Recent Economic Developments

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Part 1: Review of Recent Economic Developments, October 2005—March 2006

Main developments

An analysis of economic developments in Israel in the period reviewed—2005:IV and 2006:I[1]—attests to the continued expansion of real activity, as well as to the creation of inflationary pressures, raising fears that the rate of price increases will accelerate. On the *real* side, the rapid growth rate that has characterized the economy in the last two and a half years persisted (this includes 2005, when GDP rose by 5.2 percent and per capita GDP by 3.3 percent—among the highest growth rates in the west). The expansion was led by the business sector: during the period reviewed growth accelerated in manufacturing and the services, and a rally was evident to some extent in construction. The continued growth process in the period reviewed was expressed in positive trends in the labor market, stability in the financial markets, high yields on the stock exchange and a significant increase in trade volumes. The unemployment rate continued to decline and reached 8.8 percent, despite the increase in the number of foreign workers and continued rise in the participation rate. Positive indicators of economic activity are also in evidence from an analysis of the Companies Survey for 2006:I, which revealed an increase in activity encompassing all the principal industries, including construction, and the leading index of the Survey predicts a continued increase in business sector activity in the coming quarter. However, Israel's foreign trade data show that there was a slowdown in the period reviewed, in both goods exports and imports. On the *nominal* side, the persistent rise in domestic demand, local-currency depreciation, energy price-rises, and convergence towards Israel's production potential led to the acceleration of the rate of price increases and inflation expectations. The rise in the CPI (Consumer Price Index) for February was especially high (0.6 percent), as was that for March (0.3 percent), in comparison with both the forecast increases (0.2 and 0.1 percent respectively) and the equivalent months in previous years. In the last twelve months (March 2006 vis-à-vis March 2005) the rate of price increases deviated from the target (1-3 percent a year) for the first time in many years and stood at 3.6 percent at the end of March. All these developments, together with the narrowing spread between local-currency and dollar interest rates, led the Bank of Israel to gradually raise the interest rate in 2005:IV and 2006:I, after about eight months in which it had remained unchanged.

The period reviewed was one of transition, and was affected by significant events as well as by the reforms made during the course of 2005:II and 2005:III, including the implementation of the disengagement from Gaza, the global rise in energy prices, and the introduction of major reforms in Israel—in pensions, the initial implementation of the recommendations of the Bachar Committee, the reduction of tax rates, and the harmonization between tax rates on gains from investment abroad and in Israel. At the same time, political uncertainty increased in the wake of the assumption of power in the Palestinian Authority by the Hamas Organization, the declining health of Israel's Prime Minister and the general elections at the end of the period (28th March). To all this was added the fact that the 2006 budget has not yet been approved. The persistence of relative stability in the financial markets in these circumstances attests to Israel's economic robustness.

The second part of this review focuses on two topics which assumed prominence in the period reviewed: 1. A review of recent developments in Israel's construction market; 2. The waning of the government scheme to provide vocational training for adults in Israel.

Aggregate and by-industry nonfinancial activity

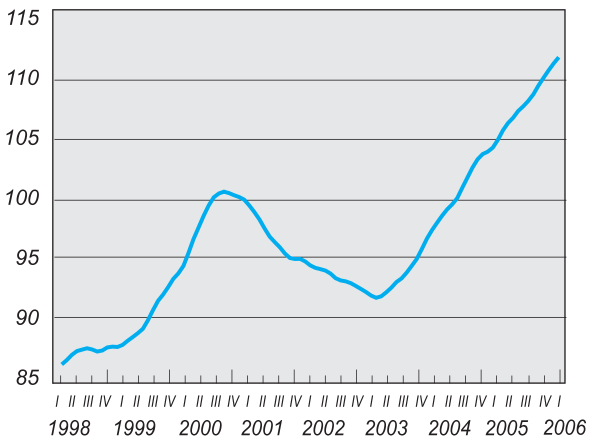
During the period reviewed the economic expansion which has characterized the world in general, and Israel in particular, persisted; growth was reflected in the composite

[1] January and February; in some instances data for March are also available.

state-of-the-economy index, which rose by 3.6 percentage points in this period, and by 6.1 percent in annual terms relative to the equivalent period a year earlier (Figure 1.1). The rise in the index was evident in all its components,[2] including the index of manufacturing production, which has gone up consistently since the beginning of 2003 (Table 2 and Figure 1.2). GDP expanded by another 4.9 percent in annual terms in the second half of the year; this was led by the rise in business-sector product, which grew by 6.6 percent—similar to its trend throughout 2005.

Figure 1.1

Level of Economic Activity,* 1988-2006**
(index: 2004 average=100)

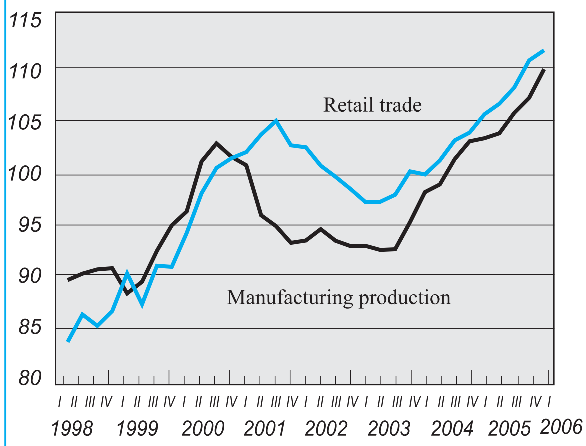


* The composite index including the change in economic-activity-growth trend.
** To March 2006.

National Accounts data for 2005:IV indicate that both GDP and business-sector product continued to expand rapidly, while private consumption remained unchanged and Israel's foreign trade slowed to some extent (Table 1). Goods and services exports dipped by 9.6 percent, while goods and services imports fell by more than 13 percent[3] (in annual terms); as a result, the net trade balance improved, and this contributed to the rise in GDP in 2005:IV vis-à-vis 2005:III. Initial monthly data for 2006 show that the decline in goods imports and exports which characterized 2005:IV was not

Figure 1.2

Manufacturing production* (index, average 2004=100) and large-scale retail trade** (index, average 2002=100), 1998-2006



* To February 2006. Seasonally adjusted.
** To March 2006. Seasonally adjusted.

checked, and these items remain low. Private consumption was one of the main factors behind the growth of the last two and a half years, but the increase, which characterized 2005: II and 2005:III, has stopped, and this extends to nondurable goods. However, indicators of the development of private consumption rose in 2005:IV and continued to do so in 2006:I (Tables 2 and 4), among them the index of sales by large retail chains, which rose by 5.2 percent in annual terms in 2005:IV, and private consumption purchases by credit card, which increased in 2006:I by 10.8 percent compared to the parallel period in 2005. Much of the output created by the continued expansion of economic activity was directed to inventory investment, which continued to soar, as it had throughout 2005. In 2005:IV fixed investment, including that in the infrastructure, did not increase.

The decline in government expenditure during this period relative to 2005:III is explained by the upward deviation in 2005:III as a result of the implementation of the disengagement from Gaza.

The factors which led to the continuation of economic growth in the period reviewed were global economic growth and stability in Israel's security situation. The contribution of these factors to growth was supported by fiscal policy, which continued to act to reduce taxes and the public sector debt while adhering to the deficit target, as well as by expansionary monetary policy, which aimed for neutrality, in view of the circumstances. On the other hand, the rise in the public's income appears to have moderated in this period, as the average real wage dipped slightly, and the capital market

[2] For example, the index of revenue in retail trade (4.7 percentage points and 6.1 percent respectively), the index of manufacturing production (5.5 percentage points and 4.9 percent respectively) and the index of revenue in commerce and services (5.0 percentage points and 9.4 percent respectively).

[3] Including diamonds; if diamonds are excluded, the decline in both exports and imports is more moderate.

began to recover from the assumption of power by the Hamas Movement and the replacement of Israel's Prime Minister due to unfortunate circumstances, leading to the blocking of the steep increases which had been in evidence in 2005:IV.[4] The rise in oil prices in 2005:IV led to a deterioration in the terms of trade, and its negative effect on growth offset some of the effect of the other factors.

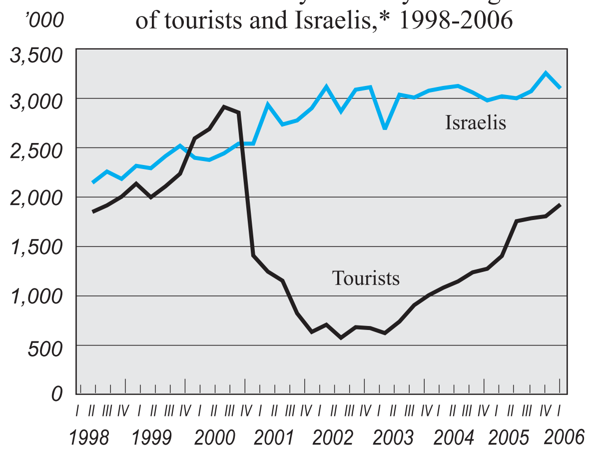
According to trend data, for the period December 2005 to February 2006, manufacturing production rose by 9.2 percent in annual terms, after a similar increase in the three months preceding the period. In 2005:IV manufacturing production rose by 5.5 percent in annual terms, and in the entire period reviewed it went up by 4.9 percent compared with the parallel period last year (Table 2 and Figure 1.2). Most of the increase stemmed from the growth recorded in the high-tech and IT industries, alongside a more moderate rise in the other technologies. This picture is consistent with the data from the Companies Survey, which continue to attest to a consistent increase in manufacturing activity as well as to an ongoing rise in the output of manufacturing firms in the period reviewed.

The continued security lull together with the local-currency depreciation vis-à-vis the dollar and the currency basket provided fertile soil for the recovery of the *tourism* industry: the number of tourist entries into Israel was up by 27.2 percent in the period reviewed over the equivalent period last year (Table 2 and Figure 1.3); there was also a slight decrease (seasonally adjusted) in the number of bed-nights of Israelis compared with stability in the number of tourist bed-nights at the beginning of 2006, and the rise in hotel occupancy rates throughout Israel persisted. The expansion in the activity of the tourism industry was also expressed in the marked rise in exports of tourism services, which was up by 30 percent in 2005 over 2004; purchases by tourists coming to Israel for business purposes were up by 50 percent (from $ 0.2 billion to $ 0.3 billion), and purchases by tourists coming to Israel privately were up by 31 percent (from $ 1.3 billion to $ 1.7 billion).

The *construction industry* continued to attract special interest because its failure to rally in the current period of expansion appears to be disconnected from developments in the rest of the principal industries. However, in 2005:IV and the first months of 2006 there have been signs that it is emerging from the slump, and this is also indicated by the analysis of the Companies Survey for 2006:I, since most of the firms in the industry have reported a rise in their activity and expect this to persist in the coming quarter. Nonetheless, building starts and completions declined in 2005:IV, after rising in 2005:III (Table 2, Figure 1.4). The supply of housing units in Israel is small, but the number of building permits for apartments has risen, as have the number of permits for new residential

Figure 1.3

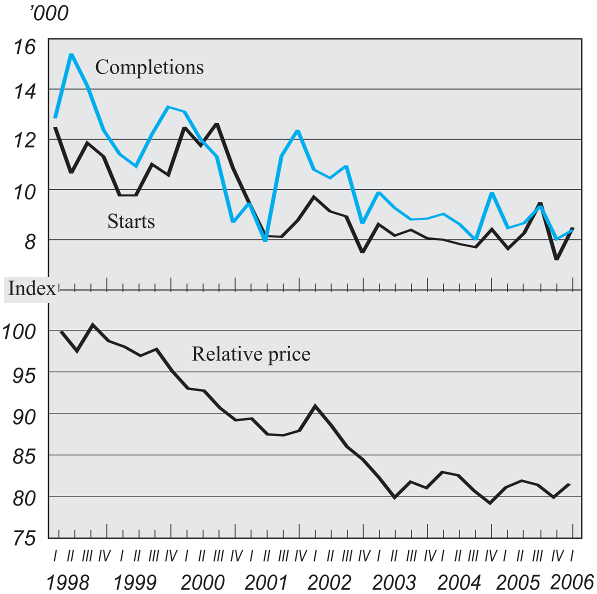
The hotel industry: monthly bed nights of tourists and Israelis,* 1998-2006



* To March 2006. Seasonally adjusted.

Figure 1.4

Housing units: quarterly starts and completions,* and relative price,** 1998-2006



* Original data, to January 2006. First quarter 2006 extrapolated.
** Prices of owner-occupied dwellings relative to CPI. To January 2006.

[4] Renewed recovery in the capital market began to appear in the second half of February 2006.

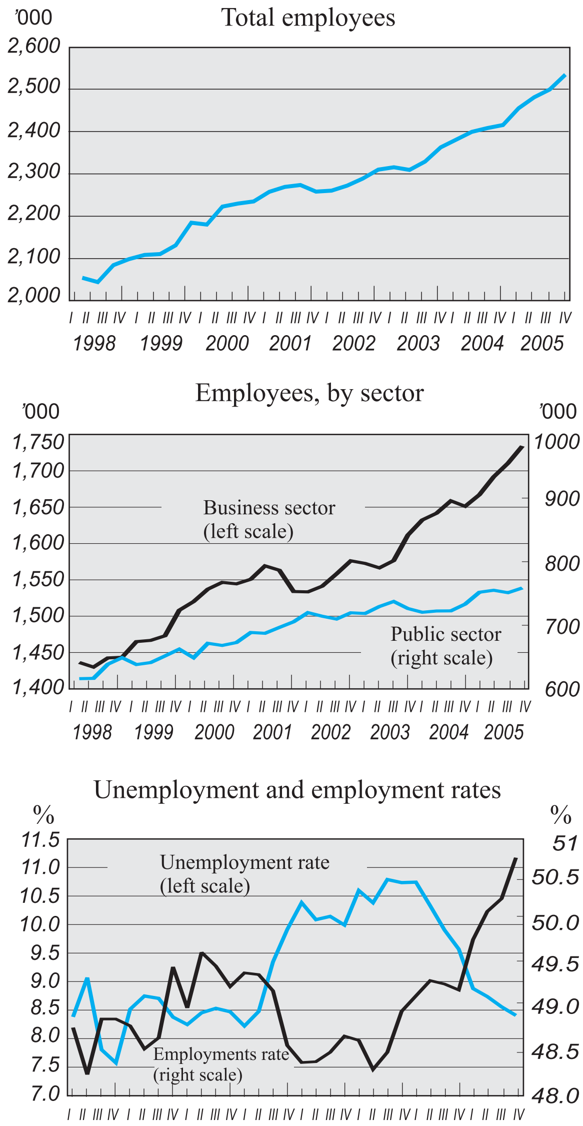
buildings, the demand for housing services, and persons employed in the construction industry—findings which reinforce the assessment regarding the industry's expected recovery. The increase in demand for apartments, alongside the decline in their supply, the rise in prices of inputs, and expectations of a continued increase in the effective interest rate have caused the relative price of apartments to rise, particularly in the central conurbation, as well as in Ashdod and Jerusalem; this is also the case with regard to prices of large and expensive apartments. Notwithstanding, and despite the rise in prices of construction inputs, the price of apartments in dollar terms continued to fall in the period reviewed, declining by 1.2 percent. The general relative price of accommodation continued to fall in 2005:IV, similar to its downward trend in 2005:III and in contrast with that in the first half of 2005. In the first quarter of 2006 it was up by 1.6 percent over the end of 2005 (for a more detailed account, see Box 2 in the second part of this review).

The labor market

The rapid economic growth of the period reviewed was also expressed in the labor market: according to the Manpower Survey, the *unemployment rate* fell to 8.8 percent in 2005: IV, compared with 8.9 percent in 2005:III.[5] Concurrently, the depth of unemployment (the rate of unemployed persons seeking work for over six months) continued to decline. The persistent decline in unemployment is particularly impressive in view of the rise in the participation rate[6] in 2005:IV to 55.7 percent, compared with the static state of this rate in 2005:II and 2005:III—55.2 percent. The decline in the unemployment rate was due to the relatively large rise in the employment rate, which went up from 50.3 percent in 2005:III to 50.8 percent in 2005:IV (Table 3, Figure 1.5). Throughout 2005 107,000 individuals, 93,000 of them Israelis, entered the labor force. The number of persons employed increased by 5 percent; the business sector expanded by 5.7 percent and the public sector by 3.5 percent.

Figure 1.5

The labor market, 1998-2005*



* To December 2005. Seasonally adjusted.

Two provisos should be added to the data on the rise in the employment rate: first, most of the increase was in part-time posts, while the proportion of persons in full-time employment as a share of those in total employment and the civilian labor force fell. Furthermore, as occurred in 2005: II, in 2005:III and 2005:IV the absolute number of persons in full-time employment declined by 1.2 and 2.6 percent respectively, compared with a 5 percent increase in the number of persons in part-time employment in 2005:III; in addition, the number of persons in part-time employment soared by more than 10 percent in 2005:IV.[7,8] All in all, there

[5] Trend data for January and February also indicate an unemployment rate of 8.8 percent.

[6] If the participation rate had remained unchanged, the unemployment rate would have fallen to 8.0 percent.

[7] Some of this marked rise may be explained by the Jewish high holydays, which occur during this period.

[8] For a fuller account, see Box 5.2 in Bank of Israel, *Annual Report, 2005*.

was a decline in labor inputs in 2005:IV. The second proviso is that among employees with a low level of education (less than twelve years of schooling) the decline in the unemployment rate is smaller than it is among employees with a higher level of education, and their unemployment rate is still very high (12.5 percent, compared with 7 percent respectively). The failure of the authorities to implement the restrictions on employing foreign and Palestinian workers appears to harm this population because of the availability of a cheaper alternative. Note in this context that the hike in the minimum wage is relevant primarily for the latter group of employees, in view of their high unemployment rate. It is important for the changes to be made gradually and to take economic growth and the rise in labor productivity into account.

The decline in the unemployment rate was expressed in a similar fall in the number of work-seekers. The number of unemployment benefits claimed did not change significantly in the period reviewed, because it declined in 2005:IV and rose by a similar rate at the beginning of 2006.

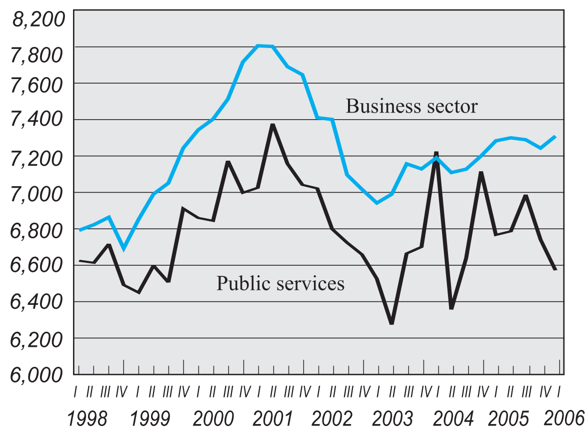
In contrast with 2005:III, the rise in employment in 2005:IV was not concentrated entirely in the business sector: 27,100 of the incremental 35,700 employees were in the business sector and 7,500 in the public services (1.5 percent and 1.0 percent respectively). Most of the expansion of employment in the public services was expressed in an increase in the number of persons employed in public administration, with an additional 6,300 employees entering this area in 2005:IV. (This figure may constitute a statistical adjustment for the decline recorded in this area in 2005:III.) Continuing the trend apparent in 2005:III, the most prominent increase in employment was in business services, where 17,000 employees were added, representing an increment of 5 percent. What is particularly surprising is the rise in the number of persons employed in construction, where 10,000 employees, constituting 8 percent of employees in the industry, were added. (However, this figure may not be indicative of the recovery of the industry, as in 2005:IV the number of Palestinian workers fell by 6,000, and some of the increment in employment of Israelis in construction derives from their replacement).

In contrast with 2005:III, the number of foreign workers rose in 2005:IV, while the number of Palestinian workers declined by over 10 percent, after remaining stable in 2005:III. Throughout 2005 the number of foreign workers rose by 5,500, constituting 3 percent, alongside the addition of 8,800 Palestinian workers, constituting 24 percent. This is against the government's declared policy of reducing their numbers.

The *real average wage* per employee post was slightly lower at the end of the year than at the end of 2005:II; it rose slightly in 2005:III, but dipped in real terms in 2005:IV, offsetting the moderate increase of 2005:III. When the period reviewed is compared with the equivalent period last year, we also find a real decline in wage levels, including in the public services[9] (Table 3, Figure 1.6). Note that there is considerable variance in the development of wages: whereas the wage of employees with a high level of human capital continued to rise, that of employees with a relatively low level of human capital was eroded, and this reflects downward pressure on the wage of low-income earners (primarily many part-time posts, foreign workers, and high unemployment rates), compared with demand pressures which serve to raise the wage of skilled workers.[10] This was particularly in evidence in 2005:IV, when the average wage of employees in the business and financial services was up by 4.7 percent over 2004:IV, while the wage of employees in agriculture, construction, hospitality and catering declined by 1.1 percent.

Figure 1.6

Real wage per employee post, 1998-2006*
(NIS, 2004 prices)



* To January 2006. Seasonally adjusted.

[9] Note that last year public services employees were given a one-off sum at this time of the year.

[10] The data are taken from the National Insurance Institute, 'By-Industry Wages per Employee Post.' The underlying assumption is that such industries as financial and business services are human capital intensive, while others, such as construction, agriculture, hospitality and catering, are characterized by employees whose human capital is relatively low.

Unit labor costs continued to fall in 2005:IV, similar to the trend in 2005 as a whole, after dipping in the preceding years. The relative stagnation in the wage level requires an explanation, as the unemployment rate has been falling steadily, and the economy would appear to be approaching full utilization of its potential. In other words, if all the real economic indicators are positive, how can this not be reflected in corresponding increases in wages?[11] The increase in the number of labor-force entrants may have contributed to this, as they exert downward pressure on the average wage; other contributory factors may have been the ongoing rise in the proportion of part-time posts and/or the weakening of the labor unions. A more exhaustive examination of the subject is required, as a sudden wage increase could trigger inflation.

General government

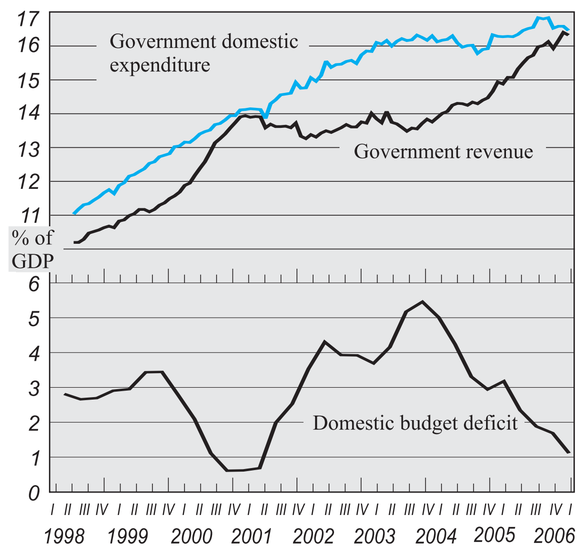
The *budget deficit* amounted to 1.9 percent of GDP in 2005, well below the target of 3.4 percent, and significantly less than the 3.8 percent deficit in 2004. The reduction of the deficit, via financing and rapid economic growth, made it possible to reduce the debt/GDP ratio, which declined by 3.6 percent to 101.6 percent of GDP (for a more detailed account, see Chapter 6 of Bank of Israel, *Annual Report, 2005*).

The under-expenditure evident in 2005 persisted, and even intensified in 2006:I, when an accrued surplus of NIS 8.7 billion in government expenditure was recorded, compared with NIS 4.7 billion in the equivalent period last year (Table 6, Figure 1.7).

Alongside the positive effect of fiscal restraint,[12] there are also negative repercussions: first of all, the policy measures introduced, especially the continued reduction in transfer payments, served in 2005 and the two preceding years to increase net inequality, at least in the short term. Second, fiscal restraint, particularly when this involves across-the-board cuts rather than resulting from greater efficiency, could harm the availability and quality of the public services provided to the population. These repercussions are

Figure 1.7

Government revenue and expenditure,*
1998-2006
(12-month moving average)



* To March 2006.

reinforced because the 2006 budget will not be approved before May 2006, so that in the first few months of 2006 the government has been continuing to function without an approved annual budget, and as a result there has been no reordering of national priorities.

Government expenditure during the period reviewed was significantly lower than its customary seasonal path. During the period government expenditure was NIS 6.1 billion less than the path which is consistent with the full implementation of expenditure determined on the basis of the 2005 budget, even though in 2006, too, a large part of government expenditure (over 14 percent) was implemented in December. In the period from January to March expenditure has been NIS 3.6 billion below the amount consistent with the budget proposal, i.e., the expenditure ceiling set by law. This under-expenditure was apparent in all the ministries, especially those ministries and other entities dealing with welfare and social issues.[13] (In 2006:I the under-expenditure in these ministries amounted to NIS 5.7 billion, about 7 percent of the extent consistent with the budget proposal.) Thus, most of those adversely affected by the failure to

[11] Labor productivity rose by 3 percent, higher than the increase in wages.

[12] The principal positive effects are an increase in the credibility of fiscal policy, which aids in reducing tax rates in a credible manner, and the reduction in Israel's risk rating, which stimulates the inflow of foreign money. These could contribute to the persistence and stabilization of economic growth.

[13] These are: the Ministries of Health, Education, Welfare, Housing, and Immigrant Absorption; the local authorities, higher education, the National Religious Authority in the Ministry of the Prime Minister, and the National Insurance Institute.

approve the budget are the low-income population, who are more in need than others of the services of these ministries. Nevertheless, there was an increase in transfer payments; National Insurance benefits rose during the period reviewed, largely due to the increase in old-age and beneficiaries' pensions and despite the decline in income assurance and unemployment payments. National Insurance benefits rose at the beginning of 2006 because the period in which the benefits were frozen under the Arrangement Laws of 2002-2003 came to an end in January 2006, and all benefits were raised by 2.7 percent.[14] The decline in income assurance and unemployment benefits (which account for about 10 percent of total transfer payments made by the National Insurance Institute), in spite of the increases in benefits, is another indication of positive developments in the labor market, but also of the more stringent conditions for obtaining these benefits.

Government revenues in 2005:IV were in line with the path of the budget forecast, and were up by 1.5 percent over 2004:IV. At the beginning of 2006 the government's tax receipts (mainly from direct but also from indirect taxes) continued to be surprisingly high, and were up by NIS 2.9 billion over the level consistent with the budget proposal,[15] and by NIS 14.6 over the equivalent period in 2005. This occurred despite the implementation of the program to cut taxes approved in June 2005, constituting evidence of the expansion of economic activity. The government's tax receipts have been growing since mid-2003, and have accelerated since mid-2004; this trend persisted in the period reviewed, when receipts were up by 7.5 percent over the equivalent period last year. The decline in government expenditure alongside the increase in its tax receipts is reflected by the continued contraction of the deficit; during the period reviewed there was even a budget surplus of NIS 5 billion, in spite of the deficit which stemmed from seasonal factors in 2005:IV.

The government's control over its expenditure in the last two years increases the likelihood that this year, too, the budget deficit will be below the target. The under-expenditure, the continued growth trend, and the increase in tax receipts give the government some flexibility to increase expenditure, but a permanent rise in expenditure should be avoided in 2006, as this will cause problems in the future. The new government which is currently being formed must continue to adhere to an expenditure path which is expected to be in line with the deficit target, thereby reducing the national debt. In implementing new social welfare programs it is necessary to bear this principle in mind. The economic growth of the last two years and the fiscal restraint which characterized the government have created a situation which enables the new government to implement social welfare programs and expand the infrastructure. It is important to implement these programs in order to help those in need, but care must be taken to ensure that there is no deviation from the targets that have been set, as this will hamper growth.

The balance of payments

An overview of Israel's foreign trade data shows that the rapid expansion of imports and exports which began in mid-2002 moderated in 2005, although the upward trend continued.

On the *current account* there was a relatively small surplus of $ 389 million[16] in 2005:IV, so that together with the surplus of the first three quarters of the year a total surplus of $ 2.385 billion has accrued, compared with $ 1.47 billion in 2004. The relatively small surplus on the current account in 2005:IV expresses a decline in exports of goods and services.[17]

As regards *goods*, the overall picture since the beginning of 2006 is that the cumulative relative stagnation in goods imports and exports in the second half of 2005 (Table 4 and Figure 1.8) has persisted: current trend data are similar to those of 2005:IV, including those for exports of manufactured goods, which rose in December and February but declined in January and March. Another indication of the fall in exports in the period reviewed may be seen from the index of Israel's exports to the US (Figure 1.9).

Goods exports (excluding diamonds) dipped by 4.3 percent in annual terms in 2006:I according to trend data, continuing the 2.1 percent decline of 2005:IV. Exports of high-tech goods, which constitute 47 percent of total manufactured exports (excluding diamonds), declined by 3.9 percent in annual terms between January and March, continuing the 5.2 percent contraction of 2005:IV. Exports of the mixed high-tech industries fell by 10.5 percent in annual terms in 2006:I. Exports of the mixed traditional industries declined by 3.3 percent in 2006:I, further to a similar decline in November

[14] Except for old-age and beneficiaries' pernsions, which were raised by only 1.8 percent, because they had been raised by 0.9 percent in January 2003. The minimum wage was also raised accordingly, by NIS 121.

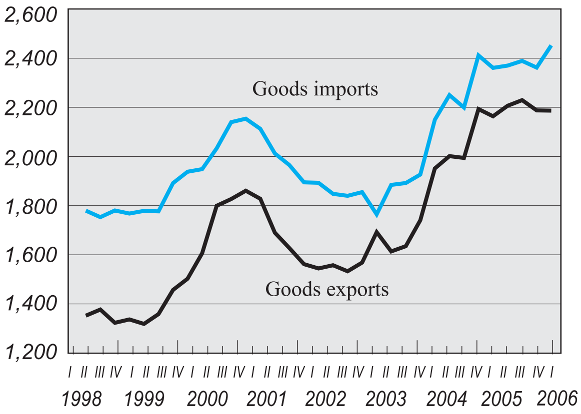
[15] About NIS 1.2 billion of the surplus reflects non-recurring receipts from ideational sales in the capital market (NIS 900 million), and exceptional receipts from large firms in January.

[16] Even in comparison with the preceding quarters of 2005 and even with 2004:IV, when there was a surplus of $ 877 million.

[17] Goods and services exports were down by 3.5 percent in 2005:IV from 2005:III.

Figure 1.8

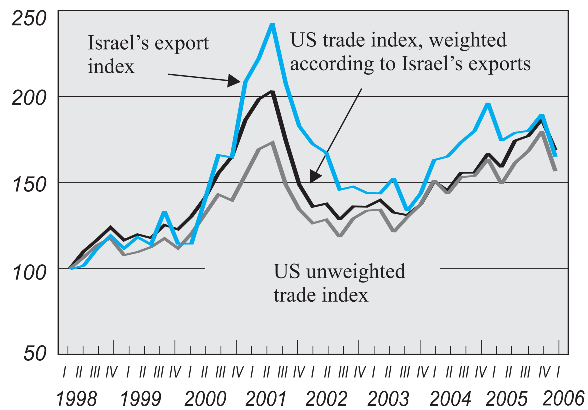
Foreign trade,* 1998-2006
($ million per month)



* Excluding ships, aircraft, diamonds, and fuel.
To March 2006. Seasonally adjusted.

Figure 1.9

Israel's exports of and US trade in electronic components, electronic communication equipment, and scientific and monitoring equipment,* 1998-2006



* To February 2006. First quarter 2006 extrapolated from two months.

and December 2005. Exports of the traditional industries remained stable during the period reviewed. Exports of diamonds (polished and rough) amounted to $ 2.7 billion in 2006:I, according to preliminary data, compared with $ 2.9 billion in the parallel period a year earlier.

Goods imports increased in the period reviewed by a negligible amount. Trend data for goods imports (excluding diamonds, ships, airplanes, and energy materials), which were calculated after adjusting for the usual seasonal effect and irregular factors, indicate stability in 2006:I, continuing the trend of 2005:IV. Imports of primary commodities (excluding diamonds and energy materials) rose by 3.2 percent in annual terms in 2006:I, after declining by 1.2 percent in November and December 2005. Imports of consumer goods rose by 6.6 percent in annual terms in 2006: I. Imports of current consumption goods were up by 14.5 percent in annual terms, while imports of durable goods fell by 6.9 percent. Imports of capital goods (excluding ships and airplanes) fell by 6.1 percent in annual terms in 2006: I. Imports of machinery and equipment (about 80 percent of capital goods imports) declined by 5.4 percent in annual terms in that period. Imports of diamonds (rough and polished) amounted to $ 2 billion in 2006:I, compared with $ 2.2 billion in 2005:I. Imports of energy goods (crude oil, oil products and coal) totaled $ 1.7 billion in 2006:I compared to $ 1.4 billion in the parallel period of 2005.

Compared with the volatility which characterized goods imports and exports, the rise in *services* which has been in evidence since 2003 persisted. Exports of services continued to expand in 2005:IV at the rapid rate which characterized the whole of 2005, further to the trend of 2004, while services imports rose in this period, but the rate of expansion was more moderate than in 2003, so that the gap between services imports and exports continued to widen in the period reviewed. The consistent increase in services trade, especially of exports, reflects the accelerated growth of these industries in Israel, as expressed in their marked contribution to the rise in GDP.

The *terms of trade index*[18] improved in 2005:IV and rose by 1.9 percent because the decline in import prices exceeded that in export prices, but at the end of 2005 the terms of trade relative to 2004 deteriorated by 3.6 percent because import prices rose more steeply than export prices as a result of the increase in oil prices.[19]

Against the backdrop of the interest-rate gap between Israel and abroad and the harmonization of the tax rates on Israelis' financial assets in Israel and abroad, residents' investments abroad continued to expand in 2005:IV, and as a result their income rose from $ 2.7 billion in 2004 to $ 4.1 billion in 2005. Since nonresidents' income from investments in Israel rose more moderately, the deficit on Israel's income account declined by $ 1 billion—an amount which contributed to the increased surplus on the current account of the balance of payments.

[18] Relative price of imports and exports.
[19] Adjusting for oil prices (which rose), the terms of trade had improved by 1.2 percent at the end of 2005 relative to the end of 2004, and in 2005:IV there was no significant change in them relative to 2005:III.

Net capital outflow[20] amounted to $ 1.5 billion in 2005:IV, compared with an average of $ 0.7 billion in the first three quarters of the year. The increase is due to the steep (almost 300 percent) rise in residents' investments abroad (particularly due to the harmonization of tax rates). Note that net capital outflow rose in spite of the increase in investment in Israel by nonresidents in 2005:IV, which offset the decline in 2005:III which had stemmed from uncertainty regarding the implementation of the disengagement process. Net capital outflow since the beginning of the year amounted to $ 1.1 billion, half of it in January and the other half in February. There was a steep increase in January in investment abroad by residents (including direct investment) as well as in investment in Israel by nonresidents (including investment in the trading portfolio). The financial account for March was balanced.

Global developments

Robust global economic growth persisted during the period reviewed. According to the most recent forecast published by the IMF, the global economy will expand by 4.9 percent in 2006, similar to its 4.8 percent growth rate in 2005. This accelerated growth also continued to trickle down to countries whose economic growth had been relatively sluggish. The US economy continued to expand at a relatively rapid rate, and according to the predictions of the IMF it will grow by another 3.4 percent in 2006. This will occur despite its involvement in Iraq, the rising deficit on its balance of payments, tight monetary policy, and the decline in public support for the Administration. Japan's economy is continuing to expand, and growth is no longer confined solely to a rise in exports; India continues to enjoy particularly rapid economic expansion, and China's economic growth is expected to persist, after expanding by 10.3 percent in annual terms in 2006:I. In the eurozone the growth path has remained stable (an average annual growth rate of 2 percent), and expectations are that this will persist in the near future, following the regime change in Germany and the stabilization of both the exchange rate and the inflation environment.

The steep increase in oil prices was virtually checked in the period reviewed, but as a result of the increase in demand due to continued economic growth and uncertainty regarding oil supplies, most economists envisage that oil prices will not decline in the medium term;[21] this will continue to constitute an obstacle to international trade, causing additional energy price rises. The further expected increase in energy prices has not yet found expression in a change in the inflation environment.

According to the main indicators, the surge in global economic growth is expected to persist in the short term. The leading indicators for the OECD countries also attest to the continued growth trend in this time period. The forecast is particularly optimistic for the US and Japan. Among the main growth factors are exports, investments, and opportune global conditions, facilitating capital flows to the developing countries. Relatively low long-term interest rates, stable inflation, and monetary policy that is appropriate for economic activity in all regions are expected to bolster these growth factors, making further expansion and the reduction of the unemployment rate possible, while maintaining financial stability and a low inflation rate. The reduction of the risk premium of the developing countries in the period reviewed, alongside the decline in yields in the advanced economies, has led to accelerated investment and capital inflow from the advanced economies to the emerging economies, giving rise to the prosperity and success of the latter. A simultaneous process has emerged in which expectations of growth are self-fulfilling. Investment in these countries, including in Israel, is expected to persist and even increase, thereby contributing to their continued economic growth.

Note, however, that the accelerated economic expansion of the developing countries is by no means assured, as it involves certain risks: 1. The 'bubble' effect, with high yields but large risks—fears that the stock markets of these countries, which are notoriously unstable, could collapse; 2. An additional rise in oil prices and in inflation expectations (particularly in Europe), resulting in tight monetary policy and a transition to a high interest-rate environment, which suppresses consumption and investment. (In the last twelve months the Fed has raised the interest rate by 2 percentage points, from 2.75 percent to 4.75 percent, and in the eurozone the interest rate has been hiked by 0.75 percentage points, from 2 to 2.75 percent; these increases will undoubtedly be followed by others; 3. The exacerbation of world Moslem fundamentalism, including the threat from Iran; 4. The ongoing lack of fiscal discipline in the US which could eventually be translated into tax increases, and hence a decline in the growth rate.

[20] Excluding the foreign currency reserves.

[21] Oil prices might fall temporarily, but this is a seasonal decline due to a reduction in demand, as the western countries experience summer.

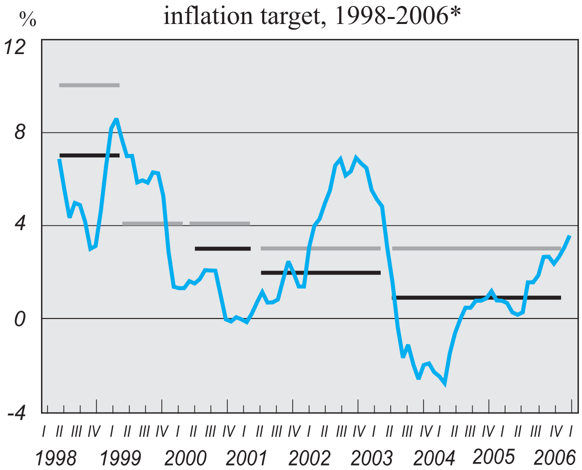
Prices, monetary policy, and the money and capital markets

In the period reviewed Israel's *rate of price increases* accelerated. The CPI rose by 0.6 percentage points in 2006:I, so that in the last twelve months (from March 2005 to March 2006) prices rose by a total of 3.6 percent, overshooting the limits of the inflation target (1-3 percent a year, Table 7 and Figure 1.10). According to trend data for this period, the annual rate at which the CPI rose was 3.2 percent. Note that both the CPI for February (0.6 percent) and that for March (0.3 percent) deviated from all the forecast levels, and were the highest for those months since 2002. Adjusting for the volatile items (fruit and vegetables, clothing and footwear), the CPI rose by 0.9 percent in 2006:I, constituting an annual increase of 3.8 percent, also overshooting the target range. The wholesale price index rose even more sharply than the CPI during the period reviewed, by 3.4 percent. Throughout the period reviewed the CPI rose by 0.3 percent and the wholesale price index by 1.9 percent. Accordingly, inflation expectations for the next twelve months rose at the beginning of February, reaching their peak (2.5 percent) in the middle of the month, but not exceeding the upper limit of the target (Table 9 and Figure 1.11). Since mid-February there has been a downward trend in expectations, and at the end of March they reached 1.8 percent. The acceleration of the rate of price increases in the period reviewed would seem to reflect the stabilization of the process of emergence from the slump in Israel and the world, alongside the conclusion of the utilization of Israel's excess capacity, and was affected to a great extent by the increase in demand, the continued local-currency depreciation,[22] the rise in the housing price index[23] (by 1.7 percent in the period reviewed with an annual increase of 6.7 percent) and the rise in energy prices. The underestimation in forecasting the three past CPI figures (for January, February, and March) supports the assessment that the acceleration of the rate of price increases also stems from the change in the inflation environment, a result of the process in fully utilizing spare production capacity in the economy (particularly among skilled workers) and the start of pressures on prices arising from excess demand. The real appreciation of import prices in 2005:IV reinforces this assessment.

[22] Most of the depreciation occurred in 2005:IV, but both depreciation and the rise in oil prices affect price levels with a lag.
[23] Throughout the period reviewed housing prices fell by 1.2 percentage points in dollar terms, despite the 0.2 and 0.4 percentage-point increases in February and March respectively. (Throughout 2005 housing prices remained stable in dollar prices.) Hence, most of the rise in the local-currency price of housing stems from the exchange rate.

Figure 1.10

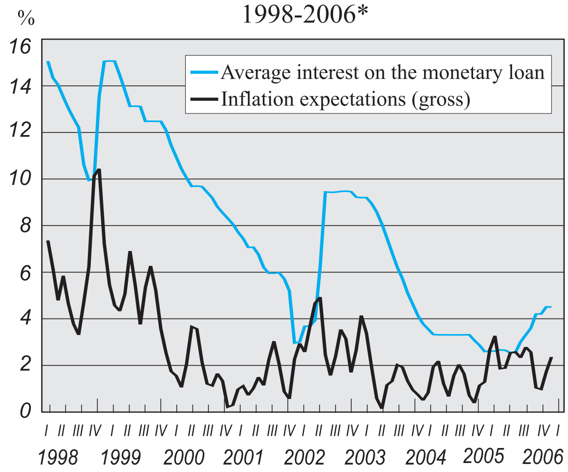
Inflation in previous 12 months and the inflation target, 1998-2006*



* To March 2006.

Figure 1.11

Interest and inflation expectations, 1998-2006*



* To March 2006.

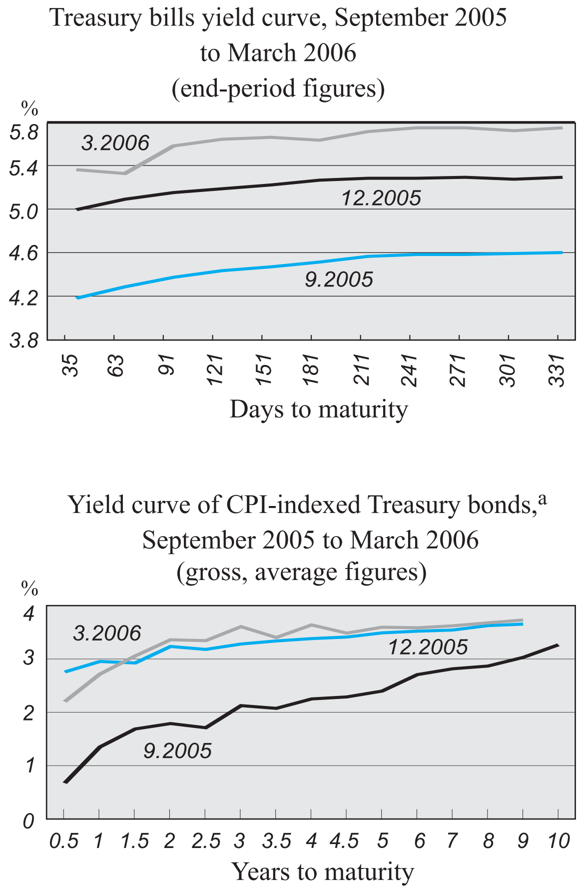
The emergence from the slump and continued economic growth obliged the Bank of Israel to shift from an expansionary monetary policy aimed at stimulating growth (a policy which is typical of an economy in recession) to a neutral monetary policy, aimed at preventing an outbreak of price rises (which is characteristic of expanding economies).[24] After eight successive months in which the interest rate remained unchanged, and during which it was still too soon to tell whether the process of inflation had begun to accelerate, the Bank of Israel's key interest rate was gradually raised by 1.5 percentage points in the period reviewed, from 3.5 percent in September 2005 to 5 percent in April 2006.

The rise in the mean and variance of inflation expectations derived from the capital market and from forecasters, interest-rate gaps which became negative, the continued local-currency depreciation, the rise in prices of energy and goods, and the gradual process of closing the output gap all impelled the Bank of Israel to increase the interest rate in October and November—by 0.25 percentage points each time. Despite these two interest-rate hikes, and because of the increase in political and economic uncertainty due to the fact that the elections were brought forward, in November the various indicators showed that in the coming year inflation was expected to remain near the target limit, and might even deviate from it. The continued depreciation of the dollar, rise in yields on indexed and unindexed bonds, relatively low real interest rate (1.9 percent), and accelerated economic growth in 2005:III led the Bank of Israel to raise the interest rate for December by 0.5 percentage points, bringing it up to 4.5 percent. Stability in the markets and in inflation expectations, as well as slight local-currency appreciation, enabled the Bank of Israel to leave the interest rate for January unchanged. The process of raising the Bank of Israel's key interest rate gradually resumed in February, when it was increased by another 0.25 percentage points in view of the proximity to the upper limit of the inflation target, the continued contraction of the output gap, inflation expectations and the rise in the Fed's interest rate. The unexpectedly high CPI in February, expectations that it would continue to be high in March and April, and the continued interest-rate hikes in Europe and the US, together with the other factors mentioned above, caused the Bank of Israel to continue raising the interest rate in April, by another 0.25 percentage points. Note that in spite of these interest-rate hikes Israel's real interest rate is still relatively low when viewed in a ten-year perspective.

The interest-rate hike in the period reviewed also affected government bonds. At the beginning of 2006 the rise in yields on government bonds for all terms persisted This indicates that the Bank of Israel's key interest rate affects long-term interest rates as well as short term ones. Another indication of this is the rise in future yield spreads between 5-year and 9-year government bonds in February and March.

The Treasury bill curve responded to the rise in expectations of accelerated inflation and the interest-rate hikes in 2005: III, since when it has continued to rise in accordance with the Bank of Israel's interest-rate increases and expectations regarding them. (Figure 1.12).

Figure 1.12



[a] Excluding the yield on CPI-indexed 10-year bonds.

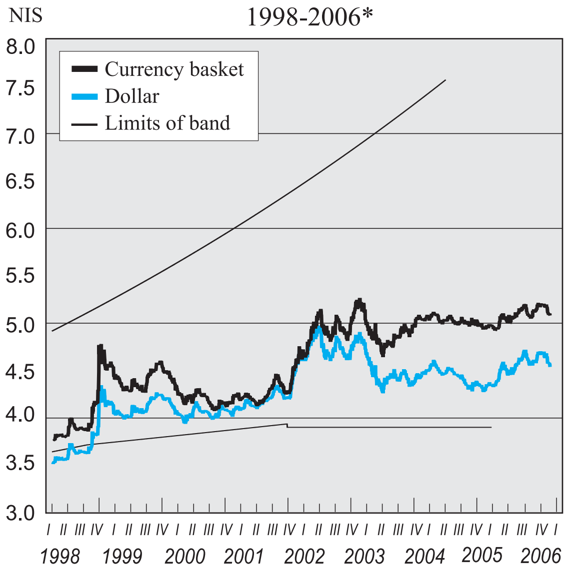
The *exchange rate* against the dollar declined in the course of the period reviewed. In line with the accelerated depreciation which characterized 2005:III, because of the global rally of the dollar and the narrowing of the interest-rate gap, it moderated (in December 2005 and March 2006 there was even local-currency appreciation), and the exchange rate has fluctuated at around NIS 4.7 to the dollar (Figure 1.13). The weakening of the local currency was affected by the narrowing of the interest-rate gap and the harmonization of tax rates on residents' investments abroad and in Israel, while the surplus on the current account, privatization, and the attractiveness of investment in emerging economies in

[24] The question of how to effect this shift is discussed in the literature, for example in the 1999 article by Calardia, Gali and Gerfler, which states that when the reason for price increases is not known (i.e., whether the pressure is from the demand or the supply side), it is preferable to raise the interest rate gradually.

general, and in Israel's high-tech industries in particular, served to reinforce this.

Figure 1.13

The NIS exchange rate against the currency basket and the dollar and the exchange-rate band, 1998-2006*



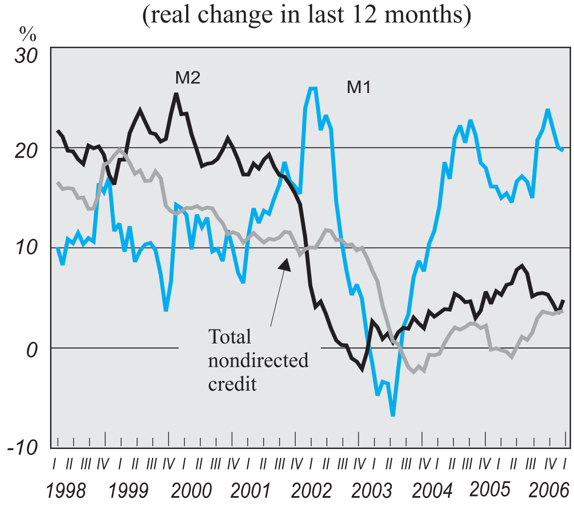
* To March 2006.

The narrow *money supply* (M1) expanded relatively sharply in 2005:IV, but since the beginning of 2006 its growth rate has moderated. On the other hand, the M2 money supply was less volatile throughout the period reviewed (Table 8, Figure 1.14). In view of the relatively low inflation and interest rates it would appear that the public is not afraid to hold considerable amounts of unindexed assets. The rise in the share of M1 in the M2 aggregate (from 13 percent at the end of 2003 to over 18 percent in the period reviewed) also reflects the ongoing process whereby the asset portfolio has become more liquid. Nondirected bank credit was characterized by volatility and the lack of any clear trend in the period reviewed; it rose from October to January, but fell in February and March, so that in the period reviewed it remained virtually unchanged. The low level of bank credit largely reflects the diversion of borrowing to nonbank sources (e.g., the stock market), which have flourished in the last two years.

In common with the trend of the last three years, the period reviewed was characterized by a surge in the *stock market*, which continued to reap the benefits of economic growth and monetary policy (with the exception of February, when share prices fell in view of the growing political uncertainty in the region due to the electoral victory of the Hamas, but since mid-February the stock market appears to have recovered). The general share-price index rose by 10 percent in the period reviewed, thereby effecting a 27 percent rise in the last twelve months.

Figure 1.14

Monetary aggregates and credit, 1998-2006*
(real change in last 12 months)



* To March 2006.

Daily turnover on the stock market continued to soar,[25] primarily in 2005:IV, with an exceptionally high rise in January (apparently due also to the Prime Minister's failing health and the 'January effect'[26]), since when it has reverted to its previous extent in 2005.

Another reason for the rise in turnover, apart from the increase in demand and use of market-makers, is the decline in the proportion of holdings by parties at interest in the last few years and the rise in the resulting 'floating amount.' Some of the explanation for this may lie in the privatization policy of recent years (especially of the Discount and Leumi banks).

The effect of the recent reforms of the capital market, pensions, and the ownership of mutual and provident funds began to be felt in 2005, but in 2006 this is expected to intensify—increasing competition in the capital market, thus making it more efficient and strengthening its standing in the financial system.

[25] Average daily turnover was NIS 366, NIS 660, and NIS 990 million in 2003, 2004, and 2005 respectively.

[26] The January effect: share yields tend to be much higher in this month than in the rest of the year, as many investors who wish to realize capital losses tend to sell towards the end of the year so as to gain tax credits, then repurchase in January.

Table 1. National Accounts,[a] 2004-2006

		2005				2006	2005	Last month for which data available
	2005	I	II	III	IV	I	IV[b]	
GDP	5.2	3.9	6.4	4.0	5.6		5.0	Dec
Business-sector product	6.6	4.4	7.6	6.1	7.0		6.3	Dec
Private consumption	3.9	-0.6	6.7	4.1	0.8		2.7	Dec
Gross domestic investment	10.2	13.8	23.2	13.9	7.9		14.6	Dec
Fixed investment	2.4	-9.5	14.8	3.3	0.2		1.8	Dec
Goods and services exports	5.6	-1.2	5.5	5.4	-9.6		-0.2	Dec
Goods and services exports								
excl. diamonds	7.8	2.5	5.9	8.9	-5.3		2.9	Dec
Goods and services imports	4.0	-1.7	14.0	-2.6	-13.6		-1.4	Dec
Goods and services imports								
excl. diamonds	5.4	1.1	11.1	2.4	-7.9		1.5	Dec
Public-sector consumption	2.0	5.0	6.3	-2.5	-4.4		1.0	Dec
Public-sector consumption								
excl. defense imports	1.1	3.8	3.0	1.3	-0.4		1.9	Dec

[a] Percentage change from previous period, in annual terms, at constant prices, seasonally adjusted.
[b] Compared with 2004:IV.
SOURCE: Central Bureau of Statistics.

Table 2. Indicators of Business Activity,[a] 2005-2006

		2005				2006		
	2005	I	II	III	IV	I	Oct 05-Mar 06[b]	Last month for which data available
Composite state-of-the-economy index	3.2	4.4	7.2	5.4	6.2	6.7	6.1	Mar
Large-scale retail trade	5.6	6.9	3.6	5.9	9.8	3.5	6.1	Mar
Manufacturing production								
(excl. diamonds)	4.6	1.1	1.8	7.6	5.5	10.5	4.9	Feb
Index of revenue in commerce	7.2	6.8	3.4	10.6	8.7	5.4	7.3	Feb
Index of commerce and services revenue	7.7	7.2	5.1	12.9	12.6	5.8	9.4	Feb
Tourist arrivals	26.8	44.4	50.6	11.1	17.1	24.5	27.2	Mar
Residential construction[c]								
Starts	2.4	-5.3	6.8	28.2			-6.0	Jan
Completions	-3.4	-7.4	0.6	20.6			-28.6	Jan
Nonresidential construction								
Area of starts		-9.9	4.5	38.6	-18.9		-18.9	Dec
Survey of companies (net balance, percent)[d]								
Weighted balance of the business sector		20	22	24	28	37		Mar
Output of manufacturing firms	25	20	21	29	29	36		Mar
Sales by trading firms	27	28	29	24	27	31		Mar

[a] Percentage change from previous period, in annual terms, at constant prices, seasonally adjusted except for construction industry data.
[b] Compared with October 2004-March 2005.
[c] Change from equivalent period one year earlier.
[d] The net balance is defined as the difference between the number of firms reporting a rise and those reporting a decline, as a proportion of all reporting firms.
SOURCE: Central Bureau of Statistics and Ministry of Housing and Construction data.

Table 3. Indicators of Labor Market Developments,[a] 2005-2006

	2005	2006	2005				2006		
	IV	I	I	II	III	IV	I	Oct 05-Mar 06[b]	Last month for which data available
	(‘000s)		percent change from previous quarter						
Civilian labor force	2,782		1.0	0.9	0.6	1.3		3.6	Dec
Israeli employees	2,538		1.7	1.1	0.8	1.4		5.0	Dec
Of which: in general government	756		2.6	0.4	-0.5	1.0		3.5	Dec
in business sector	1,780		1.1	1.7	1.2	1.5		5.7	Dec
Foreign workers and Palestinians (unadjusted)	371		1.3	2.6	-2.4	-0.5		0.9	Dec
Average hours worked weekly per employee	35.7		0.5	0.8	-1.9	-2.2		-5.4	Dec
Labor input in business sector (incl. foreign workers and Palestinians), weekly	81,900		3.2	1.3	-0.2	-2.4		1.8	Dec
Of which: Israelis	71,447		3.3	0.9	0.1	-2.3		-1.0	Dec
Labor input in general government (Israelis)	18,588		3.6	1.2	-2.4	0.4		0.2	Dec
Unemployed	244		-5.4	-0.4	-1.2	-0.2		-8.9	Dec
Work seekers	226	223	1.6	0.6	-2.0	-0.8	-1.1	-1.8	Jan
Claims for unemployment benefit	70	71	-0.2	2.2	0.7	-4.3	1.7	-0.8	Mar
	Nominal NIS (unadjusted)[c]								
Real wage per employee post[c]	7,019	7,320	-0.7	1.4	0.6	-2.4	-0.2	-0.7	Jan
In general government	6,561	6,925	-5.0	0.3	3.0	-3.6	-2.5	-4.7	Jan
In business sector	7,233	7,511	1.2	0.2	-0.1	-0.6	0.9	1.1	Jan
Nominal wage per employee post[c]	7,219	7,495	-0.3	1.8	1.7	-1.4	-0.1	1.9	Jan
In general government	6,748	7,091	-5.2	1.1	4.2	-2.8	-3.2	-2.2	Jan
In business sector	7,439	7,691	1.0	0.3	1.5	0.3	1.0	3.8	Jan
Participation rate			54.9	55.2	55.2	55.7		2.0	Dec
Employment rate			49.8	50.2	50.3	50.8		3.1	Dec
Unemployment rate			9.2	9.1	8.9	8.8		-10.6	Dec
Depth of unemployment[d]			41.0	43.9	36.6	36.1		-15.3	Dec

[a] Seasonally adjusted.
[b] Compared with Oct 2004- Mar 2005 (unadjusted).
[c] Including foreign workers and Palestinians.
[d] Percent of unemployed seeking work for more than six months (unadjusted).
SOURCE: Central Bureau of Statistics, Labor Force Survey, except for data on Israelis, non-Israelis, and labor input in the business sector, and total Israelis employed, which are the Central Bureau of Statistics’ National Accounts estimates.

Table 4. Foreign Trade, Balance of Payments, and the Reserves,[a] 2005-2006

	2005	2005 I	2005 II	2005 III	2005 IV	2006 I	Oct 05-Mar 06[b]	Last month for which data available
	percent change from previous period[c]							
Trade in goods[d]								
Goods imports	5.2	-2.1	0.4	0.8	-1.1	3.8	0.9	Mar
Of which: Consumer goods	7.3	-5.4	8.4	-3.5	-1.0	7.5	4.5	Mar
Capital goods	4.4	1.5	-0.7	4.8	-4.9	4.4	1.9	Mar
Intermediates	4.9	-2.4	-1.6	0.8	0.2	2.5	-0.5	Mar
Goods exports	8.0	-1.3	2.0	1.1	-1.9	0.0	0.4	Mar
Of which: Manufacturing	7.8	-1.8	2.6	1.2	-2.2	-0.2	0.6	Mar
Of which: High-tech	6.5	-2.8	6.9	-0.7	-0.1	-0.6	4.3	Mar
	$ million							
Balance of payments								
Goods and services exports	56,623	13,888	14,213	14,670	14,168			Dec
Goods and services imports	57,384	13,979	14,602	14,709	14,283			Dec
Balance of trade in goods and services	-761	-91	-388	-39	-115			Dec
Current account	2,385	614	597	1,230	389			Dec
Financial account (excl.								
foreign exchange reserves)[e]	-1,055	-961	-1,513	-142	-1,605			Dec
Of which: Nonresidents' direct investment[e]	1,517	1,912	1,139	341	2,673			Dec
Nonresidents' portfolio investmente	1,174	2,698	751	-183	1,429			Dec
Residents' direct and portfolio investment								
abroad[e]	2,124	1,942	1,650	2,300	2,605			Dec
Net foreign debt (precent of GDP)[e]	-17.7	-11.9	-14.5	-14.5	-17.3			Dec
Bank of Israel reserves, end-period[e]	27,858	26,704	26,210	27,319	27,858	27,896		Mar

[a] Seasonally adjusted.
[b] Compared with October 2004-March 2005 (unadjusted).
[c] The change relates to the dollar values of imports and exports, not to their volumes.
[d] Data on trade in goods do not include ships, aircraft, diamonds, and fuel.
[e] Unadjusted data.
SOURCE: Central Bureau of Statistics.

Table 5. Indicators of Economic Development in Advanced and Developing Countries[a]
(annual rate of change, percent)[b]

	2002	2003	2004	2005	2006 Projection
World GDP	3.0	4.0	5.1	4.3	4.3
Advanced countries	1.5	1.9	3.3	2.5	2.7
Developing countries	4.8	6.5	7.3	6.4	6.1
World trade	3.4	5.4	10.3	7.0	7.4
Advanced countries					
Imports	2.6	4.1	8.8	5.4	5.8
Exports	2.2	3.1	8.3	5.0	6.3
Developing countries					
Imports	6.5	11.1	16.4	13.5	11.9
Exports	6.7	10.8	14.5	10.4	10.3
Commodity prices (US$)					
Oil[c]	2.5	15.8	30.7	43.6	13.9
Nonfuel	1.7	6.9	18.5	8.6	-2.1
Inflation (CPI) in advanced countries	1.5	1.8	2.0	2.2	2.0
Short-term interest[d] (%)					
Dollar deposits	1.6	1.0	1.4	3.1	4.2
Euro deposits	3.3	2.3	2.1	2.1	2.4
Unemployment rate in advanced countries	6.4	6.6	6.3	6.1	5.9

[a] According to World Economic Outlook, Israel is classified as an advanced country. The advanced countries include the industrialized countries and some emerging markets.
[b] Except for unemployment and interest rates.
[c] Average price per barrel in 2004 was $37.76 .
d Six-month Libor rate for US dollar deposits, and three-month Libor rate on euro deposits.
SOURCE: World Economic Outlook (IMF), September 2005.

Table 6. Government Budget Performance vis-à-vis Deficit Target, 2005-2006

	2005	2005				2006	Oct 05-	Last month for
		I	II	III	IV	I	Mar 06	which data available
Domestic deficit as percent of GDP	-0.6	3.5	-1.5	-0.6	-4.0			Dec
Deviation from path[a] (domestic budget, excl. credit extended) (NIS billion)								
Government revenue	0.9	1.7	-1.0	-0.2	0.4	2.9	-1.2	Mar
Government expenditure	-8.8	-2.6	-3.4	-0.8	-2.0	-3.6	-6.1	Mar
Domestic deficit	9.7	4.3	2.4	0.6	2.4	6.5	4.9	Mar
Total government deficit	-8.4	4.7	-4.4	-1.6	-7.1	8.7	5.0	Mar
	Percent change from respective period, previous year							
Government tax revenue	5.9	3.2	8.3	10.6	1.5	14.6	7.5	Feb
of which: income tax, net	6.6	5.0	8.0	10.8	2.9	25.9	13.9	Feb
VAT, gross	4.8	1.5	5.0	9.6	3.0	11.9	7.6	Mar
Government expenditure	1.1	-1.0	4.2	9.0	-6.0	-1.4	-3.9	Mar
National Insurance allowances	1.1	-3.4	1.7	4.6	1.6	4.0	2.6	Feb
of which: Unemployment benefit	-5.9	-18.4	-3.2	1.6	-0.6	1.5	-0.3	Feb
Income support	-5.7	-10.2	-3.5	-3.0	-5.7	-5.0	-5.2	Feb
National Insurance contributions received from the public	4.9	2.1	4.5	8.1	4.8	1.2	2.8	Feb

[a] The path was determined on the basis of a deficit of 3.4 percent of GDP in 2005, and 3 percent of GDP in 2006. Figures comparing Oct 2005-Mar 2006 to respective period in 2004-05 relate to the change in each item, not to the deviation from the path.
SOURCE: Based on Ministry of Finance and National Insurance Institute data.

Table 7. Selected Price Indices,[a] 2005-2006

		2005				2006	Oct 05-	Last month for
	2005	I	II	III	IV	I	Mar 06[a]	which data available
CPI	2.4	-2.4	4.5	5.7	2.0	2.4	2.2	Mar
CPI excl. housing, fruit and vegetables	1.8	-1.5	5.1	3.1	0.8	1.9	1.3	Mar
CPI excl. housing, fruit and vegetables, price-controlled goods, clothing and footwear	1.7	0.9	2.4	6.4	-2.6	6.3	1.8	Mar
Index of housing prices	5.9	-4.8	6.4	14.0	8.9	1.3	5.0	Mar
Wholesale price index	5.2	4.0	6.3	6.7	3.8	13.8	8.7	Mar
NIS/$ exchange rate	6.2	-1.2	15.2	4.9	6.6	6.9	6.8	Mar
NIS/currency-basket rate	1.6	-3.5	4.3	5.0	0.9	8.5	4.7	Mar

[a] Annual rates of change during period, percent.
SOURCE: Central Bureau of Statistics.

Table 8. Monetary Aggregates and Nondirected Bank Credit, 2005-2006 (annual terms, percent)

	2005	2005 I	2005 II	2005 III	2005 IV	2006 I	Cumulative in previous 12 months	Oct 05-Mar 06	Last month for which data available
Rates of change		Change from preceding quarter					During period		
M1[a]	17.5	17.3	23.4	24.3	23.6	11.2	19.7	16.1	Mar
M2[b]	6.1	7.7	6.3	7.9	-0.2	2.9	4.8	2.6	Mar
M3[c]	7.9	9.9	8.8	14.0	2.6	9.4	9.3	7.1	Mar
Nondirected bank credit	1.0	-2.1	0.8	5.7	9.5	-1.5	3.7	2.5	Mar
Unindexed local-currency credit	10.8	15.5	6.3	11.9	13.8	3.2	8.2	6.1	Mar
CPI-indexed credit	-2.6	-8.1	1.5	6.8	7.8	-2.4	3.1	0.4	Mar
Credit in and indexed to foreign currency	-7.8	-17.1	-8.7	-5.6	4.7	-8.0	-2.9	-0.2	Mar

[a] Narrow money supply (cash in the hands of the public and demand deposits).

[b] M1 plus short-term local-currency unindexed deposits.

[c] M2 plus short-term CPI-indexed deposits.

SOURCE: Bank of Israel.

Table 9. Interest Rates. Yields. and the Share-Price Index. 2004-2006 (quarterly average, percent)

	2005	2005 I	2005 II	2005 III	2005 IV	2006 I	Oct 05-Mar 06[a]	Last month for which data available
Nominal interest on								
SRO deposits	2.8	2.7	2.7	2.7	3.2	3.5	3.3	Jan
Nondirected local-currency short-term	6.4	6.3	6.2	6.2	7.0	8.0	7.3	Jan
Effective local-currency credit	3.8	3.7	3.7	3.6	4.2	4.8	4.5	Mar
LIBID 3-month dollar intrest	3.4	2.7	3.2	3.6	4.2	4.6	4.4	Mar
Yield to maturity on:								
Treasury bills	4.3	4.2	4.0	4.2	4.9	5.5	5.2	Mar
Yield on 10-year bonds	3.6	3.8	3.7	3.5	3.5		3.5	Nov
Yield on 5-year bonds	3.0	3.1	3.0	2.7	3.1	3.5	3.3	Mar
Risk premium[b]		0.4	0.3	0.3	0.3	0.3	0.3	Mar
Expected inflation[c] (gross)	2.8	2.4	3.0	3.1	2.8	2.4	2.6	Mar
General Share-Price Index (change)	33.2	6.6	-1.2	13.2	11.7	1.7	13.6	Mar

[a] Compared with October 2004-March 2005.

[b] As measured by the 5-year credit-defalt-swap (CDS) market

[c] Derived from the yield gap between indexed and unindexed bonds held by tax-exempt institutional investors, minus the x-day effect on the price of the bond.

SOURCE: Bank of Israel.

Part 2: Broader Review of Selected Issues

Apartment Prices and Activity in the Construction Industry

The economic recovery led to a rise in apartment prices in the second half of 2005. However, the rise was moderate relative to the intensity of the recovery in the economy, and was accompanied by a marked increase in prices of inputs, and hence did not bring about a substantial rise in building starts and construction industry product. Note that the general development of the industry conceals considerable variance in developments regarding large and small apartments. Whereas the prices of large apartments in the central area soared in 2005, those of small apartments and of those in the peripheral areas have not gone up (Table 1). This development led to an appreciable increase in building starts of privately-constructed apartments (most of which are located in expensive areas), while in the peripheral areas, where there is still a large stock of empty apartments, prices did not rise, so that the extent of building starts did not grow either.

The survey of owner-occupied housing prices conducted by the CBS (Central Bureau of Statistics) indicates that apartment prices in sought-after areas, among them Tel Aviv, the Sharon region, the central area and Haifa (in Jerusalem most of the increase occurred during 2004), as well as the prices of large apartments, rose significantly. When apartments are divided into three price groups it can be seen that the price of the group of the most expensive apartments (large apartments in sought-after areas) rose by 10 percent in the course of the year,[1] that of average apartments rose by 5 percent, and that of cheaper apartments (the lowest third) hardly rose at all (Table 2). Concurrently, prices of inputs rose by a significant 7 percent, so that contractors' profits grew in the luxury apartments segment and fell in that of the cheap apartments. The increase in profitability in the luxury apartment segment was expressed in the rise in the number of building starts in Tel Aviv and Jerusalem (their number in the second half of 2005 rose in relation to both the preceding period and the equivalent period in 2004), but remained stable in the rest of Israel (including the Sharon region, and Haifa and the central area, where apartment prices rose too).

[1] 2005:IV vis-à-vis 2004:IV, nominal rate of change.

The greater increase in the price of luxury apartments than in that of smaller apartments had begun already in 2004, when prices of all apartments declined. There were several reasons for the change in the relative price, among them greater economic inequality in Israel, increased demand by nonresidents for luxury apartments in Israel, the decline in the extent of direct assistance extended by the government to purchasers of new homes among the weaker segments of the population,[2] the aid extended to contractors in 2001 and 2003, which created artificial surplus demand in the peripheral areas, and the rapid rise in the supply of cheap apartments in the peripheral areas in the 1990s, when demand for them declined as a result of the improved economic situation of new immigrants who were seeking to improve their living conditions.

An empirical study which examined the factors affecting the extent of building starts in Israel (on the basis of data for 1974-1990) found that the influence of population growth was three times as great as that of a similar rise in the value of private property: whereas a one percent increase in the population raised housing prices by 12 percent (after a year) and the stock of housing area by 0.6 percent (in the long term), a similar increase in the value of private property raised property prices by only 3 percent and the area of building starts by only 0.16 percent. Hence, the effect of Israel's economic recovery on activity in the construction industry is expected to be far smaller this time than formerly, as in contrast with the past it does not stem from an influx of immigrants but from a rise in income.

In general, income levels have little effect on the quantity demanded: almost every household lives in an apartment, irrespective of its economic situation. Nevertheless, the level of income has a considerable effect on the location, size, age, etc. of the apartment sought. An improvement in the economic situation will increase the demand for large apartments in sought-after areas, but the shortage of land reserves will prevent a building surge in those areas, with the result that prices will rise alongside a more moderate increase

[2] The reduction of the benefit embodied in the mortgage for eligible persons led to a 30 percent decline in the proportion of persons taking up mortgages, *inter alia* because of the cancellation of eligibility for aid of persons with low eligibility and the narrowing of the gap between market interest rates and the rate offered to eligible persons.

in building starts.[3] Construction activity in the peripheral areas is not expected to expand greatly either: land reserves there are not a solution for people who wish to improve their living conditions who reside in the center of the country (and wish to enlarge their apartment size), or for those who wish to move to the center. As far as those who have lived in the peripheral areas for a long time and who wish to improve their apartments there are concerned, this will lead to the recovery of construction activity there, but at the same time the price of less desirable properties in those areas will fall, and this will make it less worthwhile to improve apartments, thereby dampening activity. A similar mechanism was at work during the recession at the beginning of the current decade: the decline in income caused apartment prices to fall, leading to a reduction in the price of land (most of which is sold by the State), the erosion of returns to contractors and persons with the specific human capital required in the industry, as well as to a fall in the quality of the apartments constructed—but it had a limited effect on reducing the number of apartments built: the number of building starts has remained fairly stable in the last five years (31,000 units per annum), and indices of overcrowding do not attest to a deterioration during the recession years. Hence, in those years extensive suppressed demand was not generated, and so no large increase in building starts is expected in the period of prosperity.[4]

In conclusion, against the backdrop of expectations that the stagnation in the construction industry is coming to an end, it should be noted that there has been a marked rise in the price of luxury apartments, and that prices respond more rapidly than quantity (building starts), so that at a later stage the response on the price side will lead to an increase in quantity.

Table 1: Change in Apartment Prices in 2004 and 2005, by Apartment Size and Region

Apartment size	Apartment price	Change in price			Apartment price	Change in price	
(rooms)	(NIS '000)	(%)		Region	(NIS '000)	(%)	
		2005	2004			2005	2004
4.5-5	1,139	10		Tel Aviv	1,042	13	2
3.5-4	817	13	1	Sharon	908	10	7
2.5-3	577	6	6	Jerusalem	868	5	13
1.5-2	488	0	8	Gush Dan	696	5	-6
				Central	668	17	-9
				Haifa	628	13	-8
				Haifa suburbs	492	4	-7
				Southern	446	6	-6
				Northern	436	1	-3

Table 2: Development of Apartment Prices, by Price Group, CBS data

	2–5 room apartments		2–4 room apartments		
	Apartment price, 2005	Change in price during 2005	Apartment price, 2005	Change in price during 2005	Change in price during 2004
	(NIS '000)	(%)	(NIS '000)	(%)	(%)
Upper third	1,150	10	877	9	2
Middle third	627	5	523	4	0
Lower third	371	1	313	1	-8

[3] In high-demand areas projects of the Demolish-and-Construct type will become more worthwhile, but these are a long time in coming to fruition.

[4] The development of prices of cheap apartments in the peripheral areas depends on the suppressed demand for housing: the lower the suppressed demand created during a period of recession, the greater the decline in the prices of cheap apartments, so that the increase in construction activity will be more moderate.

Government-Initiated Vocational Training for Adults in Israel—A Disappearing World

Vocational training for adults is one of the important means used by governments to absorb manpower into the labor market and to improve its position on the employment ladder, particularly among the weaker sections of the population. Research around the world has shown that active labor market programs, and in particular vocational training, help to raise employment rate, to increase wages, and to reduce reliance on transfer payments, mainly in the long run and when other programs (such as assistance in finding jobs) operate alongside the training.[1] Comprehensive vocational training makes a far greater contribution to successful integration into the labor market than do more limited measures such as teaching basic work habits.[2] Vocational training is more expensive, however, and results in only limited improvement in income,[3] and does not always help the household to escape from poverty.

About 200,000 Israelis from age 20 participated in 2004 in vocational training courses of over 100 hours each, financed by the private and public sectors (Central Bureau of Statistics, Social Survey, 2004). About 13 percent of the courses were publicly funded. Most public vocational training is carried out by the Ministry of Industry, Trade and Labor, either directly or, under its supervision, via external training institutions.

Vocational training of adults funded by the Ministry can be divided into the following main categories: day courses totaling a few hundred hours of study in a variety of subjects, from computers, electricity, electronics, metalwork and machinery, to traditional areas such as child care and cosmetics; academic requalification; in factory training in manufacturing and the construction industry, that includes a wage subsidy; courses for special groups (soldiers prior to their demobilization, the ultra-orthodox, etc.); activity to enhance general human capital—relatively short preparatory and guidance courses, and completion of basic education for those not meeting the minimum requirements for participation in vocational training. Most participants in the courses are unemployed, generally referred by the Employment Service. Some of the participants are entitles to an allowance during their training period (unemployment benefit or income support benefit), and the course fees are very low.[4]

A follow-up on graduates of vocational training courses carried out by the Ministry of Trade, Industry and Labor shows that about two-thirds found employment within eighteen months from the end of the course, but the proportion assigned jobs in the professions for which they had been trained was relatively low.[5] The National Insurance Institute found that among recipients of unemployment benefits, a higher share of those who participated in vocational training courses found jobs than those who did not, and the difference between the probability of graduates of training courses finding jobs and that among those who had not participated was higher among those without higher education, those in low-paid jobs prior to becoming unemployed and the middle-aged—the groups of unemployed who have the greatest difficulty to find employment.[6]

In the last few years several legislative changes were made with regard to the system of vocational training, and it underwent a comprehensive far-reaching reform. The emergency economic plan of July 2002 reduced the unemployment benefit paid to the newly unemployed who participated in vocational training courses to 70 percent of what it was previously. The Economic Arrangements Law (Supplementary to the Budget Law) of 2003 included the period of vocational training in the entitlement period for receipt of unemployment benefit for those with 12 or more years of education, and stated that unemployed persons with less than 12 years of schooling who participate in vocational training courses will receive unemployment benefit for a maximum of 138 days. These legislative changes were intended to shorten the period in which unemployment benefit was received by making it less worthwhile to participate in vocational training courses, concurrently with focusing on the unemployed with low educational levels and diverting the resources that would be saved to expanding vocational training for recipients of income support. It was also decided to give priority to training the ultra-orthodox

[1] OECD (2006), *OECD Employment Outlook 2005*; Martin, J.P. (2001), "What Works Among Active Labour Market Policies: Evidence from OECD Countries' Experiences", *OECD Economic Studies*, 30(1), pp. 79-113.

[2] A. Dyke *et al.* (2005), *The Effect of Welfare-to-Work Program Activities on Labor Market Outcomes*, IZA DP No. 1520.

[3] J.J. Heckman, Lalonde, R.J. and Smith, J.A. (1999), "The Economics and Econometrics of Active Labor Market Programs", In: O. Ashenfelter and D. Card (editors), *Handbook of Labor Economics*, 3A, pp. 1865-2097.

[4] In addition, there are courses, supervised by the Ministry of Industry, Trade and Labor, partly or wholly financed by the participants, such as training of technicians by the National Institute for Technological Training, and evening courses which grant certification.

[5] A. Ahituv, Y. Eyal and L. Cohen (2002), "Analysis of Changes in Employment and Wages of the Unemployed Resulting from Vocational training," *Economic Quarterly*, 49 (4), 577–601 (Hebrew).

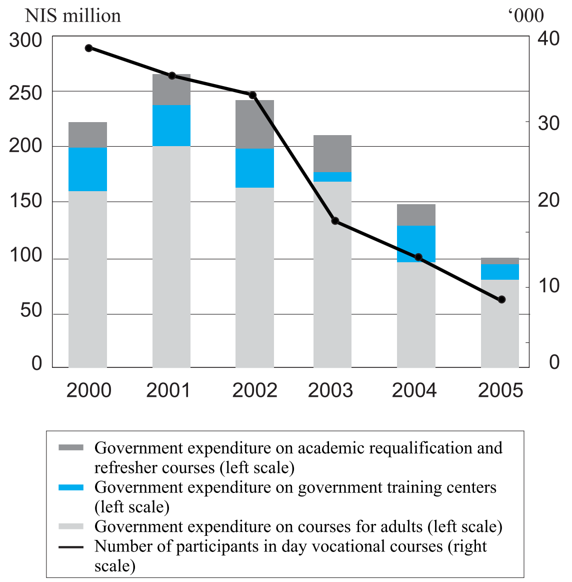
[6] The results of the two research papers must be treated with caution, however, because the first did not include control groups, and the second did not take into account the selectivity of the participants in the vocational training courses.

and Arabs, to augment training programs for Israeli workers in occupations with a high concentration of foreign workers (such as construction), and to continue with the closure of the government training centers or to enable their operation by the private sector.

Training activity contracted as a result of the legislative changes and extensive budget cuts. Thus, the number of participants in day-training courses fell from about 34,000 in 2001 to 8,000 in 2005 (Figure 2.1), and the share of recipients of unemployment benefit who participated in vocational training courses fell from around 14 percent before the legislative changes to about 1 percent today. These developments were also reflected in government expenditure, which fell from over NIS 250 million in 2001 to less than NIS 100 million in 2005. An international comparison shows that both public expenditure on vocational training as a share of GDP and the proportion of the civilian labor force participating in such courses currently place Israel in the lowest third of countries (Figure 2.2).

Figure 2.1

Government Expenditure on Adult Vocational Training[1] and the Number of Participants in Day Vocational Courses, 2000-05[2]



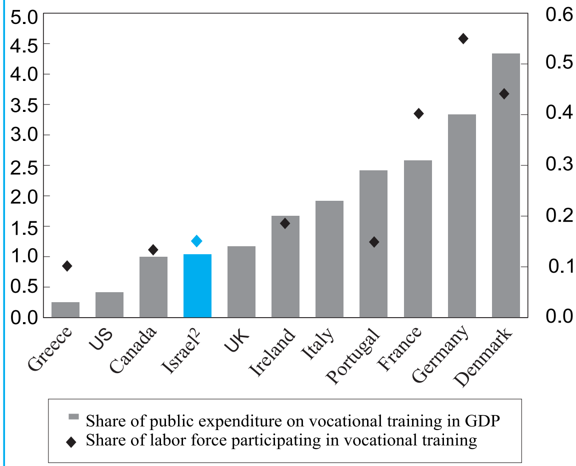
[1] Not including related expenses (e.g., Transport); NIS million, at constant 2005 prices.

[2] Adult courses (including internal plant training, in-house classes, etc.), academic requalification and supplementary education for adults. In 2005 the distribution of the number of participants in vocational training courses financed or supervised by the Ministry of Industry, Trade, and Labor was as follows: day vocational courses for adults - 8,220; training of technicians by the National Institute for Technological Training - 20,196; evening and supplementary courses - 27,178; total (including other frameworks) - 60,166.

SOURCE: Department of Vocational Training and Manpower Development in the Ministry of Industry, Trade, and Labor; CBS.

Figure 2.2

Share of Public Expenditure on Vocational Training, and Share of Labor-Force Participation in Public Vocational Courses, 2003-04,[1] Israel and Selected OECD Countries (percent)



[1] Data are for 2004 (including Israel), unless the last available data are for 2003. Expenditure: total expenditure by the Vocational Training and Manpower Development Department and expenditure to encourage the employment of single mothers. Participants in vocational training: participants in day courses (for adults, academic requalification, internal plant training, in-house classes, etc.), students attending the National Institute for Technological Training, single parents in vocational training courses.

SOURCE: OECD (2006), *OECD Employment Outlook 2005*; Ministry of Finance, Accountant-General (2005), *Financial Data for the Government of Israel to 31 December 2004* (Hebrew); Department of Vocational Training and Manpower Development in the Ministry of Industry, Trade, and Labor; Adva Center (2006), *Vocational Training - Out* (Hebrew).

It is appropriate for vocational training to focus on persons with a low level of education, since these come up against many difficulties in trying to find employment: the unemployment rate of persons with twelve years of schooling or less stood at 12.5 percent in 2005, compared with 5.9 percent for persons with a high level of education, and about 25 percent of the former had been looking for work for over a year. An indirect indication of the difficulties is to be found in the fact that in 2004 some 8 percent of discouraged workers noted their lack of appropriate training (as well as inexperience and language difficulties) as the reason for their unemployment, and this characterized mainly youngsters, persons with a low level of education, and Arabs. The weaker segments of the population do not have the means of financing vocational training, and research undertaken in Israel and elsewhere has shown that the return on training among them is higher. As stated, focusing attention on persons with a low level of education is desirable, but leaves behind those who have a higher level of education but lack specific skills, who also encounter difficulties in finding work.

The number of recipients of income support undergoing vocational training increased markedly—from some 1,600 in 2000-2001 to about 2,900 in 2005, but this still applies to only 1.6 percent of recipients of this benefit. The vast majority of this segment of the population does not work and encounters myriad obstructions in the attempt to find employment. Thus, about one third of recipients of income assurance benefit noted that their principal need is for vocational training.[7]

In recent years two active programs have been initiated for recipients of income support: the program for integrating single parents into the labor market and the 'Mehalev' ('from income assurance benefit to secure employment,' known as the Wisconsin Program). The former involved wage subsidies for single parents and a grant for employers (see Bank of Israel, *Annual Report, 2003*, Box 2.2). Employment-support services such as day-care centers, participation in fares, and vocational training were also provided. About 5,300 of the 62,000 single parents eligible for the program participated in vocational training, i.e., about one-eighth of all those registered at the Employment Service. It is expected that the program will be resumed in 2006. The role of vocational training in the Wisconsin Program is negligible, by contrast (for a description of the program, see Bank of Israel, *Annual Report, 2005*, Box 5.1).

A rising trend is also evident regarding the extent of the ultra-orthodox population participating in vocational training, and in 2005 their number reached some 2,300, about two-thirds of them women. Most of the ultra-orthodox receiving vocational training attend evening schools and finance their studies independently. The Department of Vocational Training and Manpower Development in cooperation with Joint Israel has recently introduced a special program providing vocational training for ultra-orthodox men, who attend religious seminaries (Yeshivas).[8] The vocational training was also focused on Arabs, who accounted for slightly more than ten percent of the population participating in these courses in the early 1990s and have constituted about one third in the last two years.

The legislative changes created many problems for the goverment's vocational training system. The restriction of the period during which unemployment benefit can be paid to persons with a low level of education to 138 days makes it difficult for them to participate in lengthy courses, which contribute more to their chances of finding employment. Moreover, including the period of vocational training in the number of days of eligibility for unemployment benefit disregards the fact that before the legislative change of 2003 the waiting period for courses to open was one of the main reasons for the prolonged period in which unemployment benefit was paid, as after the courses had ended people found work relatively quickly.[9] Cutting the length of courses in response to the legislative changes not only had an adverse effect on the quality of the training but also caused the focus to shift from transmitting specific human capital to a more general kind of human capital, reducing the individual's chances of finding employment.

In conclusion, bearing in mind the extent and depth of unemployment and the multiple difficulties experienced by many segments of the population in finding employment, focusing the government's vocational training programs on persons with a low level of education was appropriate. However, the program should be extended to meet the needs of other segments of the population with a relatively low skill level, and creating additional active labor-market programs such as tutoring and assistance in finding work. The decision to include the training period in the period of eligibility for unemployment benefit should be reconsidered, or at least financial support, even if only partial (e.g., a standing loan whose repayment could be made dependent on the individual's subsequent employment), should be offered to participants in courses. The possibility of introducing a differential tuition fee, creating a self-selection mechanism and a way of providing progressive aid according to needs, should also be examined. Finally, follow-up and ongoing studies should be undertaken of the extent to which graduates of vocational courses find employment; the results should be used as feedback to improve the mechanism of selecting candidates for training, the mix of courses, the content of courses, etc., in accordance with the needs of the labor market.

[7] Y. King et al. (2003), *The Employment Standing of Recipients of Income Support: Resources, Barriers, and the Need for Help in Job Finding*, Joint-Brookdale Institute and the National Insurance Institute, Research and Planning Administration, Research and Special Studies, No. 79 (Hebrew).

[8] For details see Y. King and N. Gazit (2005), *"Honorable Livelihood" (First Group): Vocational Training for the Ultra-Orthodox—Assessment*, Meyers-Joint-Brookdale Institute, Research Paper DM 05-458 (Hebrew).

[9] D. Gordon and A. Toledano (2002), *Vocational Training for the Unemployed*, The National Insurance Institute, Research and Planning Administration, Position Paper, November (Hebrew).

Diary of Events from January-March 2006

Month	Day	Event	Details
January	10	The raising of the minimum threshold for new issues on the Tel Aviv Stock Exchange came into force.	The minimum threshold value of the public's holdings ("the floating amount") on a company's first issue was raised from NIS 8 million to NIS 16 million. The significance of the change is that henceforth each new company will be required to raise at least NIS 16 million from the public. This is a consequence of the recommendations of the "auzer Committee, which dealt with the need to improve tradability on the TASE. During February, the floating amount for a company's first issue will be raised to NIS 20 million.
	18	A NIS 40 million assistance fund for encouraging small businesses in the Arab sector commenced operation.	A need arose to establish a fund for the Arab sector in light of complaints about barriers preventing small businesses in this sector from obtaining assistance. As part of the fund, the state will place a deposit in the bank to serve as security for the loans it grants to small businesses.
	23	By a majority vote, the Finance Committee approved the Ministry of Finance's original proposal regarding the rate of the banks' distribution commission.	The approval was given four-and-a-half months after the Minister of Finance first presented the regulations. The approval of the regulations, in the version proposed by the government and discussed on various occasions in the Finance Committee, complements the legislative process of the "Bachar Reform" of the capital market. The regulations for joint investments in trusts (distribution commission) and the supervisory regulations on financial services (provident funds) determine the collection method and the commission ceiling that the banks will be permitted to charge the managers of mutual funds, provident funds and pension funds for distributing their products.
	24	The CEO of the National Insurance Institute and his deputy presented the plan for reducing poverty.	The proposed program budget of NIS 3 billion a year aims to lower the rate of poor families in Israel by ten percent. The major suggested policy tool is the earned income tax credit.
	27	Hamas victory in the elections in the Palestinian Authority.	
February	9	The Bank of Israel will expand its monetary activity using "Repo" transactions.	The scope of transactions will grow to a nominal value of NIS 500 million (as opposed to NIS 200 million until now). The range of the transaction will be shortened from two weeks to one. The frequency of transactions will increase: they will be executed once a week (as opposed to once every two weeks).
	16	Securities regulations were approved requiring public companies to update investors about changes.	The new regulations require: reporting substantial events that took place following publication of the periodic report. The obligation to report, which applies to the banks, insurance companies and dual companies, will be extended to holding companies, and will also include disclosure of transactions of companies and holders of controlling interests.

Month	Day	Event	Details
	21	Banking hours are reduced in light of lengthening of the business day.	The main change from the point of view of the banks' customers is that operations taking place both in the morning and the afternoon will be recorded on that day.
	23	The acting Prime Minister and Minister of Finance approved the plan for reducing social gaps.	According to the plan, earned income tax credit will be used to reduce the social gaps.
March	2	For the first time, the Supervisor of Banks presented a report to the Finance Committee on the embezzlements that were reported to the banking supervision in 2005.	According to the report, 21 cases of embezzlement were reported to the Supervisor of Banks in 2005, totaling NIS 7.5 million.
		The Finance Committee approved the privatization of the two oil refineries – in Haifa and Ashdod	Only 3 Knesset members participated in the discussion.
	10	In Japan the monetary policy in force for the past five years was terminated. The aim of this policy was to eliminate deflation.	As a result of the termination of the policy, credit to banks will be cut by 80%.
	17	The World Bank: The Palestinian Authority is on the verge of an economic slump.	The main cause of the slump, according to the World Bank, is the cessation of the flow of money from Israel to the Palestinian Authority because of Hamas's rise to power.
	27	The interest rate in April 2006 will be increased by 0.25 percentage points, to 5 percent.	The decision to raise the interest rate is designed to maintain price stability within the boundaries of the inflation target determined by the government–1-3 percent. This is the second interest-rate hike in the past three months. The interest rate in February was also raised by 0.25 percentage points, while in March it remained unchanged.
	28	General elections to the Israeli Knesset.	The results: Kadima: 29 seats; Labor-Meimad: 19; Shas: 12; Likud: 12; Yisrael Beitenu: 11; Ichud Leumi–Mafdal: 9; Gil (Pensioners): 7; Torah and Shabbat Judaism: 6; Meretz: 5; United Arab List–Arab Renewal: 4; National Democratic Assembly (Balad): 3; Hadash: 3.
		For the 15th time in succession, the Fed raised the interest rate.	Despite the retirement of the Fed Chairman Alan Greenspan, and his replacement by Ben Bernanke, the fixed policy of raising the interest rate has not changed. The new interest rate stands at 4.75 percent.
	29	In France the trade unions went on strike for twenty-four hours, as pressure for rescinding the "Employment Law".	The new Employment Law deals with employees under the age of 26 employed for a trial period of two years. The law allows employers to fire these employees without having to provide justification for their actions and without warning. The aim of the law is to reduce the high rate of unemployment among 18-25 year olds.