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May 4, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Israel - Staff Report for the 1983 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1983 Article IV consultation with Israel. A draft decision appears on page 19. This subject has been tentatively scheduled for discussion on Wednesday, June 8, 1983.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Owen Evans, ext. 76004.

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INTERNATIONAL MONETARY FUND

ISRAEL

Staff Report for the 1983 Article IV Consultation

Prepared by the Staff Representatives
for the 1983 Consultation with Israel

Approved by Brian Rose and Subimal Mookerjee

May 3, 1983

I. Introduction

A staff team consisting of Messrs. Schmitt, Singh, Boote, and Evans (all EUR) and Mrs. Ghafir (ADM) as secretary, held Article IV consultation discussions in Jerusalem and Tel Aviv during March 1-14, 1983. The mission had discussions with the Minister of Finance, Mr. Y. Aridor, the Governor of the Bank of Israel, Mr. M. Mandelbaum, their officials, and representatives of the Ministry of Commerce and Industry. The mission also met with the Manufacturers Association, the Bankers Association, the Histadrut Trade Union Federation, and members of the economics faculty of the Hebrew University. Mr. Polak, Executive Director for Israel, attended some of the meetings. Israel continues to avail itself of the transitional arrangements under Article XIV.

II. The Economic Background

The Israel economy has shown evidence of increasing domestic and external imbalance. In 1982, inflation accelerated again to about 125 per cent and output was stagnant. Indicators of balance of payments performance also reveal a significant deterioration in underlying trends (Table 1). These developments followed directly from the short, consumption-oriented recovery of 1981. The associated net additional demand resulted in an increase in both domestic inflation and in the external deficit. The balance between higher inflation and an increased external deficit depended on exchange rate policy. The more of the excess demand that could be met by increased imports, the less of it remained to put pressure on prices at home. How much inflation was then required to accommodate the domestic excess demand depended on how quickly and how completely incomes--and wealth--were adjusted to prices.

Most of the accommodation was achieved at the expense of investment. Indexation mechanisms assured that increasing labor incomes and rising public expenditures were protected from inflationary erosion, while few procedures were available to index profits and sustain

Table 1. Israel: Summary Indicators

(Annual percentage change)

	1978	1979	1980	1981	1982 Est.
National accounts at constant prices					
GDP	4.4	3.7	2.7	4.2	0.8
Domestic demand	4.9	7.2	-5.4	6.3	6.9
Consumption 1/	6.0	5.7	-2.0	8.2	7.0
Investment	1.1	12.8	-17.4	-1.0	6.3
Price indicators (yearly averages)					
Consumer prices	50.6	78.3	131.0	116.8	120.4
Wholesale prices	53.2	79.0	135.1	122.7	125.7
Business product deflator 2/	54.0	73.7	141.9	119.3	122.0
Wage developments					
Real wage per employee	0.1	9.6	-7.0	8.5	-2.0
Real unit labor cost	3.8	7.0	-8.2	-0.8	3.0
Balance of payments					
Export volume 3/	9.3	9.0	9.2	12.5	2.5
Import volume 3/	12.2	14.4	-14.5	10.9	8.5
Civilian current deficit 4/ (in per cent of GNP)	5.7	9.7	5.5	5.5	9.8
Debt service ratio 5/	25.9	26.0	25.9	25.0	31.8
Real exchange rate 6/	-22.0	9.3	3.3	3.9	8.7

Sources: Data provided by the Israeli authorities; and staff estimates.

1/ Private and public consumption, excluding direct defense imports.
2/ Net domestic business sector product deflator.
3/ Goods excluding diamonds.
4/ Excluding official transfers.
5/ Debt service as per cent of exports of goods and services (excluding receipts of investment income).
6/ Movements of wholesale prices relative to competitors, adjusted for exchange rate changes, based on 1980 trade excluding diamonds.

investment. 1/ The long-run decline in the share of investment in GNP has already eroded the economy's growth potential. But with investment continuing to exceed domestic savings, the external deficit has remained high, and has recently widened. Accordingly, the gross claims of debt service on the country's exports of goods and services rose to an estimated 29 per cent in 1982.

1. The acceleration in inflation

Inflation accelerated very markedly in the past decade, particularly after the initiation of more expansionary policies in late 1977. The inflation rate jumped to 50 per cent in 1978 as the expansion in demand ran up against capacity and manpower constraints much sooner than expected. At the same time, there was the tendency for the inflation rate to become more rapid the longer it persisted. This was so because, as inflation persisted, both the degree of indexation and the frequency of adjustment increased. This was particularly evident for wages and financial assets. First, the reluctance of wage earners to accept declines in their real incomes led to a greater degree of indexation and more frequent adjustments in nominal wages. In fact, the overall wage agreements negotiated resulted in increases in real wages. Second, expectations of continuing or accelerating inflation stimulated shifts toward assets protected from inflation. Both these responses magnified the effects of the underlying demand imbalances and resulted in progressively higher rates of price increase.

Inflation jumped to the triple-digit range in 1980, reflecting a lagged response to the second round of oil price increases, the sharp expansion in demand during 1977-79, and continued large increases in real wages. As long as the exchange rate moved to offset the inflation differentials between Israel and the rest of the world, the excess demand was reflected in domestic price increases. After mid-1981, when this was less and less the case, a larger proportion of the excess demand was shifted abroad. Inflation moderated slightly, while balance of payments pressures increased. Quarterly developments in the inflation rate indicate a deceleration which lasted until mid-1982 after which the rate of price increases accelerated again to about the record levels achieved in 1980/81.

The real demand pressures that have been at the basis of the inflationary process have been broadly accommodated by the growth in the monetary magnitudes. The progressively larger budget deficits in recent years have required increasing recourse to net money creation. And the widespread indexation of financial assets, including foreign exchange-indexed assets, has meant that monetary growth has been largely beyond the direct influence of policy. As inflation accelerated so did the shifts out of nonlinked shekel financial assets, and by end-1981 these comprised only about 20 per cent of a broader monetary aggregate (M4).

1/ An analysis of the impact on the economy of high and accelerating inflation is contained in the recent economic developments paper.

2. Wage developments

An important element in the underlying imbalance has been the behavior of real wages. Indicators of the growth in real wages show that, over the past decade, real wages per employee have risen far in excess of productivity (Chart 1). Between 1974 and 1982, real wage costs per employee increased by 15 per cent, compared with a decline of 4 per cent in real net national product per employee, adjusted for the decline in the terms of trade.

Until 1980, the indexation adjustment affecting cost of living allowances took place twice yearly; subsequently it has been on a quarterly basis. Until October 1979, the degree of indexation was 70 per cent. This was replaced by a formula which varied the degree of adjustment between 80 per cent and 90 per cent depending on the quarterly inflation rate. The fact that wages were not fully indexed might have reduced real wages; however, this has not been the case as other aspects of the wage negotiations have often proceeded on the basis of excessively high estimates of the rate of prospective inflation. In addition to the indexed allowances, there have been at least two other types of agreements. At the national level, the agreement between the Employers' Federation and the Histadrut has generally focussed on the real wage. Except for 1980, when the acceleration in inflation to the triple-digit range was not anticipated fully, this process has generally assured increases in real wages. At the sectoral, industrial, or plant level there have been the diverse wage agreements which have led to considerable differences in relative wages.

Trends in unit labor costs have been broadly similar to those in real wages. Over the period 1974-82, real unit labor costs rose by 21 per cent, with a rapid increase in the second half of the 1970s being only partially offset by declines in 1980 and 1981. These trends in unit labor costs have added to pressure on profit margins, reduced the rates of return on capital, and affected the demand for labor.

Low and stagnant labor productivity remains an important obstacle to reversing the upward trend in unit labor costs. Only agriculture has continued to experience strong gains in productivity. Business sector labor productivity has grown only very little since the mid-1970s. The gains totaling about 3.5 per cent that did result in 1981 and 1982 reflected a "shake-out" of labor, and have neither restored the balance necessary nor altered the underlying factors that resulted in the relative stagnation during much of the 1970s.

3. Balance of payments and competitiveness

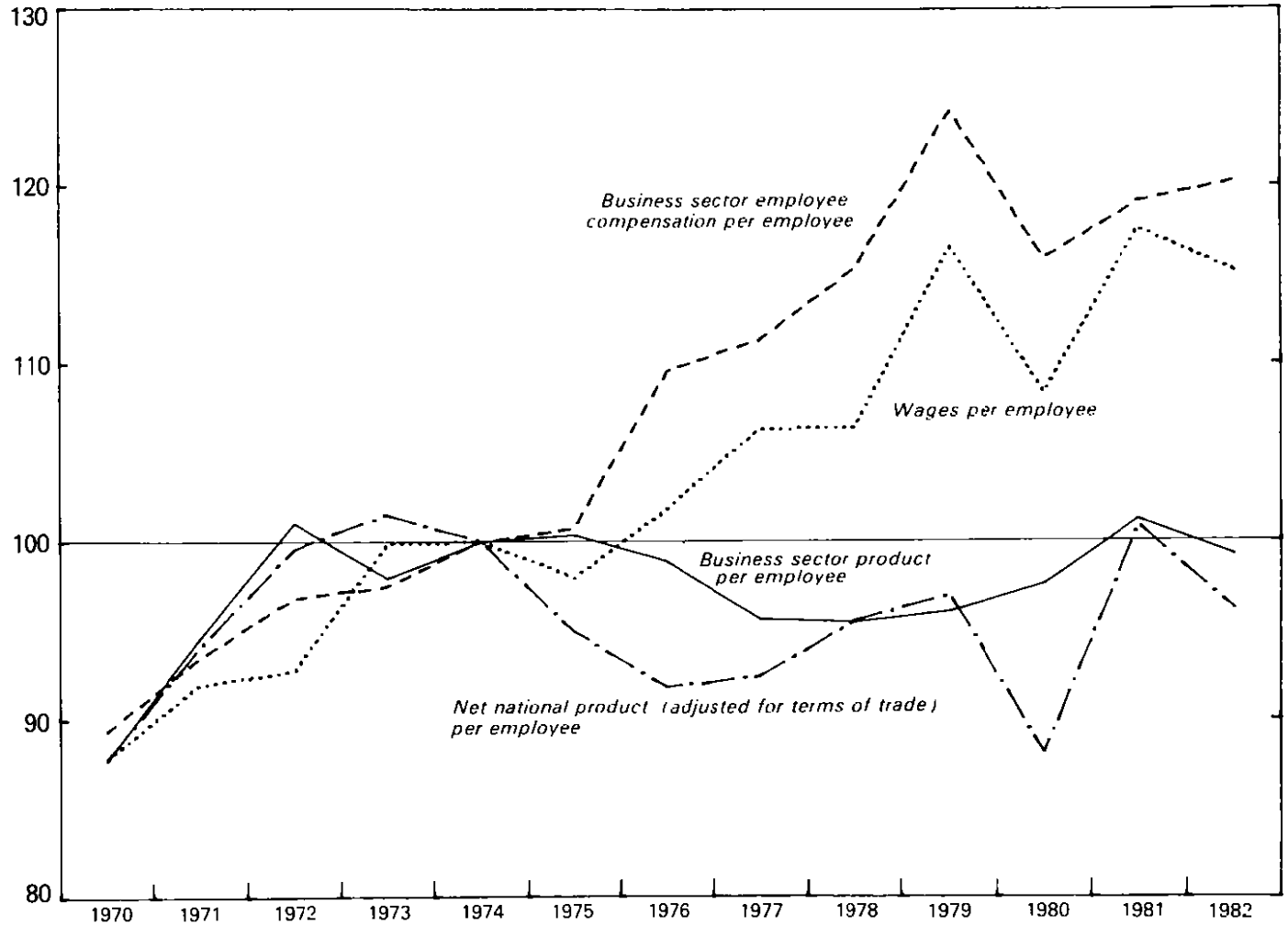
Two factors explain the recent deterioration of the balance of payments: depressed external markets and a loss in competitiveness. Indicators of competitiveness show that Israel's competitiveness began to

CHART 1

ISRAEL

REAL WAGES AND REAL PRODUCT[1]

(1974=100)



Sources: IMF *International Financial Statistics*; Israel Central Bureau of Statistics, *Monthly Bulletin of Statistics*; Bank of Israel estimates and staff estimates.

[1] Deflated by the business value added deflator and total employment.

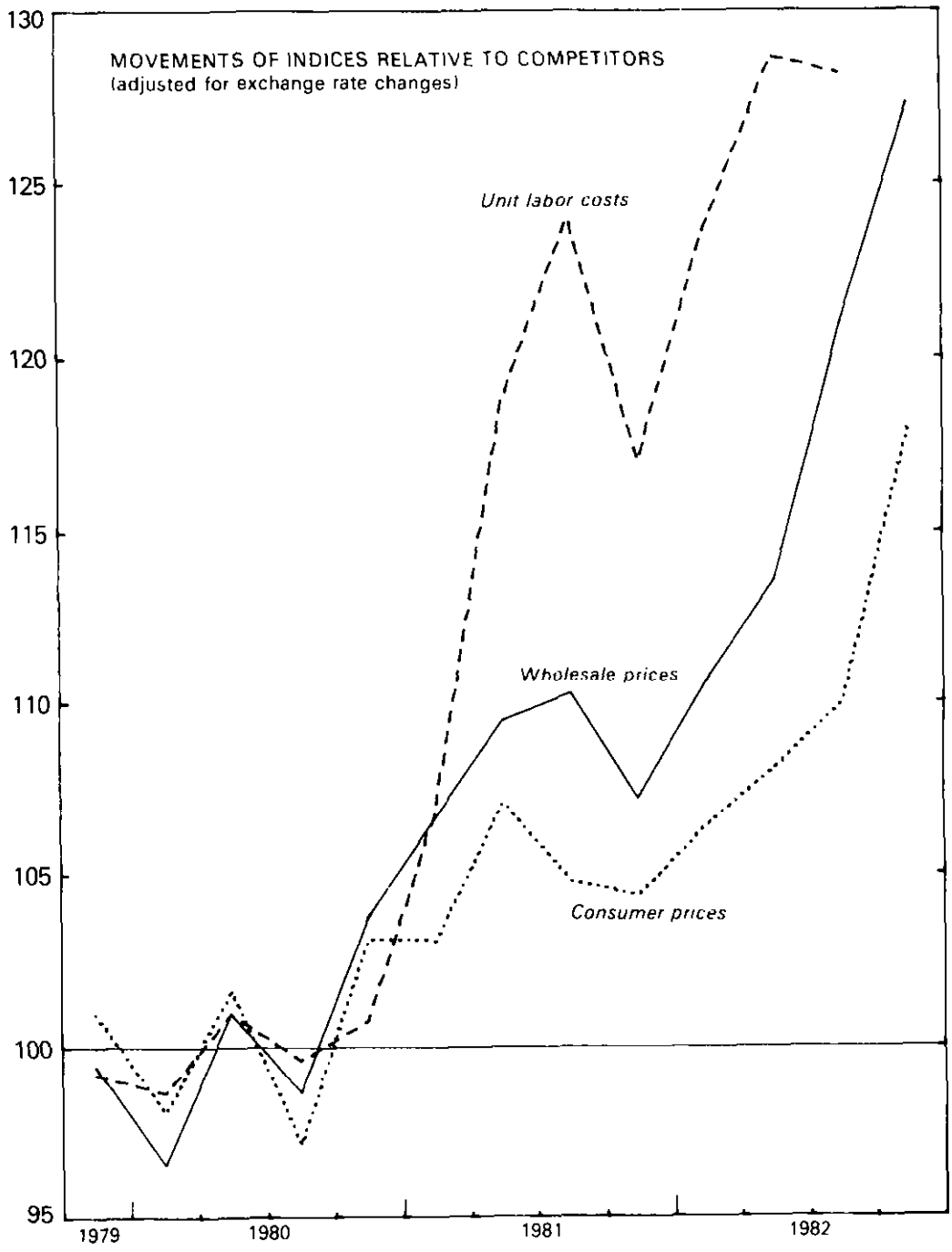
CHART 2

ISRAEL

INDICATORS OF EXPORT COMPETITIVENESS

(1980 bilateral trade excluding diamonds)

(1980 =100)



Source: Based on Appendix II to the Recent Economic Developments paper.

decline after 1979, reversing at least a decade of improvement. The decline is most pronounced when Israel's unit labor costs are compared with those of its major competitors; since 1979 there has been an increase of about 28 per cent, about a third of which was experienced in 1982 (Chart 2). Other indicators show a more modest deterioration, indicative of squeezed profit margins during this period, and, in addition, suggest that the principal shift occurred in 1982. There have been two other influences on competitiveness during this period. The preferential access of exporters to concessional "directed" credits has been reduced though the effect of this has been partly offset by a new insurance scheme for exporters, introduced in July 1981, that has thus far resulted in net payments to exporters in both 1981 and 1982.

The progressively greater indexation of wages and financial assets has had important implications for exchange rate policy. The efficacy of exchange rate policy in reducing excess demand is undermined if the stock of financial assets is unchanged in real terms and if the money wage response matches the increase in prices.

Nondiamond export volumes grew by only 2.5 per cent in 1982, in striking contrast to growth rates of 9-12 per cent realized in previous years. The weaker export performance in 1982 reflects virtually stagnant industrial exports. Together with the sharp decline in diamond export volumes--reflecting a particularly depressed international market--overall export volumes are estimated to have declined by 2 per cent in 1982. On the other hand, import demand has continued to rise at a rapid rate. Nondiamond import volumes rose by 11 per cent in 1981 and 9 per cent in 1982 reflecting, in both years, rapid increases in domestic demand. Consumer demand, particularly for imported durables, was stimulated by the real appreciation which altered price relatives at a time when gross disposable incomes also increased strongly.

The civilian trade deficit increased sharply, in consequence, to US$2.0 billion in 1982, or about 9 per cent of GNP. At the same time, the deficit on invisibles account deteriorated markedly, rising from US$0.7 billion in 1981 to US$1.2 billion in 1982. This resulted from a sharp rise in interest payments abroad and reduced tourist and transportation earnings. The civilian current account deficit, in proportion to GNP, about doubled from 5.5 per cent to 10 per cent.

As in previous years, capital inflows including official transfers were sufficient to result in a net increase in Bank of Israel exchange reserves which remain equivalent to about three months of imports of goods and services. Long-term capital inflows virtually doubled in 1982 while transfers increased only slightly. Although precise data are not available, it appears that commercial banks' reliance on foreign borrowing also increased in 1982.

III. Economic Policies

The authorities view inflation as the major problem for economic policy, and have initiated a strategy which they expect will reduce the annual inflation rate to 80 per cent during fiscal 1983/84, and considerably further in the subsequent two years. 1/ This strategy is based on the view that the current high inflation rate cannot be explained by real imbalances alone, but that it reflects also a purely monetary element. While the policies now being implemented will reduce some of the real imbalances, the strategy aims principally at reducing the monetary element in the inflation rate by achieving a coordinated deceleration in key nominal variables, particularly wages, controlled prices, and the rate of depreciation of the shekel.

In formulating this strategy, a number of constraints were considered by the authorities. In the particular circumstances of the Israeli economy, they could not accept a further increase in the unemployment rate, which had recently risen to 5 per cent. Also, they could not risk any further increase in the inflation rate, even were it temporary and resulting from adjustment policies. The present policy mix reflects these constraints.

It was recognized that a slowing down in the depreciation rate could, in the short run, adversely affect the balance of payments which was already under some strain. The authorities thought, however, that the increased current account deficit in 1982 had been due mainly to factors other than a lack of competitiveness. In their view, the markedly weaker export performance reflected, in major part, depressed external markets. They stressed that a revival in exports would require a recovery in domestic output which had stagnated in 1982. This, in turn, required an increase in investment, which could initially be financed through additional foreign borrowing. They acknowledged that this policy entailed a possible deterioration in the balance of payments, but thought this would be temporary, and the resultant debt service burden would remain manageable.

The authorities accepted that achievement of both internal and external objectives would eventually require a reduction in the real demand imbalances. Their approach to policy was said to be flexible; they would not hesitate to change course, particularly in the area of exchange rate policy, if the perceived benefits did not accrue quickly.

1. Labor market policies

A key element in the underlying imbalance has been the rapid rise in real wages. This growth has not only increased domestic absorption considerably beyond the growth in aggregate product, but also reduced

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1/ Fiscal year April 1-March 30.

competitiveness. There is widespread recognition of the need to restrain or reduce real wages and other nonwage costs of employment, as one component of policies designed to achieve internal and external adjustment.

The authorities explained that the recently negotiated wage agreement, covering the period through fiscal 1983/84, changes several aspects of the wage bargaining process. There was a change in the automatic indexation mechanism and, consequently, cost of living allowances from the quarter beginning May 1, 1983, will henceforth reflect the within-quarter price increase rather than the average increase between successive quarters. This revision has two implications. The transition to the new procedure would result in one month's price increase not being compensated. This, in itself, could reduce real wages by about 4 per cent during fiscal 1982/83 as a whole. While the frequency of adjustment would not be affected, this change would ensure a somewhat quicker reflection of changes in inflation rates in cost of living payments. As the authorities expected inflation to decelerate, this was seen as facilitating the achievement of a deceleration in nominal wages, though they recognized that it would exacerbate the problem if inflation were to accelerate.

The agreement provides for a review in April 1983, and also for subsequent reviews during 1983/84. However, the authorities expect that claims for the compensation of real wage declines will be resisted. For the first time the wage agreement specifically removes the obligation of employers to compensate for real wage declines that may result during the period of the agreement. Also, ambiguity has been retained regarding the base period from which changes in real wages are to be measured. The agreement also prohibits all wage-related industrial action during the period of its applicability.

While restraint or reductions in real wages, if achieved, would make a critical contribution toward reversing the long-term upward trend in unit labor costs, there are other nonwage costs of labor that need to be addressed, as well as the relative stagnation of labor productivity. In particular, payroll taxes have risen sharply in real terms since the mid-1970s and have added to employment costs. The authorities are seeking, through a variety of measures, to reduce disincentives to the use of labor. They are considering reducing payroll taxes, although this needs to be balanced by other fiscal measures.

Future gains in productivity may depend on some further rationalization in the use of labor. In the absence of a strong growth in output this will be difficult to obtain without increasing unemployment. There are some automatic balancing mechanisms that ensure high employment within the Israeli labor force. As the demand for labor slackens, the absorption of immigrant labor declines, including labor from the administered territories. The net emigration that occurred in 1981 was a source of particular concern to the authorities and a great premium is placed on the ability of the economy to attract labor from abroad. However, unless improvements in productivity, and in unit labor costs,

can be obtained, it will become increasingly difficult to preserve the competitive position of the economy and to generate sufficient new employment opportunities in the future.

2. Fiscal policy

The authorities recognized that the public sector has been a major factor in creating the real imbalance in the Israeli economy. This has been reflected directly in the growing proportion of government expenditures to GNP and, indirectly, in the growing borrowing requirements resulting from budget deficits. Except for fiscal 1980/81, the share of expenditures in GNP has risen steadily since the late 1970s, from about 68 per cent of GNP to its estimated level of 90 per cent in 1982/83 (Chart 3). Virtually all of the increase has been in current expenditures. Although a large part was defense related, and to a great extent matched by grant and concessional financing abroad, major increases have also taken place in transfers and subsidies, and in interest payments. Over the years, and particularly since 1980/81, an increasing proportion of current expenditure, especially wages, transfers, and interest payments, has been effectively linked to inflation. In addition, through policy measures, the real value of these payments has been consistently increased. In particular, commodity and other subsidy payments have increased in real terms. Thus, the share of transfers and subsidies in GNP has risen from about 17 per cent in the late 1970s to over 22 per cent in 1982/83. The burdens of restraint have fallen on investment expenditures, where fewer indexation mechanisms apply and these expenditures have barely maintained their share in GNP.

In assessing the impact of budgetary transactions on domestic demand, the authorities disaggregate the budget into its domestic and external components. This analysis has illustrated the dilemma confronting budgetary and, indeed, overall economic policy. The choice has been between a larger deficit on domestic transactions and a consequent greater rate of inflation, or a greater external deficit. Over time, this tradeoff has itself been reduced and the economy has tended to experience both higher rates of inflation as well as an increasing external deficit. Thus, in 1981/82, the deficit on domestic transactions tripled to about 9 per cent of GNP when policy turned sharply expansionary and domestic transfer and subsidy payments were increased. In 1982/83, a year of particular expenditure stress, the direct budgetary contribution to the external deficit doubled, compared with the late 1970s, reaching 20 per cent of GNP. Quarterly data indicate a marked reduction in the domestic deficit in 1982/83, particularly in the second half of the year, reflecting the impact of the new domestic revenue measures and also the relatively greater increase in expenditures abroad.

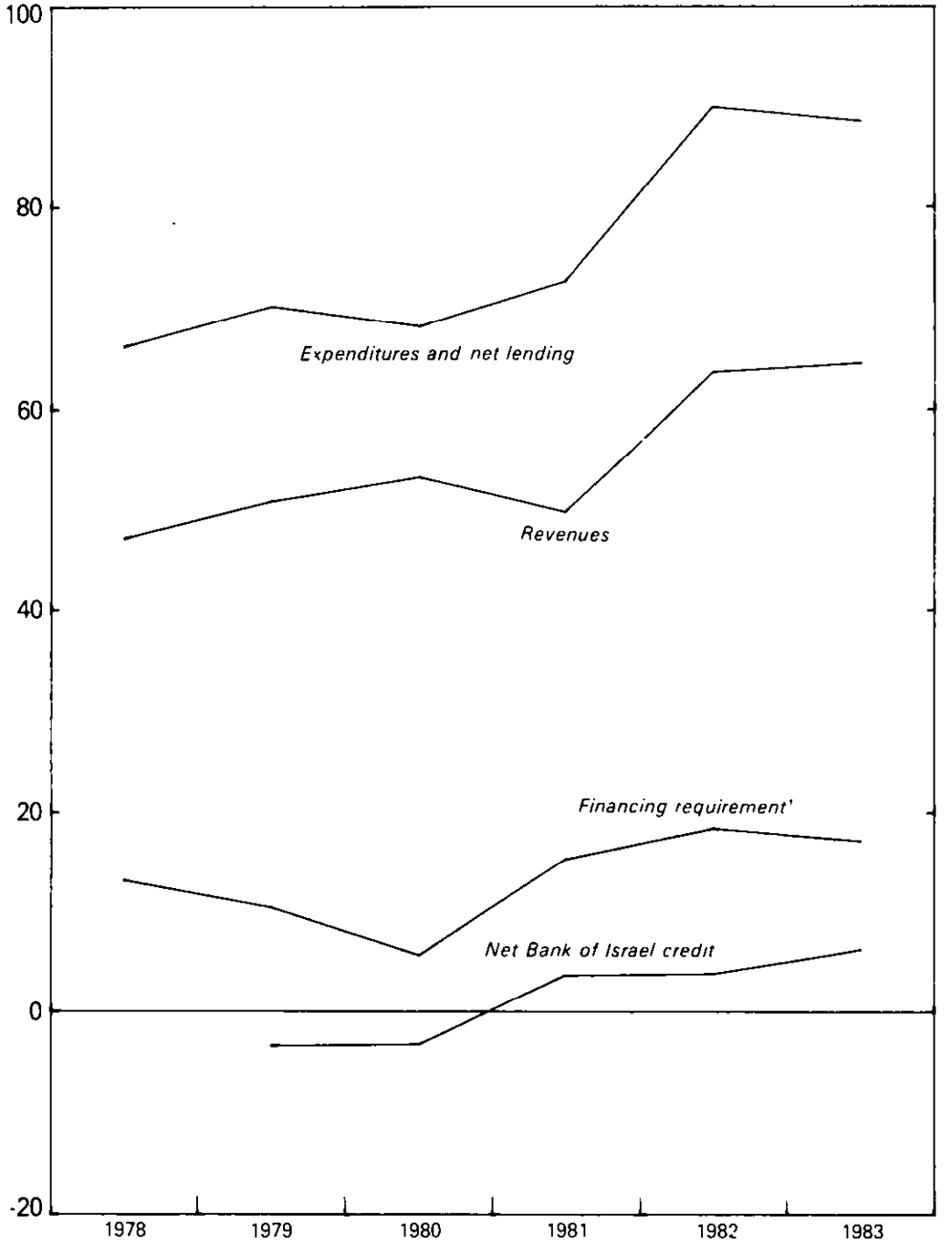
The Government has sought to finance its increasing expenditures as much as possible by increasing domestic taxes. With taxes already exceeding half of GNP, and all budgetary revenues equivalent to about two thirds of GNP, it may prove more difficult to raise these further in real terms. Net of transfer payments and domestic production subsidies,

CHART 3

ISRAEL

BUDGETARY DEVELOPMENTS

(Per cent of GNP)



Source: Based on data provided by the Ministry of Finance.
[1] After accounting for grants from abroad.

however, the tax performance has been less impressive. Direct taxes less transfer payments have constituted between 6-8 per cent of GNP, while the proportion of net indirect taxes to GNP actually fell in 1981, and is estimated to have been less than 5 per cent in 1982.

A very sharp increase in taxes was realized in 1982/83--equivalent to about 15 per cent of GNP. At least half this effort reflected a substantial package of measures implemented on June 15, 1982, and which was presented as the Government's response to the budgetary costs of the war in Lebanon. The increase in budgetary resources through discretionary action exceeded the direct and other identifiable costs of the war, in part because these costs have been spread over several years. The principal new measures were the reintroduction of a compulsory loan levy on income taxpayers, an increase in the value added tax (VAT), an import levy, and a tax on the sales of shares and stocks.

The tax effort has not been sufficient to prevent the budget deficit from rising sharply. As a proportion of GNP, the overall budget deficit rose to 23 per cent in 1981/82 and to 26 per cent in 1982/83. Reliance on foreign resources in financing the deficit has been high and, indeed, increased sharply in 1982/83. Even after taking account of the reliance on foreign resources, the domestic financing requirement has risen steeply, from near balance in 1980/81 to about 10.5 per cent of GNP in 1982/83. The authorities have been able to raise much of this through the issue of long-term bonds, but the recourse to central bank credit has nevertheless risen to about 4 per cent of GNP in 1982, compared with a surplus in the late 1970s.

A major issue for the budget has been that of subsidy policy and its role in containing inflationary pressures. There have been frequent changes in policy since 1980/81 when restraint was first exercised on the growth of subsidies. This restraint was eased toward the the end of 1980/81 when the rates of existing subsidies were increased and the range of subsidized commodities extended considerably. When budgetary costs rose very steeply, a reversal in policy was effected midway through fiscal 1981/82. More recently, the new strategy for decelerating the inflation rate has again slowed the growth of administered prices. Consequently, subsidy payments in the budget have not been reduced in proportion to GNP and, in 1982/83, remained at about their 1980/81 level. They are projected to increase in 1983/84. Together with transfer payments, these two categories of government expenditures are estimated to rise to about 23 per cent of GNP in the 1983/84 budget.

The 1983/84 budget projects only a small decline in total budget expenditures in relation to GNP. No new revenue measures have been introduced; however, the import levy, intended to be a temporary measure for 1982/83, has been extended. The compulsory loan was also intended to be temporary but the authorities expect that equivalent resources will continue to be raised in 1983/84. Small declines in the budget deficit and in the financing requirement are projected. In previous years, some slippage has usually occurred. However, the authorities are

strengthening expenditure control and reviewing procedures to reduce the extent of indexation of current expenditures. The budget projects the share of foreign resource inflows to decline significantly, and that of net credit from the Bank of Israel to rise to about 6 per cent of GNP. The domestic deficit is projected to rise again, and it appears likely that, even if the budget is implemented as planned, the domestic expansionary impact will be greater than 1982/83.

3. Monetary policy

The principal focus of monetary policy has been the control of short-term bank credit to the private sector. Credit to the government has been determined independently by the budgetary process and the degree of success in selling bonds to the nonbank public. Even within the category of short-term credit to the private sector, the authorities have limited their room for maneuver by affording preferential access to priority groups (principally exporters). These concessional "directed credits," even after declining in recent years, still account for a third of all private sector credit. Until November 1982, the authorities had sought to realize credit objectives through the specification of individual bank ceilings on the growth in (shekel and foreign currency) nondirected credit. These ceilings existed since 1979, but proved increasingly difficult to administer, and had, in any case, led to substantial disintermediation. Reflecting these problems, the ceilings on credit in shekels were abolished in November 1982. The authorities will continue to use a credit aggregate as an intermediate target, but by operating on the monetary base. To be successful this method will require the development of a monetary base in unlinked local currency.

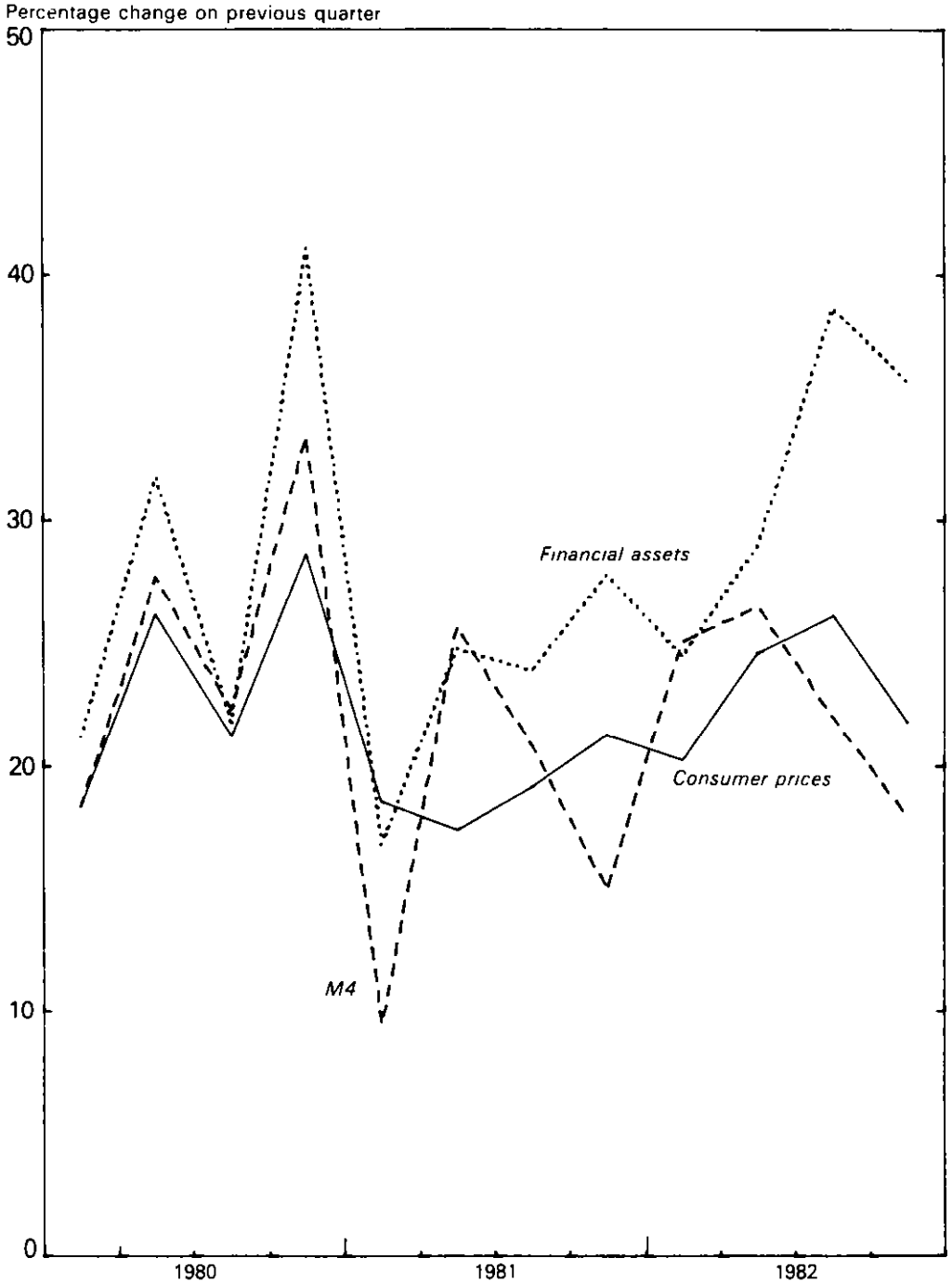
The absence of a significant unlinked monetary base has, in the past, severely constrained the conduct of monetary policy. Over recent years, as inflation accelerated, the public shifted its holdings of monetary assets toward those linked to foreign exchange or to prices. The availability of highly liquid government bonds linked to the consumer price index, and domestic deposits indexed to foreign exchange (PATAM accounts), resulted in large shifts in the public's holdings of monetary assets. By 1981, over 80 per cent of broad money (M4) comprised these linked monetary instruments. In addition, other financial assets have been available to the public, such as stock market instruments and savings schemes, which have been relatively liquid in character and have assured holders of relatively higher real rates of return. Indeed, the share of M4 in total financial assets has itself declined from 44 per cent at end-1977 to 30 per cent in 1981, and 23 per cent in 1982.

These developments have meant, first, that unindexed monetary assets have fallen to levels that afford negligible revenue to the Government from the inflation tax and, second, that broad money growth has become largely endogenous to the system. Monetary policy has thus been able to exercise little control over the real value of monetary assets and inflation has, largely in this way, been broadly accommodated by the growth in these aggregates (Chart 4).

CHART 4

ISRAEL

PERCENTAGE GROWTH OF M4, CONSUMER PRICES AND FINANCIAL ASSETS OF PUBLIC



Source: Bank of Israel

The authorities have become very concerned about the implications of these developments for monetary policy. Several measures to reduce the attractiveness of the terms on which indexed monetary assets are available were initiated in 1982. The liquidity of PATAM accounts was reduced by increasing the liquidity requirements associated with them, and by sharply increasing penalties on early withdrawal. At the same time, in order to induce shifts to unlinked shekel deposits, new time deposits of two- and four-week maturities were introduced, with higher interest payments that are exempt from income tax. The ability of the banks to pay these higher rates was enhanced by increasing the interest rate paid on the interest-bearing portion of the reserves held against them at the Bank of Israel. Refinancing from the Bank of Israel is now being provided in proportion to their unlinked shekel liabilities. In addition, a tax of 2 per cent was introduced on all transactions in indexed bonds and shares. These measures have already succeeded in raising the share of unlinked shekel monetary assets in M4 from 20 per cent in 1981 to 24 per cent in 1982.

The abolition in 1982 of individual bank ceilings on the growth in nondirected shekel credits is intended to reduce the administrative element in monetary policy. These changes should, in time, improve competition in banking, eliminate the segmentation of markets, and increase the efficiency of credit flows. As part of this process, further restrictions have been imposed on directed credits. The preferential access of priority groups to the concessional directed credits has been curbed further by tightening eligibility and raising the interest charged. These changes have reduced distortions in the allocation of credit, and the share of directed credits in total credit to the private sector has declined from 44 per cent in 1980 to about a third by the end of 1982.

The authorities noted that, as part of their efforts at increased control of the monetary base, increased reliance will be placed on changes in reserve requirements and variations in central bank credit. Toward this end, penalties on liquidity deficiencies were increased in November 1982. Reserve ratios were also altered in 1982, with the objective of stimulating the growth in unlinked shekel monetary deposits; however, directed export credits continue to be exempt from the computation of reserve requirements. In addition, the authorities are planning a more active interest rate policy; they intend to introduce 90-day Treasury bills during 1983 and to conduct more active open market operations. They see this as an essential component of their new emphasis on monetary base control. Thus far, open market operations have been virtually absent. Active open market operation will permit the authorities to control the behavior of bank reserves more closely but will also require much greater flexibility in interest rate policy.

Interest rate policy has sought to reduce differentials between directed and nondirected credits, and between domestic and foreign interest rates on foreign currency credits. The latter has enabled the surcharge on foreign borrowing to be reduced progressively from 9 per cent to 1 per per cent in 1982, but ceilings on such foreign currency credits will

continue to restrain such borrowing while differentials persist. The real costs of all commercial bank credits were allowed to decline in 1982, partly through reductions in nominal interest rates. When account is taken of tax deductions that apply to interest payments, the real cost has indeed been negative for several years.

The authorities will continue to place primary emphasis on containing the growth in short-term private credit. In recent years, they have attempted to restrain the growth in this aggregate to below the rate of inflation and this thrust will continue. Targets will not be publicly announced, and the Bank of Israel will rely on the new monetary instruments to achieve targets for the banking system as a whole. As in the past, these targets do not include long-term investment credits extended by banks. Also excluded from the targets are credits granted for the holding of oil inventories, credits to the diamond sector, and to shipping companies.

4. External policies

The authorities have also become concerned about recent developments in the external current account, but said that the pressures that were reflected in the 1982 balance of payments arose suddenly. They attributed the sharp increase in the civilian current account deficit principally to a decline in export volumes after several years of rapid growth. This had reflected depressed external markets but also some limited loss of competitiveness. 1/

a. Exchange rate policy

The authorities explained that they had recently sought to decelerate the rate of nominal depreciation of the shekel in line with a slowdown of inflation. The rate of nominal depreciation was not, in fact, sufficient, in the second half of 1982, to offset the inflation differentials between Israel and a weighted average of competitor countries. A similar deceleration has been evident for a longer period, notably during the first half of 1981. The authorities explained that large net capital inflows have, in any event, exerted upward pressure on the shekel in the exchange market. These capital inflows have principally related to large official transfers, although in 1982 there were also increased private short-term inflows through the banking system.

The strengthening of the dollar against European currencies added another complication. While the shekel depreciated somewhat in real terms against the U.S. dollar, it appreciated in real terms against the main European currencies. This had additionally hurt the profitability

1/ An analysis of changes in Israel's competitiveness is contained in Appendix II of the recent economic developments paper.

of exports to European markets, and some shift had taken place between Europe and the United States as the destination for exports. The transition had involved costs and in the process exports had suffered in 1982.

To alleviate some of the uncertainties on exporters a new insurance scheme against exchange risks had been established for exporters effective July 1, 1981. The scheme resulted in a loss of US$60 million in 1981 and US$200 million in 1982. While it was not intended to constitute a subsidy for exporters, the scheme has offset some of the erosion in competitiveness that resulted from the gradual reduction in subsidized directed credits for exports. The losses incurred by the insurance scheme were indicative of the appreciation of the real exchange rate that had been experienced, particularly in 1982.

The authorities stressed the difficulty of restoring competitiveness through changes in the nominal exchange rate as long as the consequent effects on the inflation rate remained unacceptable. The actual deterioration had, in any case, been limited, and was certainly much less than implied by the calculations based on differential movements in unit labor costs. It had not offset the competitive gains experienced by Israeli exporters during much of the 1970s. The authorities also pointed out that large changes in the structure of Israel's exports had been achieved in recent years with greater specialization in products of sophisticated technology. This made it difficult to compare changes in competitiveness over time. Nevertheless, the authorities recognized that future developments in exports needed particular attention, and that flexibility would be exercised in implementing the current policy if the recent developments in export performance were to continue into 1983.

b. External debt

Israel's external debt increased sharply in 1982 from 88 per cent to about 96 per cent of GNP, reflecting the increased current account deficit. While official concessional borrowing rose sharply, there was also greater reliance on private borrowing through banks. This followed a period of two years when the debt/GNP ratio stabilized at levels below those reached in the late 1970s. Israel's external debt has traditionally been large by international standards, reflecting the dominance of government debt, much of it in the form of direct loans from foreign governments and publicly placed bonds on concessional rates of interest. At end-1982, about two thirds of total external debt was the liability of the Government, with 91 per cent of this debt on a long-term basis and the remainder in the form of medium-term loans. The debt service problem reflects mainly private sector borrowing from abroad, the share of which in the total rose to 29 per cent at end-1982 compared with an average of about 23 per cent in the preceding three years.

The relatively greater reliance on private borrowing in 1982 reflected almost entirely debt incurred by the banking system. Such borrowing rose by US$1.5 billion in 1982, of which about half was short

term of less than one year's maturity. At end-1982, the short-term component of Israeli total external debt constituted about 16 per cent, compared with an average of 11 per cent in 1979-80 and 13 per cent in 1981. The authorities explained that the increase in the short-term liabilities of commercial banks was explained by special factors arising from changes in the system of export credits. The Bank of Israel had transferred the operation of export credit to commercial banks and ceased the practice of discounting foreign currency export credits by commercial banks. This change meant that the foreign resources required to meet export credit demands affected commercial banks' net foreign asset positions rather than that of the Bank of Israel. The authorities stressed that the changes in the banks' liabilities did not represent a shift in the private sector's demand for foreign borrowing. They had, in fact, reduced ceilings on private short-term foreign borrowings through the banking system at end-1981, for purposes other than export credits.

Nevertheless, there has been a sharp increase in the net debt service ratio. Debt service as a percentage of exports of goods and services rose from an average of about 24 per cent during 1979-81 to about 29 per cent in 1982; net of interest receipts from abroad, this ratio rose from about 19 per cent to 24 per cent. The increase was mainly due to higher interest payments.

c. Trade policies

Israel's import system continues to be guided by the Free Imports Order of 1978 and is virtually free from licensing and quantitative restrictions. The major changes since the last consultation have included some additions to the restricted list of imports to meet specific domestic protection objectives, and the recent introduction of an import levy. During 1981 and 1982, 28 import categories were added to the list of restricted imports estimated to account for less than 3 per cent of total non-oil imports. The levy of 3 per cent on the c.i.f. value of all imports subject to the value-added tax, introduced on June 15, 1982, was part of a package of measures to demonstrate the authorities' commitment to spread the sacrifices associated with the Lebanon war. While the authorities stated that this measure would substitute, in part, for the deceleration in the nominal depreciation of the shekel, they are determined not to tackle the growing pressures on the balance of payments by resorting to import restrictions. The import levy was intended to be a temporary measure for the fiscal year 1982/83 only. It has recently been extended, but the authorities have stated that they would abolish it not later than the end of the 1983/84 fiscal year. Exporters are being compensated for the levy by rebate arrangements. Israel continues to reduce duty rates on imports from the EC in line with her commitments to the Communities; value-added tax rates are being raised. Israel's exports to the Communities are already exempt from import duties. The exchange risk insurance scheme, introduced in July 1981, was not intended to be a subsidy to exporters, although net payments to exporters had resulted since the introduction of the scheme. In the long run the scheme was meant to be self-financing.

On other trade matters, the authorities stated that Israel's exports to Egypt had virtually ceased after mid-1982, when the Egyptian authorities stopped issuing import licenses for imports from Israel. They hoped this trade would resume again in the near future.

III. The Economic Outlook for 1983 and Beyond

The economic outlook for future years depends critically on the extent to which the authorities are able to reduce domestic absorption and shift resources to the traded goods sector. Official forecasts for 1983 project private consumption to rise by 1.4 per cent or significantly less rapidly than in the preceding two years. This will imply a decline in real private consumption per capita. Civilian public consumption is projected to rise by less than 1 per cent while gross domestic investment is expected to rise considerably more rapidly than in recent history, by 9 per cent in real terms. The increase in real domestic demand again exceeds the forecast real increase in GDP of 2 per cent. The authorities are hoping that the policies already in place, will result in a deceleration in the inflation rate to 80 per cent in 1983 measured as the average increase in the CPI over 1982.

Achievement of these forecasts will not be easy and will depend on the extent to which real private and public consumption can be restrained or reduced, and a turnaround in the external current account obtained. Important determinants will be the behavior of real wages, moderation of excess demand pressures from the budget, and the stance of exchange rate policy. The authorities are projecting that the estimated decline in real wages in 1982/83, which will result from the current wage agreement, will be consolidated and built upon during the remainder of 1983. Assuming that the budget is implemented as introduced, the budgetary deficit will be reduced in proportion to GNP, although there will be a sharp increase in net central bank credit to the Government, and a greater contribution to reserve money creation than obtained in 1982/83.

Developments in the external trade account will depend critically on the stance of exchange rate policy, and whether a further erosion of competitiveness is allowed to result in 1983, as well as on the intended restraint in domestic absorption. The scenario sketched for 1983 by the authorities may well be on the optimistic side, particularly in light of past slippages in government expenditures and in the behavior of public employment and real wages. The danger is, again, that private and public consumption will rise faster than officially forecast with some further squeezing of investment. If this were to occur, the more rapid growth in domestic demand would place renewed pressure on the balance of payments.

Preliminary calculations of financial developments indicate that, if the balance of payments for 1983 evolves as forecast by the authorities, and the growth in domestic liquidity is restrained in line with the projected growth in GDP and officially forecast inflation of 80 per cent, the implied growth in domestic credit will be very stringent.

Assuming the budget financing need is met as implied by the 1983/84 budgetary forecast, the residual available for private credit will imply a sharp reduction in real terms. It seems likely therefore that the growth in domestic credit will be greater than implied by this set of calculations, and the resultant deficit in the balance of payments will also be greater.

The authorities' medium-term projections for the balance of payments and for the evolution of their external debt position indicate relatively rapid external adjustment and a sharp reversal of the recent increase in the proportion of debt service payments to exports of goods and services. The authorities stressed that these projections should be understood as targets for policy. They noted that the balance of payments and external debt were particularly difficult to forecast as they depend critically on the international cycle and on the availability of long-term capital inflows. The authorities project the external deficit on goods and services account to decline from US$4.9 billion in 1982 to US$4.6 billion in 1983 and to be at about this level in 1986. This implies a return to the rapid rates of export volume growth that were experienced in the 1970s. As a proportion to projected GNP, the deficit is expected to decline considerably more rapidly reflecting the authorities' assumption of aggregate growth rates of 6-7 per cent after 1983. Correspondingly, the debt service expressed as a percentage of goods and services is projected to peak at 29 per cent in 1983 and then decline in 1985 to about 22 per cent, below the average that prevailed in 1980/81.

The staff believes these projections to be ambitious particularly with respect to the projected sharp recovery in export performance and in aggregate growth. On the basis of a more cautious reading of present trends and policies, the external deficit on goods and services could widen in 1983 to US$5.3 billion and to exceed US$6 billion by 1985. Such a deterioration would result in a marked worsening of the debt service ratio to perhaps 37 per cent by 1985.

IV. Staff Appraisal

The authorities view inflation as the major problem for economic policy, and their economic strategy is designed to reduce the monetary element in the inflation rate by acting on the nominal variables. They intend the effects on real output and employment to be minimal, that is they are not prepared to accept the inevitable consequences in the short run for employment and consumption of policies aimed at sharply reducing domestic demand. However, the pressures on the balance of payments reflect the growing underlying real imbalances, and unless these are reduced the pressures will continue.

The underlying imbalance in the Israel economy has worsened in recent years, not least because of the rapid rise in real wages, which has not only increased domestic absorption but also reduced competitiveness. The external deficit on the civilian current account expanded

from 5.5 per cent of GNP in 1980-81 to about 10 per cent in 1982. While the depressed state of the world economy was a factor in this deterioration, more important has been the erosion in competitiveness. This has been, in part, a matter of exchange rate policy, although the effects of reduced concessional export credits have been relevant. The depreciation of the shekel has not always been rapid enough in the last four years to compensate for inflation differentials. This was particularly the case in 1982 and, under the present policy of decelerating the rate of nominal depreciation of the shekel, further losses in competitiveness may result. This has doubtless helped to moderate domestic inflation, but at the expense of the balance of payments.

It is imperative that the recent declining trend in competitiveness be reversed. To the extent that an accelerated depreciation of the exchange rate is necessary for this purpose, some temporary increase in the inflation rate must be accepted. A lesser depreciation would be required if the effective indexation of wages can also be reduced. The authorities have recognized the importance of including indexation in negotiating new wage contracts, and of creating room within those contracts for a reduction in real wages. Periodic reviews of real wage trends may still be demanded by the trade unions, but employers are no longer committed to make up shortfalls to which the formal indexation mechanism may have given rise. The new wage contracts are a signal achievement, therefore, and should be consolidated and built upon. Meanwhile, supplementary methods for improving competitiveness need to be considered, such as reducing the nonwage costs of labor.

The public sector has been another major factor in the deterioration of the real imbalance in the Israel economy. Gross budgetary expenditure rose from below 70 per cent of GNP to around 90 per cent in the last three years. All of the increase was in current expenditures. Although a large part was defense-related, particularly last year, major increases also took place in transfers and subsidies, and in interest payments. The authorities are to be commended for the vigor with which they have raised revenues in response. Nevertheless, the gross financing requirement of the budget is estimated to have risen from 15 per cent of GNP to 26 per cent over the last three years. In fiscal 1983/84 the authorities intend to restrain the growth of public expenditures; revenues are also expected to increase on the basis of last year's measures. Even so, the gross financing requirement is not targeted to drop much below 24 per cent of GNP in the next fiscal year, even without allowance for the slippage that on past performance should probably be expected. This points to the need for further cuts in government expenditure.

Inflation has been broadly accommodated by the growth in the monetary aggregates. To a large extent this accommodation was rendered automatic by the widespread indexation of financial assets and liabilities to the exchange rate or to prices. The possibility of using exchange rate depreciation to reduce real excess demand is also compromised, of course, if the stock of financial assets is unchanged in real terms without any change in spending patterns.

Until recently credit to the private sector was controlled by rationing, though the scope for rationing was limited by the preferential access granted to priority groups at concessionary terms. The authorities have now moved to rationalize the allocation of credit by reducing eligibility for preferred access and raising the interest charged. A complete abolition of directed credit would be desirable. Credit ceilings in local currency have been abolished. The authorities continue to watch a credit total but intend to control it by operating on the monetary base. Increased reliance will henceforth be placed on changes in reserve requirements and variations in central bank credit. Authority to operate in Treasury bills has been requested, and should be granted shortly. To be successful this will require considerably greater flexibility in interest rate policy.

A significant monetary base in unlinked local currency still needs to be developed. Given the option of holding index-linked assets, the public has moved out of unlinked deposits, thus reducing the base the authorities could operate on. The authorities have therefore sought to reverse the process by measures to reduce the liquidity of linked assets and to improve the yield on those unlinked. These steps to strengthen monetary control deserve strong encouragement. If monetary policy is to contribute to the control of inflation, however, it must work toward progressively tighter nominal credit targets for the economy as a whole, including the public sector. Without that, and the deregulation of interest rates, the real imbalances are also likely to persist.

For the medium term, greater room needs to be made for investment which has, in the past, been the least protected component of demand. The economy's growth potential has certainly declined over the years as wages and taxes have increasingly encroached on profits. The increase in investment that is now urgently required will have to be accommodated within domestic demand growth consistent with adjustment in the balance of payments. This will require, in turn, reduction in other components of domestic demand.

It is recommended that the next Article IV consultation with Israel be held on the standard 12-month cycle.

The following draft decision is proposed for adoption by the Executive Board:

Proposed Decision

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Israel, in the light of the 1983 Article IV consultation with Israel conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Israel continues to maintain a liberal system of payments and transfers for current international transactions.

Table 2. Israel: National Accounts

(Percentage change at constant prices)

	Average 1974-77	1978	1979	1980	1981	Est. 1982	Forecast 1983
Gross domestic expenditure	-0.4	4.9	7.2	-5.4	6.3	6.9	2.8
Private consumption	3.0	7.4	7.1	-3.2	10.5	6.8	1.4
Government consumption 1/	-2.6	2.5	1.9	1.7	2.8	7.7	0.8
Gross domestic investment	-5.5	1.1	12.8	-17.4	-1.0	6.3	9.0
Foreign balance							
Exports of goods and nonfactor services	9.8	5.2	3.3	6.3	3.9	-4.8	4.7
Imports of goods and nonfactor services 1/	1.8	6.0	10.6	-10.6	7.9	7.5	5.5
Gross domestic product at market prices	1.9	4.4	3.7	2.7	4.2	0.8	2.0
Net factor payments abroad	-2.1	14.7	24.8	2.6	-7.4	20.4	10.0
Gross national product at market prices	2.1	4.1	3.0	2.7	4.6	--	1.8
Memorandum item:							
Gross domestic product of busines sector	1.9	4.5	3.5	2.7	5.3	-0.4	2.5

Source: Bank of Israel.

1/ Excludes direct defense imports.

Table 3. Israel: Balance of Payments

(In millions of U.S. dollars)

	1979	1980	1981	1982	Israel proj. 1983	Staff proj. 1983
Exports, f.o.b.	4,717	5,800	5,929	5,446	5,800	5,500
Imports, f.o.b.	-8,141	-9,167	-9,670	-9,104	-9,000	-9,325
Defense imports	(-1,225)	(-1,713)	(-2,211)	(-1,639)	(-1,125)	(-1,125)
Civilian imports	(-6,916)	(-7,454)	(-7,460)	(-7,465)	(-7,975)	(-8,200)
Trade balance	-3,424	-3,367	-3,741	-3,658	-3,300	-3,825
Civilian trade balance	(-2,199)	(-1,654)	(-1,530)	(-2,019)	(-2,175)	(-2,700)
Services (net)	-519	-560	-689	-1,225	-1,430	-1,500
Private transfers (net)	1,091	1,134	1,085	1,112	1,125	1,125
Current balance	-2,852	-2,793	-3,345	-3,771	-3,605	-4,200
Civilian current balance	(-1,627)	(-1,080)	(-1,134)	(-2,132)	(-2,375)	(-3,075)
Official transfers	1,702	1,834	1,800	1,865	1,850	1,850
Current account balance including all transfers	-1,150	-959	-1,545	-1,906	-1,755	-2,350
Long-term capital	1,221	1,234	1,046	1,903	1,538	1,538
Short-term capital 1/	348	155	1,080	422	717	1,312
Overall balance	419	429	581	419	500	500
Memorandum item:						
Percent changes in						
Export volume	2.5	8.9	6.9	-2 2/	4	-2
Import volume	4.8	-10.8	2.8	9 2/	7	9
Proportions to GNP:						
Civilian current deficit	9.7	5.5	5.5	9.8	10.7	13.9
Current deficit	17.0	14.3	16.1	17.3	16.3	19.0
Current deficit including official transfers	6.8	4.9	7.4	8.8	7.9	10.6
Gross official reserves (Months of imports of goods and services)	3.1	2.9	2.8	2.9	...	...

Sources: Israel, Central Bureau of Statistics, Monthly Bulletin of Statistics, Bank of Israel, Annual Report and National Budget for 1983.

1/ Including errors and omissions.
2/ Staff estimates based on National Budget for 1983.

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Percent changes in						
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Proportions to GNP:						
Civilian current deficit	9.7	5.5	5.5	9.8	10.7	13.9
Current deficit	17.0	14.3	16.1	17.3	16.3	19.0
Current deficit including official transfers	6.8	4.9	7.4	8.8	7.9	10.6
Gross official reserves (Months of imports of goods and services)	3.1	2.9	2.8	2.9	...	...

Sources: Israel, Central Bureau of Statistics, Monthly Bulletin of Statistics, Bank of Israel, Annual Report and National Budget for 1983.

1/ Including errors and omissions.
2/ Staff estimates based on National Budget for 1983.

Table 4. Israel: Developments in the Main Budget Aggregates 1978/79-1983/84 1/

(In per cent of GNP)

	1978/79	1979/80	1980/81	1981/82	Estimate 1982/83	Budget 1983/84
Budget expenditures	66.2	70.2	68.2	72.6	90.0	88.5
Current expenditures	58.9	61.3	60.4	64.1	78.9	75.7
Of which:						
Transfers and subsidies	(17.2)	(16.8)	(18.9)	(22.0)	(22.3)	(23.2)
Interest payments	(8.6)	(6.9)	(8.4)	(11.1)	(14.9)	(17.6)
Defense expenditures	(22.7)	(27.0)	(24.7)	(22.7)	(30.6)	(24.6)
Capital expenditures and net lending	7.3	8.9	7.8	8.5	7.8	8.7
Reserves	--	--	--	--	3.3	4.1
Budget revenues	47.1	50.8	53.2	49.7	63.6	64.6
Of which:						
Tax revenues 2/	38.8	40.3	36.7	37.1	52.0	52.6
Budget deficit	19.1	19.4	15.0	22.9	26.4	23.9
Foreign grants	5.9	8.9	9.2	7.6	8.0	6.7
Total financing requirement	13.2	10.5	5.8	15.3	18.4	17.2
Foreign borrowing (net)	9.0	8.0	5.0	5.3	7.8	5.0
Domestic bond issues (net)	4.2	5.8	4.0	6.2	6.6	5.8
Net credit from Bank of Israel	--	-3.3	-3.2	3.8	3.9	6.3
Memorandum item:						
Net impact on base money	0.8	-1.2	1.8	6.7	3.3 3/	3.8

Source: Ministry of Finance.

1/ GNP in fiscal years.
2/ Including compulsory loans.
3/ Provisional.

Table 5. Israel: Monetary Survey

(In millions of Israel shekels)

	End third quarter 1982	Flows during year 1981	Flows during year 1982 1/	Real percentage increase 1981	Real percentage increase 1982 1/
1. Net domestic assets	280,532	81,699	129,032	7.7	-2.5
Domestic credit	263,483	74,479	123,087	5.7	-1.2
Public sector	(87,305)	(27,884)	(40,413)	(22.4)	(-2.0)
Private sector	(176,178)	(46,595)	(82,674)	(-1.1)	(-0.8)
Nongovernment bonds	17,049	7,220	5,945	41.9	-19.2
2. Net foreign assets	-24,244	-8,502	-19,136	--	--
3. Other items, net	1,400	-5,182	15,281	--	--
4. Total (1+2+3)	257,689	68,015	125,178	2.0	2.4
5. M_1 and unlinked time deposits	36,826	9,785	17,807	2.2	2.0
6. PATAM deposits	164,538	40,924	81,782	-1.8	4.7
7. Savings schemes and linked deposits	56,325	17,306	25,589	13.6	-3.5
8. Total (5+6+7)	257,689	68,015	125,178	2.0	2.4
			1980	1981	1982
Memorandum items:					
Directed credit as a percentage of total credit to the private sector			44.2	38.0	32.3 1/
Nonlinked assets as a percentage of liquid assets (M_4)			17.2	19.7	24.0
Liquid assets (M_4) as a percentage of total financial assets			36.4	30.0	22.8

Source: Bank of Israel.
1/ To third quarter.

Table 6. Israel: Indicators of Debt Service Burden

	1979	1980	1981	Est. 1982 1/	Proj. 1983 1/
	(In millions of U.S. dollars)				
Principal repayments	839	957	1,071	1,100	1,200
Net debt service	1,410	1,803	1,813	2,077	2,325
Debt service 2/	1,946	2,345	2,346	2,780	3,080
	(In per cent)				
Interest on debt as a percentage of exports of goods and services 3/	15.2	15.7	13.5	18.3	18.8
Net debt service as a percentage of exports of goods and services 3/	18.9	19.9	19.4	23.8	24.2
Debt service as a percentage of exports of goods and services 4/	23.8	23.9	23.5	29.3	29.0
Debt service as a percentage of current receipts 5/	17.7	18.3	18.2	22.3	22.0

Sources: Bank of Israel, Annual Report, 1981; and data supplied by the Israeli authorities.

1/ Staff estimates and projections based on the national budget for 1983.
2/ Excludes liabilities of Israeli banks operating abroad.
3/ Excluding receipts of investment income.
4/ Excluding banks' receipts of investment income.
5/ Exports of goods and services (excluding banks' receipts of investment income) plus private and official tranfers.

Table 7. Israel: Illustrative Analysis of Medium Term Debt Scenario

(In billions of U.S. dollars)

	Est. 1982	Projections 1983	1984	1985
Israeli authorities				
Goods and services deficit	4.9	4.6	4.2	4.5
Debt outstanding (net of foreign assets of commercial banks)	20.8	23.0	24.3	25.0
Debt service as a percentage of exports of goods and services 1/	29.3	29.0	26.0	22.0
Debt service as a percentage of current receipts 2/	22.3	22.0	21.0	18.0
Possible variant				
Goods and services deficit	4.9	5.3	5.3	6.2
Debt outstanding (net of foreign assets of commercial banks)	20.8	23.7	26.1	28.5
Debt service as a percentage of exports of goods and services 1/	29.3	33.0	36.0	37.0
Debt service as a percentage of current receipts 2/	22.3	25.0	27.0	29.0

Sources: Israel, Central Bureau of Statistics, Monthly Bulletin of Statistics; National Budget for 1983.

1/ Excluding banks' investment income.
2/ Exports of goods and services (excluding banks' investment income) plus official and private transfers.

Israel - Basic Data

Population (1982)	4.021 million
GNP in 1982 (market prices)	IS 528,261 million

	(In per cent of GDP)
Origin of GDP in 1982 (at factor cost)	
Agriculture, forestry and fishing	7.0
Industry, mining, and quarrying	21.0
Construction	6.0
Finance trade and services	25.0
Other	41.0
Gross domestic product	100.0

	1980	1981	1982 1/
	(Annual percentage change)		
National accounts			
Use of resources (constant prices)			
Private consumption	-3.2	10.5	6.8
Public consumption 2/	1.7	2.8	7.7
Gross investment	-17.4	-1.0	6.3
Total domestic demand	-5.4	6.3	6.9
	(In per cent of GNP)		
Budget aggregates (fiscal years)			
Expenditures	68.2	72.6	90.0
Of which: defense	24.7	22.7	30.6
Revenues	53.2	49.7	63.6
Deficit	15.0	22.9	26.4
	(Real percentage change; end of period)		
Monetary developments			
Liquid financial assets (M4)	6.4	-5.6	-1.0
Financial assets of pulbic	16.5	14.6	30.7
Domestic credit	-6.0	5.7	-1.2 3/
	(Annual average percentage change)		
Prices and employment			
Consumer prices	131.0	116.8	120.4
Wholesale prices	135.1	122.7	125.7
Unemployment rate (in per cent)	4.8	5.1	5.0
External position			
Current account deficit 4/ (as a per cent of GNP)	5.5	5.5	9.8
Debt outstanding (in billions of U.S. dollars)	16.7	18.2	20.8
Debt service (as a percentage of current receipts)	19.5	19.1	23.7

1/ Provisional data.
2/ Excluding direct defense imports
3/ To third quarter
4/ Excluding official transfers
5/ Exports of goods and services (excluding receipts of investment income), plus private and official transfers.

Fund Relations

(As of April 29, 1983)

Date of membership:	July 12, 1954
Status:	Article XIV
Quota:	SDR 307.5 million. (Proposed quota of SDR 446.6 under the Eighth General Review of Quotas).

Fund holdings of Israel shekels:

	Currency amount	
	In millions of SDRs	In per cent of quota
Total	325.60	105.88
Compensatory financing facility	18.10	5.88
Credit tranches	307.50	100.00

SDR holdings (as of April 28, 1983):	SDR 0.97 million or 0.9 per cent of net cumulative allocations of SDR 106.36 million.
Gold distribution (four distributions):	111,257.225 fine ounces
Exchange system:	Since the exchange reform of October 28, 1977, the exchange rate is determined largely on the basis of supply and demand conditions in the exchange markets, with intervention by the authorities when necessary to maintain orderly conditions in the market.
Last decision:	The Executive Directors, in concluding the 1981 consultation with Israel (SM/81/94, 4/27/81, and SM/81/97, 5/1/81) adopted the following decision (Decision No. 6852-(81/78), adopted May 11, 1981): 1. The Fund takes this decision in concluding the 1981 Article XIV consultation discussions with Israel, in light of the 1981 Article IV consultation with Israel, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance Over Exchange Rate Policies). 2. The Fund notes with satisfaction that Israel continues to maintain a liberal system of payments and transfers for current international transactions.