



Bank of Israel

Prime Minister's Office

Ministry of Finance

## **NATIONAL BUDGET FOR 2002–2005**

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The 2002–2005 National Budget includes an initial summary of economic developments in 2001, the major provisions of economic policy for 2002–2005, and a forecast of main developments in that period.

The summary of developments in 2001 is based on incomplete data and provisional estimates from the Central Bureau of Statistics, the Ministry of Finance, and the Bank of Israel.

Parts A and C of this publication—developments in 2001 and the forecast for 2002–2005—were prepared jointly by the Economic Research and State Revenue Division of the Ministry of Finance, the Research Department of the Bank of Israel, and the Prime Minister’s Office. Part B—economic policy for 2002–2005—was prepared by the Ministry of Finance and the Prime Minister’s Office, with the exception of the section on monetary policy, which is presented by the Bank of Israel.

## A. ECONOMIC DEVELOPMENTS IN 2001

### **Main developments**

In 2001 Israel's economy suffered from the worst recession for some considerable time (the analysis herein is based on preliminary data and forecasts). GDP increased at a very slow rate of 0.5 percent, below the rate of population growth, so that per capita GDP fell by 1.9 percent. Business-sector product went down by 0.7 percent.<sup>1</sup> Exports, which had led growth in the past, dropped sharply, by 11 percent, and the balance-of-payments deficit rose by half a percent of GDP. The rate of price rises increased, and current forecasts are that for the year 2001 as a whole it will fall within the target inflation range. There was evidence of the recession in all private-sector industries, and particularly in high-tech. Start-ups, which had contributed a notable 2.8 percentage points to the rise of business-sector product in 2000, were directly responsible for a 1.4 percentage point reduction in its rate of growth in 2001: excluding start-ups, business-sector product increased by 0.7 percent in 2001. In contrast to the low level of business-sector activity in 2001, there was significant government involvement in economic activity: public consumption rose significantly, and employment in the public services rose very markedly.

The main reasons for the slowdown in economic activity which started in the last quarter of 2000 were the shocks in Israel and worldwide: the security-related events in Israel, the deceleration throughout the world and specifically in the US, and the crisis in international capital markets. The persistence and increasing severity of the shocks during the year deepened the recession in Israel. The effect of the *intifada* on the rate of growth was felt mainly in incoming tourism and exports to the Palestinian Authority, but also in industries with a higher proportion of unskilled labor (mainly construction and agriculture), due to the disruption of the regular arrival of Palestinian workers. The global recession, and particularly that in the US, harmed Israel's exports via its effect on international trade which reduced the demand for those exports. High-tech industries in particular were affected; these suffered not only from the effects of the worldwide crisis in high-tech but also from the crisis in the capital markets which was reflected principally in those industries. Quite apart from the effects of the above factors on the rate of economic growth, a certain deceleration was expected in any case, as growth rates such as those prevailing from the last quarter of 1999 till the third quarter of 2000 cannot be maintained for long.

On the uses side, the slowdown in 2001 was led by exports, whose volume (excluding diamonds and start-ups) declined by about 7 percent, after rising by 20 percent in 2000 and by about 10 percent in each of the years 1997–1999. In contrast, domestic uses (excluding direct defense imports)

<sup>1</sup> The only other time when business-sector product went down was in 1966.

rose by 3.5 percent, similar to their rise in 2000. On the domestic uses side, the increase in public and private consumption and the cutback in investments feature prominently. Public consumption (excluding direct defense imports) increased by 4.9 percent, due partly to a rise in defense expenditure resulting from the *intifada*, but civilian consumption also rose, by 3.9 percent, after rising by 1.6 percent in 2000. While there was a marked increase in public expenditure, the rise in tax revenues was below the forecast, so that the public-sector deficit rose considerably. Private consumption went up by 3.8 percent, giving a rise of 1.3 percent in per capita consumption. Although the rise in private consumption was lower than last year's, it still greatly outstripped the growth of GDP. The two major causes for the increase in private consumption were the rise in per capita disposable income (of more than 3 percent), and continued rapid wage increases. Part of the persistent rise in private consumption may also be explained as the result of the smoothing of consumption over the business cycle. Investment, whose share in GDP has declined over the last few years, suffered another serious fall, but is still at a high level.

With the recession there was a 3 percent cutback of labor input in the business sector; most industries were affected, and in particular agriculture, construction, and hotels and restaurants—all directly affected by the security situation. Despite the recession, the rate of unemployment remained similar to its level in 2000, at 8.8 percent of the civilian labor force (219,400 unemployed persons). This was due to the acceleration in the rise of the number of employees in public services in 2001, which reached 4.7 percent,<sup>2</sup> higher than the increase in the civilian labor force. The reduction in employment in the business sector reflected a drastic decline (of about 80 percent) in the number of Palestinian workers, while the number of Israeli employees continued to rise, albeit by a modest 1.7 percent.<sup>3</sup> The real wage per employee post was 5.4 percent higher in the first seven months of the year than in the equivalent period in 2000—5.9 percent in the business sector and 4.4 percent in the public services. The rise in the wage is surprising in the light of the low level of economic activity and of the significant rise in the real wage in the last few years, which exceeded the rise in productivity.<sup>4</sup> The rate of increase of the real wage eased in the course of 2001.

The balance-of-payments current account deteriorated in 2001, and its deficit is expected to rise to \$ 2 billion (at current prices), from \$ 1.4 billion in 2000. This reflects a considerable fall in exports (of both goods and services) and a more moderate decline in imports. The main reasons for the fall in the volume of goods exports were the worldwide economic slowdown, which was accompanied by a deceleration in international trade, and the crisis in the high-tech industries. As a result of the dependence of Israel's exports on those of high-tech products, the decline was more severe than the general decline in international trade. Services exports were greatly affected by the serious fall in exports of tourist services which resulted from the security-related political situation and by the reduction to almost zero in exports of the high-tech companies due to the worldwide

<sup>2</sup> Employment in public services includes, in addition to those in the public sector, also private-sector employees in public services such as education, and health and welfare services. Nevertheless, payment of a large share of private-sector activity in such areas is made via the public sector. Another bias in the number of public-sector employees is caused by the fact that some are employed through employment agencies, and they are therefore sometimes classified under business services.

<sup>3</sup> The number of business-sector employees also includes temporary absentees from work, the number of whom increased greatly in 2001.

<sup>4</sup> For possible explanations of part of the rise, see the section on the labor market.

crisis in high-tech industries. The decline in imports was mainly the outcome of the fall in imports of factor input services, but also partly of the reduction in goods imports which resulted from the marked slowdown in economic activity. The fall in imports of factor input services was caused by reduced dividend payments to nonresidents out of profits on the sales of start-up companies, lower interest payments by banks on nonresidents' foreign-currency deposits due to falling interest rates abroad, and a drop in total wage payments to Palestinian workers.

The CPI rose in the first nine months of the year at an annual rate of 2.7 percent, a rate which, unlike in 1998 and 1999, fell within the target range set by the government for the current year (2.5 percent to 3.5 percent). The rate of price increases in 2001 is mainly the result of monetary policy and the path taken by the exchange rate. Monetary policy, which again focused on attaining the inflation target while creating the conditions which would enable the targets for the next few years to be achieved too, was reflected by the gradual reduction of the Bank of Israel's interest rate. The NIS depreciated due to the reduction of nonresidents' investment in Israel (in reaction to the security situation in Israel and to the situation in the world's capital markets), and also due partly to the considerable fall in exports, in contrast to the trends in 2000. In contrast to 2000, when inflation expectations and nominal interest both went down, expectations were stable in the first half of the year and rose in the second half, and real interest fell to a significantly lower level than in the last two years (3.5 percent in September 2001, compared to 7 percent in 1999–2000). The deviation of the budget deficit from its target for 2001 and the upward adjustment of the target for 2002 may also have contributed to price rises in 2001. The low level of economic activity this year, on the other hand, served to moderate the rate of price increases.

### **Private consumption and gross domestic investment**

Private consumption rose by 3.8 percent in real terms in 2001 (a 1.3 percent increase in per capita consumption), less than the 6.6 percent increase in 2000, but a high rate by comparison with the growth of GDP, investment, and exports this year. The slowdown was particularly marked in per capita purchases of durables, which declined by 4.5 percent after surging by 17.5 percent in 2000. The rise in private consumption—despite the slowdown in economic activity and the high rate of unemployment—was apparently due to the increase of more than 3 percent in disposable per capita income (far in excess of the growth of GDP) and to the continued rise (of 5.4 percent) in the real wage, and is also partly explained by the smoothing of consumption over the business cycle.

Gross domestic investment went down by 1.7 percent, following a decline of 4.1 percent in 2000. Total domestic investment after deducting the rise in stocks (investment in fixed assets) fell by 7 percent in 2001 after rising by a modest 0.4 percent per annum in 1999 and 2000. This fall reflects the considerable drop in construction activity and in housing investment, and also reductions in the other components of investment. Investment in the principal industries went down by 3.8 percent, after rising by 3.4 percent in 2000, so that gross business capital stock at the beginning of 2002 will be 5.3 percent higher than it was at the beginning of 2001. This rise is below the 6.5 increase in 2000, but above the rate of growth of business-sector product. The downward trend in housing investment intensified, with a 15.8 percent drop. This reduction reflects the effect of the security situation and the resulting greater uncertainty on the demand for housing on the one hand,

and on the supply side of the construction industry, due to the sharp drop in the number of Palestinian workers, on the other. Investment in buildings and earthwork declined by 7.3 percent, and investment in equipment by 7.6 percent. The slowdown also encompassed investment in intangible assets (software), which rose by only 1.6 percent, after rising rapidly in the last few years. The fall in investment in 2001 had two main causes: (1) the greater security-related and economic uncertainty related to the *intifada* and the worldwide slowdown, which led to widespread postponement of investments, and (2) the decline in economic activity and the sharp drop in share prices which reflects investors' expectations of a reduced flow of receipts on investment projects. In this context it is relevant to note both the persistent fall in the return on capital, deriving from the faster rise in the real wage than in the productivity of labor, and the increase in the capital/GDP ratio.

### **Fiscal developments**

The share of the public sector in GDP rose significantly, from 52.5 percent in 2000 to about 55 percent in 2001, its level in the mid-1990s; the average level in the OECD countries is 42 percent. This rise reflects a marked increase of 6 percent (deflated by the implicit index of GDP prices) in the current expenditure of the public sector. Public consumption and transfer payments both rose, whereas expenditure on the capital account showed no increase, and direct investment actually dipped.<sup>5</sup> The rise in defense expenditure (most of which was financed by a parallel rise in the utilization of the US defense aid) accounts for less than a third of the rise in the share of public expenditure, with the rest of the increase due to higher civilian expenditure. The latter was the outcome of accelerated volume growth (i.e., a rise of 3.9 percent compared to 1.6 percent in 2000), and the continued rapid rise of the price of public consumption relative to GDP prices. In particular, the hourly wage rose by 4.5 percent, 2.5 percentage points more than the rise in GDP prices. Transfer payments increased by about 9 percent in real terms (deflated by GDP prices) due to the continued growth in the number of those eligible and the rise in the allowances resulting from the increase in the average wage and from statutory changes (e.g., the "Large Families Law," higher invalidity benefits). Only 18 percent of the rise of National Insurance benefits payments is explained by the increase in payments of unemployment benefit and income support, slightly more than the share of these benefits in the total.

The tax burden, after rising from 39 percent of GDP in 1999 to 40.8 percent in 2000, rose again in 2001, to 41.3 percent, having remained more or less stable throughout the 1990s. The tax burden rose as a result of an increase of more than half a percent of GDP in direct taxes (including payments to the National Insurance Institute), whereas the share of indirect taxes dipped slightly. The rise in the tax burden and the increase in current expenditure (a significant part of which is permanent thus reducing the potential to lower the tax burden in the future) do not help to steer the economy onto the path of sustainable growth.

The rapid rise of public expenditure together with a far slower rise in revenues led to a substantial increase in the public-sector deficit (excluding the Bank of Israel), which grew to 3.1 percent of GDP, 1.5 percentage points higher than that in 2000. The budget deficit is expected to deviate from its target in 2001 (1.75 percent of GDP), due to a reduction in domestic revenues—both from taxes

<sup>5</sup> In contrast, investment in the transport infrastructure not financed by the government (e.g., the Cross Israel Highway) increased.

and from other source—which were below the budget estimate due to the lower-than-expected rise in prices and the slowdown in economic activity, while expenses stayed at the level in the budget plan. According to the assessments of the Ministry of Finance, the budget deficit is expected to reach 2.75 percent of GDP, compared with 0.7 percent of GDP in 2000. This jump in the deficit will increase the share of the public debt in GDP, and is likely to raise the burden of interest payments for the next few years.

### **The labor market**

The deterioration in the security situation and the subsequent slowdown in economic activity were also expressed in stronger indications of slack in the labor market: the number of employed persons in the business sector went down by 1.9 percent, about 35,000 employees. The number of Palestinian workers fell steeply, by 75,000, while the number of Israelis employed rose by 26,000 and the number of foreign workers by 15,000. Although the rate of unemployment declined in the first half of the year, the Central Bureau of Statistics (CBS) forecasts that it will rise again in the second half. Moreover, it seems that the slight reduction in the unemployment rate in the first half-year does not reflect a genuine improvement in the level of activity but various biases in the estimated number of employed persons, the most notable being the steep increase in the number of those temporarily absent from work, who are registered as employed although some of them will not return to their jobs. The rate of participation remained at its 2000 level of 54.3 percent.

The cutback in business-sector employment affected most industries, and was most marked in agriculture (where there was a 13 percent reduction), construction (17 percent), hotels and catering (6.6 percent). Reduced employment in agriculture and construction reflect the further deterioration in these industries resulting from the security situation which cut the number of Palestinian workers by 80 percent. The latest intifada is having a significant effect on employment in tourism, too, both on the demand for labor, and also the supply of labor from the Palestinian Autonomy. Internal tourism was also affected by the slowdown in activity of other industries, especially high-tech, which led to a decline in demand.

The fall in employment in construction and tourism was partially offset by a light rise in the number of Israelis employed and a marked increase in the number of foreign workers. The number of Israelis in agriculture and manufacturing, however, went down in line with the reduction in the number of Palestinian workers. The sharp rise in the number of Israelis employed in business services (11.4 percent), similar to the increase in 2000, offset both the marked fall in the number of Palestinian workers in this industry<sup>6</sup> and the contraction of employment in the business sector. The considerable increase (4.7 percent) in the number of Israelis employed in the public services also helped offset the fall in business-sector employment.

The average real wage per employee post (including Palestinian workers) rose by 5.4 percent in the first seven months of the year 2000. In the business sector it rose by 5.9 percent, and in the public services by 4.4 percent. Excluding Palestinian workers, the average real wage per employee

<sup>6</sup> Annual data on the change in employment in the two-digit industries in the business services industry is unavailable. Based on the data for the first half year, it seems that the rise in the number of Israelis employed occurred in those industries which do not have a high proportion of Palestinian workers, and was not in reaction to a decline in the number of the latter.

post rose by 4.7 percent overall, and by 4.8 percent in the business sector. The rise in the business sector was a continuation of the steep upward trend in the last few years, and encompassed most industries. In addition, the average number of hours worked per employee declined by 0.9 percent (0.5 percent excluding the Palestinian workers) so that the hourly wage rose by even more than the real wage per employee post. The rate of increase of the real wage slowed somewhat in 2001. It is difficult to find a satisfactory explanation for the continued rise of the business-sector real wage in 2001: the differential between the actual rise in prices and the expected rise leaves a large part of the rise in the real wage unexplained. The continued rise in the real wage cannot be fully explained by a rise in productivity, as the real wage increased by more than the rise in productivity (product per man hour rose by 2 percent in the whole of 2001). The rise in productivity, moreover, reflects mainly the significant reduction in the number of Palestinian workers, whereas there was a rise in the wage even when Palestinian workers were excluded from the calculation. In the light of the crisis in the high-tech industries, the significant wage rises in them cannot be explained by a shortage of labor. The change in the composition of employment in the business sector—a rise in the share of the industries paying above-average wages—can explain only part of the rise in the real wage.<sup>7</sup>

### **The balance of payments**

The two major factors which affected the economy—the renewed intifada and the worldwide crisis in high-tech industries—greatly affected the balance of payments too. The current account deficit deteriorated, reaching \$ 2 billion, or 1.8 percent of GDP, up from 1.3 percent in 2000. The deterioration was caused by the sharp fall in goods exports, a decline in the export of tourist services and of start-ups, while there was only a small reduction in goods and services imports, and a significant drop in the import of factor inputs. Regarding capital flows, nonresidents' investment in Israel slumped by over 50 percent from its level of over \$ 9 billion in 2000 to about \$ 3 billion in the first three quarters of 2001. At the same time investment abroad by Israelis, which to a great extent reflect nonresidents' investment in Israel, went down.

Goods exports fell in 2001 by about 9 percent (in current dollar terms), after rising continuously for nine years at an average rate of almost 11 percent a year. Leading the decline was the drop in exports of the advanced industries, the outcome of the crisis affecting the high-tech field and of the slowdown in the US and other economies which led to a marked deceleration in the growth of international trade. The slowdown in high-tech exports halted the structural change taking place, at least temporarily. Exports of advanced industries amounted to 76 percent of all manufacturing exports, similar to its share in 2000.

Services exports declined by 23 percent, and exports of tourist services fell by almost 50 percent from their pre-intifada level. The drop in tourist services accounted for more than half of the reduction in total services exports. Exports of start-ups (which are recorded as services exports) suffered directly from the effects of world crisis in high-tech, and slumped to almost zero.

The slowdown in the economy reduced goods imports by some 6 percent in 2001 (in current

<sup>7</sup> The change in the composition of employment in the business sector contributed 2.4 percentage points to the rise in the real wage in the first half of 2001 (compared with the equivalent period in 2000); most of the change has already been expressed in a rise in productivity.

dollar terms). Services imports went down by just under 2 percent, and imports of factor inputs by 23 percent. Nearly half of the latter decline was the result of the lower dividend payments to nonresidents on profits from sales of start-ups: as exports of start-ups fell to almost nothing, dividend payments on them also fell. Other factors contributing to the reduction in imports of factor inputs include the 80 percent drop in wage payments to Palestinians and the fall in interest rates abroad, which lowered banks' interest payments on nonresidents' foreign-currency deposits and the government's interest payments.

The renewed intifada and the increased security risk, together with the sharp falls on the Nasdaq and the difficulty in issuing shares abroad, led to a fall in nonresidents' investments in Israel. Investment in the equity portfolio (shares and tradable bonds), which by their nature are sensitive to the situation in capital markets around the world, went down by more than 80 percent in the first three quarters of 2001 from their level in the equivalent period in 2000. In this period direct investments dropped by half, to slightly above \$ 2 billion, similar to their level in 1999. The contraction of foreign-currency sources apparently contributed to an increased credit flow and a reduction in the rate of increase in Israeli's foreign-currency deposits in domestic banks.<sup>8</sup>

### **Prices and monetary developments**

The CPI rose at an annual rate of 2.7 percent in the first nine months of 2001, after zero inflation in 2000. Taking into account economic developments and recent rates of interest, inflation for the year is expected to fall within the target range of 2.5 percent to 3.5 percent, following two years in which it was below than the lower limit of the target range. The rise in the exchange rate in the above period and its acceleration in the second half of the year (after its decline in 2000), stemming from the reduction in nonresidents' investments in Israel, boosted the CPI by about 1.5 percentage points. The effect on the CPI of the rise in the exchange rate is still considerable (in the short term), although it is less marked than it was in the second half of the 1990s.

The notable effect on prices which capital inflow exerted in 2000 via the appreciation of the NIS moderated in 2001, as capital inflow of nonresidents went down; the reduction resulted mainly from developments on international capital markets, and the security and political developments, despite the increase in the interest-rate differential between Israel and the US which had narrowed in 1999 and 2000. Total nonresidents' investments in Israel fell in January–August 2001 to about \$ 3.5 billion (down from \$ 9.4 billion in the same period in 2000). All components of foreign investment followed the trend, including autonomous investment, which is not sensitive to the interest-rate differential, and Israelis' investment abroad, partly due to the drop in stock markets abroad. Total investment by Israelis abroad went down to about \$ 4.5 billion (compared to \$ 7.4 billion in the equivalent period in 2000). Capital raised abroad by nonfinancial Israeli companies in January–August 2001 totaled \$ 1.1 billion, down from more than \$ 4 billion in the whole of 2000, also due to the financial crisis in the US.

The rise in the housing component of the CPI was the most notable of the changes in the different categories. From January to September 2001 the housing component rose at an annual rate of 7 percent, and reflected a rise in prices of owner-occupied apartments and rents. The rise includes the

<sup>8</sup> These activities are recorded in the balance of payments only indirectly, under "Banks' activities abroad".

effect of the higher exchange rate as well as a rise in the relative price of housing. Although such a rise does not automatically have a continuing effect, it could exert a longer term influence through the mechanism of linkage to the CPI. In the first nine months of 2001, the CPI excluding housing rose at an annual rate of 1.5 percent. The index of prices of controlled and supervised goods rose by less than the overall CPI (by only 2 percent), unlike in 2000, helping to hold back the rise in prices. The wholesale price index also contributed to the low level of inflation, as it went down at an annual rate of 1.8 percent (annual rate), after rising by 2 percent in 2000. These last two effects resulted from the global slowdown. The price index of imported goods excluding oil went down at an annual rate of 6.3 percent in January–July 2001, and in that period oil prices fell by 5 percent.

The object of monetary policy was to attain the inflation targets set for 2001 and 2002, while getting the long-term path of inflation from 2003 to converge with the range defined as price stability (between 1 percent and 3 percent)<sup>9</sup> From January to September 2001 the Bank of Israel gradually lowered its published ("headline") rate of interest by a cumulative 1.9 percentage points—as part of a process which has continued for more than two and a half years—from 8.2 percent at the end of 2000 to 6.3 percent in September 2001, and inflation expectations rose in that period from 1.3 percent to 2.9 percent. The background to the rise in inflation expectations was the accelerated rate of depreciation of the NIS, increased political uncertainty, and the return of inflation to its long-term target path after hovering below it, and the risk that the rise in the budget deficit would persist. The pace of interest-rate reductions reflected the aim of ensuring financial stability, which has in fact been preserved during the year despite the many shocks which the economy endured both in its domestic activities and in its export markets.

Short-term real interest, which is the difference between the Bank of Israel's headline rate of interest and inflation expectations, went down gradually from about 7 percent at the beginning of 2001 to 3.2 percent in September. This reduction is of special significance in this period of recession which is characterized by financing difficulties encountered by companies. While short-term real interest declined constantly throughout 2001, the downward trend in long-term real interest evident in the first seven months of the year halted, and there was actually a small rise. This interest, the return on government bonds, was 4.6 percent in September, having reached as low as 4.4 percent in June). The downward trend in the long-term interest rate is based on the weakness of demand for investment, and the decline in nominal interest which forms part of monetary policy. The public's trend of moving into short-term assets, however, acts in the opposite direction, tending to moderate the decline in long-term returns. The halt to the reduction of the return on bonds was also affected by increased borrowing by the government due to the rise in the budget deficit. The path followed by long-term real interest was also reflected by a reduction in mortgage interest, but this has halted recently.

The rise in borrowing for budget purposes was expressed in the extent of bonds and deposits in the Ministry of Finance amounting to NIS 32 billion in the first eight months of 2001, compared with a total of NIS 31.5 billion in the whole of 2000. The share of financing via tradable bonds rose from 66 percent in 2000 to 72 percent in 2001, continuing the long-term trend. Interest payments

<sup>9</sup> In August 2000, as part of the attempt to reach the European standard of management of macroeconomic policy set out in the Maastricht Treaty of 1991, the government decided on a long-term path of declining inflation targets. Within this framework, the target for 2001 was set at 2.5–3.5 percent, for 2002 at 2–3 percent, and from 2003 onwards at 1–3 percent.

on the domestic debt account for about a third of total annual income from bonds and deposits with the Ministry of Finance, constituting a not insignificant part of the budget. Increasing the debt would thus entail an increase in the sources allocated to these budget payments.

The downward trend of the share of CPI-indexed assets in the public's financial assets portfolio, and the rise in the share of unindexed assets continued, but more slowly. The move from indexed to unindexed assets in most months in the January–September period was expressed in withdrawals from CPI-indexed savings schemes and in positive accumulation in mutual funds specializing in investment in unindexed assets.<sup>10</sup> In the first half of 2001 there was an accumulation of about NIS 13 billion in these funds,<sup>11</sup> in addition to an accumulation of NIS 10 billion in 2000. The development of the monetary aggregates generally mirrors that of interest rates, which, as stated, followed a downward path, so that in 2001 the money supply grew by about 18.3 percent (annual rate), and the interest-bearing deposits (SROs and resident unindexed time deposits) grew more slowly than previously, as did the wider M2 aggregate. Nevertheless, the money supply increased significantly faster than did nominal GDP in the first nine months of 2001, and if it continues, is likely to threaten the achievement of the target of price stability set for 2003 and beyond. Total nondirected credit rose by 10.9 percent in January–September, similar to its rise in 2000. Despite the increased interest-rate differential between Israel and abroad, faster depreciation in the last few months, and higher inflation (than in 2000), the nondirected credit component has been stable in 2001. The long-term moderate upward trend of the credit/GDP ratio continued in 2001; the recession—which is typified by a contraction of companies' working capital, obliging them to increase the share of external sources in financing their production—contributed to this trend.

One notable feature of 2001 has been the fact that the international rating agencies and the players in the capital and money markets have continued show their confidence in Israel's economy, as is reflected by the stability of the financial markets and the foreign-currency market. This stability is the result of fiscal and monetary policies pursued over the last few years, the essence of which has been the convergence of the rate of inflation and of the budget deficit to those prevailing in the countries Israel wishes to emulate. The commitment to a long term and responsible macroeconomic policy assumes even greater importance at a time like this when uncertainty in the global economy and in the geopolitical environment is as high as we have known in the last few years. The importance of structural changes in various spheres—the removal of barriers, reform of the capital market and the tax system, reducing concentration—also increases at such a time.

<sup>10</sup> Nevertheless, despite the acceleration in the rise of the exchange rate and in inflation in the last few months, renewed accumulation has taken place in savings schemes, and their balance rose by about NIS 1.5 billion in August and September.

<sup>11</sup> Local-currency unindexed assets have gradually become the major part of the assets of mutual funds, and in June 2001 accounted for 75 percent of their assets.

## B. ECONOMIC POLICY

### **General**

The economic policy planned for 2002 aims at supporting Israel's return to a path of substantial growth in order to realise its potential in the medium and long terms.

Sustainable economic growth is the only way of ensuring that unemployment is reduced in the long run alongside the continuous increase in the number of employed persons. Israel's GDP growth rate is substantially influenced by a series of external factors, chief among them the expansion of the country's export markets. The sharp increase in uncertainty in Israel and the world in the course of 2001 has impeded the activity of the business sector. Economy policy for 2002 is consequently designed to create a stable economic environment that will enable the business sector to expand its activity. The budget proposal for 2002 is intended to provide support for future growth, including infrastructure investment. The return on increased expenditure in these categories will be expressed in higher future growth rates.

The object of structural change in any economic sphere is to continue to remove obstacles from the path of the business sector and further the social aims that the government has placed at the top of its list of priorities. One of the courses intended to attain these aims is to refrain from increasing the tax burden, which is relatively high in Israel. It will be possible to ease it in the future by gradually reducing government expenditure as a share of GDP.

Another objective is to reduce the government deficit as a share of GDP in the next few years relative to the expected deficit in 2001. The government's deficit target for 2002 has been set at 2.4 percent of GDP, in 2003 and 2004 it should not exceed 2.0 and 1.5 percent of GDP respectively, and in 2005 it should not be more than 1.0 percent of GDP.

If it becomes clear during 2002 that GDP growth is not in line with the rate assumed in the national budget, causing the expected deficit to deviate significantly from the target set, changes in the budget will be considered in order to moderate this deviation. Naturally, this process will have to take all the macroeconomic parameters into account.

The security situation, which led to the cessation of employment in Israel of many Palestinian workers, has created a 'window of opportunity' for the return to employment of a large number of Israelis and the reduction of inequality in income distribution. Consequently, the government decided to introduce a series of measures aimed at reducing the number of foreign workers in Israel. These included significantly and gradually reducing the number of permits for foreign workers, augmenting the control and supervision of those entering Israel and residing there illegally, and prohibiting the implementation of government tenders with entities that employ foreign workers.

The rest of this chapter presents the guidelines for Israel's economic policy in 2002 and that implemented in 2001.

## **Budgetary policy**

The proposed budget for 2002 submitted to the Knesset comprises expenditure (excluding the repayment of principal and credit extended) of NIS 215.7 billion, and total income (excluding credit payments) of NIS 203.6 billion. As a result, the planned overall deficit (excluding credit) will amount to NIS 12.1 billion—2.4 percent of expected GDP in 2002.

In order to enable Israel to attain its potential GDP growth rate, based on the expansion of the business sector, the government must reduce its economic involvement. Consequently, government policy, as expressed in the proposed national budget for 2002, will be based on two main pillars:

1. Reducing the government's deficit as a share of GDP in 2002 relative to 2001. A lower government deficit will make the business environment more stable and enable the business sector to raise capital for investment. In 2001 the overall government deficit (excluding credit) is expected to reach 2.75 percent of GDP. Because of the fall in tax revenues due to the economic slowdown, this rate is 1.0 percent of GDP higher than the deficit target set in the 2001 budget. In view of this, the government decided to amend the Budget Deficit Reduction Law, so that in 2002 the deficit target will not exceed 2.4 percent of GDP, in 2003 it will not be more than 2.0 percent of GDP, in 2004 it will not be above 1.5 percent of GDP, and in 2005 it will be no more than 1.0 percent of GDP. The government thus continues to transmit a message of consistent action aimed at reducing the government deficit, in line with the trend in advanced countries throughout the world, while adapting short-term policy to the state of the economy.

2. Gradually lowering government spending as a share of GDP relative to the expected rate for 2001 in order to free sources for the business sector. Government expenditure as a share of GDP is higher in Israel than the accepted rate in western countries, so that it is important to continue reducing it. On the basis of the proposed budget for 2002, the share of government spending in GDP is expected to fall by 0.3 percentage points.

Tax revenues in 2002 are expected to amount to NIS 161.3 billion—a 4.5 percent real rise over the 2001 forecast. The increase in tax revenues predicted for 2002 comes in the wake of rapid growth—amounting to a real 13 percent in 2000—and a slower growth rate (a real 1 percent) in 2001.

The tax burden, i.e., the share in GDP of total tax revenues in the budget, will amount to 32 percent of GDP in 2002, similar to its rates in 2000 and 2001. Nevertheless, the tax burden in 2000–2002 is above its average in the 1990s, when it was about 31 percent of GDP.

## **The composition of the budget and structural changes**

In order to adhere to the budget framework while altering the government's priorities some departures from the budget—amounting to NIS 4.5 billion—are required.

The proposed departures meet the following criteria:

- They shift expenditure from areas whose contribution to economic growth is relatively small to those in which it is higher;
- They serve to make government more efficient;
- They endeavor as far as possible to avoid harming underprivileged sections of the population.

While remaining within the budget framework, these deviations make it possible to add items which are high on the government's list of priorities. The proposed budget for 2002 comprises suggestions for reducing the current expenditure of government ministries as well as for cutting transfer payments. Concurrently, the government has decided to raise investment in the transport infrastructure by NIS 1.45 billion, to increase investment in water by NIS 450 million, and to invest an additional NIS 200 million in education and welfare projects, placing the emphasis on day centers as well as on computer and Internet clubs in development towns and underprivileged neighborhoods. In addition, NIS 30 million will be assigned for space research and biotechnology. Resources will also be allocated for building classrooms and reducing university tuition fees, and funds will be earmarked for programs intended to help the underprivileged sections of the population.

In 2002 the government is expected to transfer NIS 1.45 billion for investment in transport—NIS 735 million of it in cash—so that investment in land transport will be about 22 percent more than in the 2001 budget, bringing investment in this category up to about NIS 4.92 billion. The expansion of infrastructure investment serves to stimulate growth, not only by increasing the economic activity arising directly from the work but also by expanding and improving the physical infrastructure, since a modern infrastructure is a precondition for accelerating business-sector growth. In this framework, investment in roads and railways will be increased and public transport systems developed.

**Water:** NIS 450 million will be invested in water projects, NIS 235 million of it in cash mainly to support the establishment of water and sewage corporations in local authorities and to invest in improving the water and sewage infrastructure in urban areas.

**Security:** an additional NIS 1.3 billion will be allocated in order to respond to the need for increased security activity arising from the current situation.

**Physical infrastructure:** the government will take steps aimed at creating the conditions to enable the business sector to increase its investment in the physical infrastructure, whether by furthering statutory planning or by establishing the regulatory framework that will make it possible for entrepreneurs to take the risks involved in investments of this kind.

**Simplifying planning procedures and land use:** measures will be introduced in order to accelerate the sale of land, simplify planning processes, and ease development procedures. Shortening and simplifying planning procedures is a necessary precondition for attaining the government's policy objectives in the area of infrastructure investment.

**Construction:** in order to stimulate the expansion of construction activity, the government will act to accelerate the rate at which land is sold, encourage greater building density, and locate land held by various government entities and no longer needed for their activities.

**Employment:** measures will be introduced aimed at reducing the number of foreign workers employed in Israel, both by cutting the number of permits issued and by enforcing the laws against these workers' illegal stay in Israel more strictly.

The government will also continue to act to open up additional areas to competition and reduce consumer prices of goods and services—involving *inter alia* lower prices of nonprescription drugs, greater competition in the field of national radio broadcasting, and increased competition in the area of public transport.

## **Government policy on wages and the labor force**

On 31 January 2001 a group agreement was reached with the New General Federation of Labor (Histadrut) granting a 3.6 percent wage increment as of January 1, 2001 to the employees it represents and paying a one-off grant of NIS 1,250 for 1999 and 2000. In addition, it was agreed that negotiations would continue on the ultimate level of the above wage increment. These negotiations are still at their initial level.

On 13 July, 2000 a wage agreement was reached with the Association of Physicians for the period between July 1, 1998 and December 31, 2001. Intensive negotiations are currently under way with the teachers on an agreement for 1999–2000.

The level of real wages in the general government sector rose by 4.7 percent in 2000 because the wage agreements for 1997 and 1998 with the various sections represented by the Federation of Labor went into effect only at the end of 1999—affecting wages for a whole year in 2000 and a few months in 1999. Furthermore, the CPI rose by zero percent during 2000, and by 1.1 percent as a year-on-year average.

Real wages in the general government sector are expected to rise considerably in 2001, too, as a result of the implementation of the agreement reached in January 2001 and the low inflation rate.

The government's policy is to maintain the level of real wages in the general government sector; thus, future wage agreements will be consistent with the declining inflation path while reducing components that operate automatically to increase nominal wages (wage drift). Similarly, the government aims at adapting the structure of employment in the general government sector to technological advances and management needs.

In July 1997, in the wake of the grave findings published in the annual report of the Director-General, Wages and Labor Agreements, the government decided to set up a mechanism for enforcing section 29 of the Budget Principles Law (which determines that government-financed entities may not alter the salary or retirement terms of their employees beyond what is customary for all general government employees). Discussions are currently being held on expanding the supervision of additional government-financed and subsidized entities.

As a result of this decision, an enforcement unit was established in the Ministry of Finance's Wages Division. It is responsible for coordinating the activities required in order to enforce the Budget Principles Law, including submitting claims on behalf of the state in matters regarding the annulment of agreements, arrangements, and wage deviations.

## **Deficit financing and capital-market policy**

The financing of the budget deficit will be based on domestic and foreign sources, as well as on privatization proceeds. The trend towards greater negotiability and liquidity in the government bond market will continue. In the framework of this policy, the sizes of the series issued to the public in 2002 will be increased, and their number reduced, serving to increase negotiability and liquidity in this important market.

The Ministry of Finance intends to continue issuing unindexed, fixed-interest, 10-year bonds in 2002. These bonds have become the benchmark in the unindexed bond market.

The replacement of earmarked with negotiable bonds is intended to continue in 2002; during the year the Ministry of Finance will hold auctions for the early repayment of bonds to the value of over NIS 1 billion. It also plans to hold swap auctions in which bonds that are more tradable may be substituted for other less tradable ones.

The financing of the deficit (including credit extended) required in 2002 is about NIS 11.1 billion. Net borrowing abroad is expected to amount to NIS –1.0 billion, while net borrowing in Israel will be some NIS 10.6 billion. Expected privatization proceeds of NIS 1.5 billion will complete the total sources for financing the deficit.

### **Monetary policy**

In August 2000 the government adopted annual inflation targets of 2–3 percent for 2002 and price stability—defined as an inflation rate of 1–3 percent—for 2003 and subsequently. These targets embody commitment to maintaining price stability as part of the strategy for Israel’s integration within the global economy, embracing the accepted standards of macroeconomic policy management in western countries.

In 2001 monetary policy focused on attaining the inflation targets set by the government for the year and the next two years, while creating the conditions for convergence to price stability in 2003. This is to be achieved while maintaining stability in the financial and foreign-currency markets, especially in view of the domestic and external shocks to which Israel has been exposed this year. The Bank of Israel will continue to endeavor to maintain price stability. Monetary policy aimed at achieving this end will contribute in the most efficient way to restoring the economy to a path of sustainable growth once external conditions permit.

## C. EXPECTED DEVELOPMENTS IN 2002 AND FORECAST FOR 2005–2003

### **Main developments expected in 2002**

The forecast of economic developments in 2002 is shrouded in particularly great uncertainty. This derives from several external factors, the development of which impacts on the forecast. Most of them are external to the economy and are not the outcome of structural failure or policies.

Alongside the continuation of the security unrest that erupted in the last quarter of 2000, the slowdown that emerged in the industrial economies in 2001 has persisted far longer than predicted by most forecasters. Their recovery has been postponed as the result of several negative developments in the global economy in August–October. The crisis in the financial markets, which intensified in August and was further exacerbated by the terrorist attacks on the US on September 11, together with the direct damage inflicted on many industries, led to a significant downwards adjustment of growth forecasts for 2002 in the US and the rest of the world. The updated forecasts made at the beginning of October predict GDP growth of 1.0 percent in the US, in contrast with the 2.9 percent predicted in July and 2.6 percent at the beginning of September.<sup>12</sup>

In the high-tech industry, which has accounted for a growing share of Israel's economy in recent years, there is also considerable uncertainty. The adjustment of the value of high-tech companies, and the domino effect arising from the difficulties many of them have experienced, were expressed in plummeting investment in start-ups. In August–October the Nasdaq, which serves as the main indicator of the state of the high-tech industry, fell by 20 percent. Experts in the high-tech sphere are finding it difficult to predict future developments, and this is reflected by the Nasdaq.

As a result of the considerable uncertainty regarding external developments, two scenarios with differing underlying assumptions as to the course of the global economy—and the US in particular—will be presented below. Both scenarios assume that there will not be a dramatic change, for better or for worse, in the security-political situation.

The first scenario, which is also the one on which the national budget is based, is that there will be GDP growth of 4 percent in 2002. This scenario assumes the rapid recovery of both the US and the global economy, and hence also of world trade, enabling the rapid expansion of Israel's exports. This scenario also posits a gradual rally in the global high-tech industry and financial markets at the beginning of 2002. It also predicts an improvement in Israel's balance of payments, with the current-account deficit declining from 1.8 percent of GDP in 2001 to 1.6 percent in 2002.

The second scenario assumes the persistence of the economic slump in the first half of the year and the start of the recovery only in the second half, so that GDP growth will be just 2 percent. The

<sup>12</sup> Source: The Economist. In the euro zone the forecast for 2002 made in July was a GDP growth rate of 2.4 percent; in September it was updated to 2.2 percent, and in October to 1.5 percent. The equivalent figures for Japan are 0.9, 0.5, and -0.4 percent respectively.

recession in the US and the rest of the world is expected to continue in 2002 and the situation will begin to improve only in the second half of the year. In this scenario, the high-tech industry will rally more gradually and at a slower pace than in the first one, and the balance of payments deficit will remain at its 2001 level.

Naturally, the weakening of economic growth globally, and the further deterioration of the financial markets in the last few months, could affect growth in Israel. Because of recent developments—primarily those that occurred in August–October and changed the situation on which the national budget was based—it seems now increasingly unlikely that the 4 percent GDP growth rate assumed in the first scenario will be attained.

An improvement or deterioration in the security situation will, of course, affect economic growth. Tension in the region impacts directly on the economy: on the demand side, incoming tourism and industries that export to the Palestinian Authority will be adversely affected. The readiness of venture capital firms to invest in start-up companies in Israel may also influence those companies' ability to recover. In the labor market, the supply of Palestinian workers will continue to be limited.

The unemployment rate predicted in each scenario—8.9 and 9.6 percent of the labor force respectively—is derived from the GDP growth rate predicated on the assumption that the number of foreign workers will remain the same as in 2001. Naturally, if the number of foreign workers is reduced, this will contribute to a decline in the unemployment rate.

Note, finally, that macroeconomic policy is an important component of the assumptions underlying the two scenarios. If the real interest rate is reduced, the government's inflation target attained, and the declining deficit path restored as specified in the Budget Deficit Reduction Law, and if both the share of general government current expenditure in GDP and the public debt are reduced, confidence will increase in the business environment and the economy will be able to return to a path of sustainable growth.

### **Forecast for 2003 and 2005**

A trend change in external factors, in the context of a macroeconomic policy that fosters growth, will make a return to sustainable growth possible in 2003–2005. This policy involves continuing to reduce the share of general government expenditure in GDP, lowering the government deficit in accordance with the Budget Deficit Reduction Law, while easing the debt burden and enabling the reduction of interest, altering the composition of government expenditure alongside increased infrastructure investment, changing the tax system in order to foster growth, and maintaining price stability. Only if these conditions, which require a substantial change in the implementation of government policy, obtain will a gradual rally in growth be possible in 2003, expressed in GDP growth of 4–5 percent in each year in the period from 2003 to 2005. The turnaround in growth will be even more apparent in the development of business-sector product, which could grow by an annual average of 5.6 percent in 2003–2005. The recovery will express mainly the rapid expansion of exports (by an annual average of 9 percent), but also of domestic demand, including all the components of investment. Domestic demand is expected to grow by an annual average of 4.4 percent in this period.

The recovery of exports will of course reflect the rapid growth of the principal advanced economies—incorporating the high-tech industry and start-up companies—and consequently of world trade.

The forecast assumes that fiscal policy will act to attain the target of a lower budget deficit in 2003–2005, in accordance with the government’s decision. Reaching the target (without raising the tax rate) will require a fiscal effort in 2003 that will enable a return to the declining deficit path, especially if the low-growth scenario for 2002 is fulfilled and no corrective measures are implemented during the 2002 budget year. In this case, it will be necessary to reduce the real growth rate (i.e., adjusting for consumer prices) of general government expenditure in 2003—from 4 percent to 2 percent—while cutting the share of general government current expenditure by 1 percent of GDP. In particular, the growth rates of both public consumption (excluding defense imports) and public consumption per capita, which has risen significantly in the last two years, will have to be cut. If it becomes clear in the course of 2002 that the deficit is deviating significantly from the target, changes in the budget will have to be considered in order to correct the deviation, making it easier to meet the declining deficit targets determined for 2003 and subsequently.

Fiscal policy that is in line with the above principles will support sustainable growth while increasing productivity. The main ways of stimulating growth are through creating expectations that the tax rate will be lowered in the future and that the balance of payments will stabilize. The latter will serve to lower the risk premium on loans from abroad as well as to free sources in the capital market for the business sector—serving to reduce long-term interest. The effect of all these factors will be to increase investment.

The scenario predicated on these assumptions envisages the gradual reduction of the unemployment rate, to around 6.5 percent at the end of the period, as well as the reduction of the current-account deficit in 2003–2005, expressed principally in a significant rise in the public-sector saving rate in that period.

Note that the forecast presented here does not assume a decline in the tax rate. If the rate at which general government expenditure grows is even more moderate than that assumed, alongside a reduction in the tax rate and adherence to the declining deficit path, the growth rate of GDP could be higher than that predicted.

**Table 1**  
**Indicators of Economic Development, 2000–2005**

	2000	Est. 2001	Forecast 2002*		2003-2005 <sup>a</sup>
			Scen- ario A	Scen- ario B	
<b>Sources and uses</b>			(real change) <sup>b</sup>		
Gross domestic product	6.2	0.5	4.0	1.9	4.3
Domestic business-sector product	8.3	-0.7	4.6	1.8	5.6
Private per capita consumption	3.9	1.3	1.6	0.7	2.0
Public consumption excl. defense imports	1.5	4.9	2.5	2.6	1.2
<i>of which</i> Civilian consumption	1.6	3.9	2.4	2.4	1.4
Investment in fixed assets	0.4	-7.0	1.8	-6.3	8.3
Domestic uses (excl. defense imports)	2.7	2.9	2.7	1.4	4.4
Exports of goods and services	23.9	-11.4	5.4	1.7	9.0
Civilian imports	13.1	-4.7	2.3	0.5	8.3
<b>Balance of payments</b>			(billions of current \$)		
Civilian import surplus (goods and services)	-0.6	3.0	0.5	2.6	1.9
Current account	-1.4	-2.0	-1.8	-1.9	-1.4
Current account (as percent of GDP)	-1.3	-1.8	-1.6	-1.7	-1.1
Current account <i>plus</i> capital transfers	-0.2	...	...	...	...
Foreign currency reserves of Bank of Israel (end-year) <sup>c</sup>	23.2	24.5			
<b>Population, employment, and prices</b>			(real change, percent)		
Immigrant arrivals during year ('000s)	60.2	41.1	40	40	40
Mean population growth	2.6	2.4	2.4	2.4	2.4
Unemployment rate (percent of labor force)	8.8	8.8	8.9	9.6	7.8
Rise in CPI during year <sup>d</sup>	0.0	2.7	...	...	...
Employed Israelis, total	4.0	2.6	2.2	1.4	3.5
<i>of which</i> In business sector	4.6	1.7	2.1	1.0	3.8
<b>General government</b>			(percent of GDP)		
Domestic deficit (planned) of government, excl. credit	2.5	1.75	2.4	3.0 <sup>e</sup>	1.5
Government domestic deficit, cash data	0.7	...			

\* The forecast for the year 2002 is based on the partial and preliminary statistics published by the Central Bureau of Statistics for 2001. The final figures may be significantly different.

<sup>a</sup> Average.

<sup>b</sup> In preceding year's prices.

<sup>c</sup> In 2001, to end-September.

<sup>d</sup> In 2001, to end-September, annual rate.

<sup>e</sup> Unless corrective measures are taken.

**Table 2**  
**Resources and Uses, 2000–2002**

	Current value 2000	Change over previous year (%)					
		Prices		Quantity			
		Est. 2000	Est. 2001	Est. 2000	Est. 2001	Forecast 2002	
						Scenario A	Scenario B
(NIS million)							
Total resources	670,742	1.4	1.9	8.1	-0.9	3.4	1.5
Gross domestic product	458,204	1.9	2.0	6.2	0.5	4.0	1.9
Imports of goods and services	212,538	0.2	1.9	12.2	-3.9	2.2	0.5
<i>of which</i> Civilian imports	203,243	0.4	1.9	13.1	-4.7	2.3	0.5
Total uses	670,742	1.4	1.9	8.1	-0.9	3.4	1.5
<i>of which</i> Excl. direct defense imports	661,447	1.5	2.0	8.3	-1.1	3.4	1.5
Private consumption	259,423	1.2	1.9	6.6	3.8	4.1	3.1
General government consumption	129,380	4.6	2.9	1.1	5.4	2.4	2.4
<i>of which</i> Excl. direct defense imports	120,085	5.3	3.0	1.5	4.9	2.5	2.6
Gross domestic investment	97,447	3.9	3.3	-4.1	-1.7	-0.8	-4.9
<i>of which</i> In fixed assets	92,051	-1.0	1.5	0.4	-7.0	1.8	-6.3
Value of exports at domestic prices	184,492	-1.7	0.4	23.9	-11.4	5.4	1.7
Net payments to factor inputs abroad	21,604	...	...	...	...	...	...
Gross national product	436,600	...	...	...	...	...	...
Gross business-sector product	317,347	1.2	1.2	8.3	-0.7	4.6	1.8

**Table 3**  
**National Product and Income, 2000–2002**

	Current value 2000	Real change over previous year (%) <sup>a</sup>				
		Forecast 2002		Estimate 2001	Scenario A	Scenario B
		2000	2001			
		2000	2001	A	B	
(NIS million)						
Gross national product (market prices)	436,600	6.0	3.3	3.8	1.8	
Depreciation	63,856	2.0	3.4	3.0	3.0	
Indirect taxes on domestic production	61,152	2.2	1.4	5.0	2.5	
Subsidies to domestic production	3,295	7.6	0.1	0.0	0.0	
Subsidy component of government loans	47	-29.6	-37.4	-30.0	-30.0	
National income	314,934	7.7	3.6	3.7	1.4	
Depreciation in private sector	57,728	1.8	3.6	3.0	3.0	
General government's domestic income from property	-552	30.2	-	4.0	4.0	
Income tax and bonds	74,407	23.2	2.3	4.5	1.8	
National Insurance payments	27,635	10.3	7.2	5.0	3.0	
Net current transfer payments	72,298	9.2	8.1	5.5	5.5	
Private transfers from abroad	9,942	2.9	2.0	3.0	3.0	
Gross private disposable income from all sources	353,412	3.9	3.6	3.7	2.4	
Gross private saving rate from all sources (percent)		26.6	26.4	26.2	25.9	

<sup>a</sup> In terms of purchasing power.

**Table 4**  
**General Government Consumption, 2000–2002**

	Current value 2000	Real change over previous year (%)		
		2000	Estimate 2001	Forecast 2002
(NIS million)				
Civilian consumption	90,203	1.6	3.9	2.4
Wages	59,742	0.4	3.6	2.4
Purchases	24,333	4.1	5.0	2.4
Depreciation	6,128	3.5	2.8	3.0
Net defense consumption	39,177	0.1	8.7	2.4
Gross domestic defense consumption	31,331	3.3	8.1	3.0
Wages	17,347	-0.3	3.6	2.0
Purchases, incl. construction	13,984	7.9	13.7	4.0
Direct imports	9,370	-2.6	12.1	0.7
Sales	1,524	81.2	15.7	4.0
Total net public expenditure	129,380	1.1	5.4	2.4
General government consumption, excl. direct defense imports	120,010	1.4	4.9	2.6

**Table 5**  
**Gross Investment, 2000–2002**

	Current value 2000	Real change over previous year (%)			
		2000	Estimate 2001	Forecast 2002	
				Scenario A	Scenario B
(NIS million)					
Gross investment	97,447	-4.1	-1.7	-0.8	-4.9
Change in inventory (percent of GDP)	5,396	1.2	2.6	2.1	2.7
Fixed assets	92,051	0.4	-7.0	1.8	-6.3
Residential construction	24,551	-7.2	-15.8	2.2	-8.2
Nonresidential investment	67,500	3.4	-3.8	1.7	-5.7
Ships and aircraft	973	-66.4	196.8	-64.2	-86.3
Nonresidential investment excl. ships and aircraft	66,527	6.6	-6.8	5.0	-2.0
Structures and earthworks	19,390	-8.1	-7.3		
Equipment and machinery	32,298	9.2	-7.6		
<i>of which</i> Imported	22,301	10.8	-9.0		
Domestic production	9,997	5.3	-4.5		
Land transport equipment	8,806	32.4	-8.0		
Intangible assets	6,033	15.0	1.6		

**Table 6**  
**The Balance of Payments, 2000–2002**

	2000	Estimate 2000	Forecast 2002	
			Scenario A	Scenario B
<i>(Current \$, billion)</i>				
Goods and services exports	45.2	39.1	41.3	40.0
Goods and services imports	46.5	44.2	44.0	44.8
Total defense imports	1.9	2.1	2.2	2.2
Civilian import surplus: goods and services	-0.6	3.0	0.5	2.6
Net income from factor inputs abroad	-6.7	-3.8	-5.9	-4.1
Net current unilateral transfers	6.6	6.9	6.8	7.0
Current account	-1.4	-2.0	-1.8	-1.9
Capital transfers	1.2	...	...	...
Current account <i>plus</i> capital transfers	-0.2	...	...	...

**Table 7**  
**Population, Labor Force, and Employment, 2000–2002**

	2000	Est. 2001	Change over previous year (%)					
			Forecast 2002		Est.		Forecast 2002	
			Scen- ario A	Scen- ario B	2000	2001	Scen- ario A	Scen- ario B
<i>Thousands</i>								
Mean population	6,287	6,440	6,594	6,594	2.6	2.4	2.4	2.4
Working age population	4,487	4,604	4,707	4,707	2.9	2.6	2.2	2.2
Civilian labor force	2,435	2,498	2,557	2,557	3.8	2.6	2.3	2.3
Employed in business sector	1,816	1,781	1,814	1,796	2.9	-1.9	1.9	0.9
Employed in public services	668	700	716	716	2.7	4.7	2.3	2.3
Total Israelis employed	2,221	2,280	2,329	2,311	4.0	2.6	2.2	1.4
Unemployed persons	214	219	228	246	2.5	2.3	4.3	12.5
<i>Percent</i>								
Working age/total population	71.4	71.5	71.4	71.4				
Participation rate	54.3	54.3	54.3	54.3				
Unemployment rate	8.8	8.8	8.9	9.6				

**Table 8**  
**Selected Interest Rates, 1999–2001<sup>a</sup>**

(averages, annual rates, percent)

	1999	2000	2001 (till August)
Credit lines and overdrawn demand deposits	19	15.8	13.7
Unindexed, foreign-currency, term credit	14.9	11.6	9.2
Resident time deposits	11.3	8.6	6.5
SRO deposits	10.7	8.0	5.9
Yield to maturity on Treasury bills	11.4	8.8	6.8
Gross yield to maturity on 5-year CPI-indexed bonds	5.6	6.0	5.1

<sup>a</sup> All interest rates are effective nominal rates, except for yields on bonds, which are real.

SOURCE: Bank of Israel.

**Table 9**  
**Monetary Indicators, 1999–2001<sup>a</sup>**

	Average reserves (NIS mill.)			Change (percent)			
	1999	2000	2001 (to Sept)	Since beginning of year (to Sept, annual terms)		Over same period in previous year	
				2000	2001	2000	2001
M1	21,485	23,846	26,765	5.0	20.3	8.7	19.1
SRO and time deposits	141,455	171,737	198,656	19.2	14.2	21.5	16.6
M2 (incl. Treasury bills)	162,940	195,583	225,421	17.3	14.9	19.8	16.9
Deposits in and indexed to foreign currency <sup>b</sup>	41,043	46,668	51,484	7.3	17.4	7.9	15.1
M3	202,835	241,562	276,241	15.5	15.3	17.6	16.6
Total assets in banks and							
Bank of Israel <sup>c</sup>	391,583	437,635	480,967	6.4	6.2	9.9	11.7
Stocks and bonds	429,806	522,416	483,177	13.5	-8.5	22.9	-13.6
Total assets of public	821,389	960,051	964,144	10.2	-1.4	16.7	-2.2
Unindexed and CPI-indexed credit	287,458	328,412	354,954	15.2	8.8	15.7	7.8
Credit in and indexed to							
foreign currency	96,044	105,196	119,923	-0.1	19.0	3.2	23.1
Total nondirected credit	383,501	433,608	474,877	11.2	11.3	12.5	11.4

<sup>a</sup> Data are final to July, preliminary to September; the first five and last three items are averages of daily data.

<sup>b</sup> Including time deposits, resident and demand deposits, unrestricted deposits (individuals and corporations), and residents' nonresident deposits.

<sup>c</sup> Including M3, restitutions deposits, savings schemes, earmarked deposits, and CPI-indexed long-term deposits.