | 1.132 | 1.028 |
| 1983 January | 7,851.4 | 1.128 | 1.054 |

^a This index is measured as six-month averages. The first column gives the midpoint of each six-month period covered in the survey of dwelling prices. For comparative purposes the consumer price index and the index of construction input prices are presented for the same periods.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.