Chapter 3
Prices

1. MAIN DEVELOPMENTS

The Consumer Price Index (CPI) rose by 9.4 percent during 1992, the first time since 1970 that the increase has been below 10 percent. This significant achievement reflects the reduction of the inflation rate from the annual average of 18.5 percent which had prevailed since the economic stabilization program (ESP) of July 1985. Some reasons for the steady rate of inflation in the past, as well as for its reduction in 1992, are offered below.

The rate of increase of the CPI fell by about 9 percent during 1992. Focusing on this one indicator may be deceptive, however, and could lead to the erroneous conclusion that the inflation rate fell steeply. According to other indexes—such as the average change in the price level, the wholesale price index, the index of tradables prices[1] and the CPI excluding housing—the inflation rate fell by between 5 and 7 percentage points.

An analysis of the inflationary process since 1985, especially the decline from the 18 percent level, raises complex problems, and requires long-term investigation. It is impossible at present to analyze the fall in inflation over a period of time, as to date 1992 is the only year in which the rate of increase of the CPI was below 10 percent, and it is therefore too early to offer a full explanation. Nevertheless, an examination of the inflation rates of recent years suggests that anti-inflationary forces were operating prior to 1992; various indexes were indicating a moderate fall in inflation as early as 1990. Particularly notable is the slowdown in price increases excluding housing. In 1989 the CPI excluding housing rose on average by 17.8 percent, in 1990 by 13.4 percent, in 1991 by 15.7 percent, and in 1992 by only 12.2 percent (Table 3.2). According to this and other indexes (Tables 3.3 and 3.5), there were signs of a reduction in 1990; the decline was halted in 1991, mainly as a result of temporary factors, and in 1992 there was a larger fall.

The reduction of the basic inflation rate was made possible by the conditions prevailing in the economy, particularly labor market trends of the last few years—the rise

[1] Both in theory and in practice, it is difficult to make a clear-cut distinction between tradables and nontradables: many goods and services can, under certain circumstances, shift from one to the other. One way of evaluating price trends in the two groups is to divide the items in the CPI into these two categories; such a division is not unambiguous, however, as every tradable item includes nontradable elements, and vice versa. Another limitation is that the CPI covers only some final uses.

Table 3.1
Selected Price Indexes, 1970–93:I

(percent change, annual rate)

	CPI	Implicit price index of		Wholesale prices[b]
		Domestic use of resources[a]	GDP	
Change during period[c]				
1970–73[d]	15.4	17.4	16.2	
1974–78[d]	41.2	42.4	43.1	
1979–82[d]	118.9	119.2	120.5	123.1
1983–85[d]	256.1	247.3	243.9	247.0
1986–90[d]	18.1	19.2	19.5	16.8
1990	17.6	16.1	15.3	12.6
1991	18.0	16.4	21.5	14.6
1992	9.4	10.0	10.5	9.1
1991				
I	13.3	19.3	30.3	16.9
II	27.0	29.9	42.3	25.5
III	30.0	14.2	14.2	7.0
IV	3.7	3.8	2.9	9.8
1992				
I	10.4	8.7	11.2	9.6
II	6.3	18.0	13.8	11.9
III	11.7	9.0	11.8	5.4
IV	9.1	4.8	5.3	9.7
1993				
I	16.2			10.2
Average change				
1986	48.1	47.5	48.5	45.1
1987	19.9	20.5	20.3	18.5
1988	16.3	17.4	19.7	17.5
1989	20.2	20.4	20.4	21.0
1990	17.2	16.4	16.1	11.6
1991	19.0	18.1	21.3	16.0
1992	11.9	10.9	11.6	10.2

[a] Net of direct defense imports.
[b] Prices of industrial output for domestic market.
[c] CPI and wholesale price figures based on monthly data; GDP and resource use, on quarterly data.
[d] Geometric mean of period.

SOURCE: Central Bureau of Statistics.

in unemployment and the persistent decline in real wages—as well as by a fiscal policy which maintained a relatively low deficit and defined budgetary targets for the next few years. External factors also played a part in slowing inflation in 1992, by slowing world price increases (prices of final products, and even more so, of imported intermediates); as the exchange rate rose at the same pace as in previous years, prices of tradables rose by less than in the past.

Table 3.2
Main Components of the Consumer Price Index, 1987–92

(annual change, percent)

	Weighting in CPI[a]							
	New	Old	1987	1988	1989	1990	1991	1992
Total	1,000	1,000	19.9	16.3	20.2	17.2	19.0	11.9
Housing	165	165	17.7	17.0	32.3	34.2	31.6	11.2
Controlled goods[b]	**131**	**195**	18.1	15.9	29.1	18.7	22.7	16.4
Fruit and vegetables	64.0	64.0	20.9	17.7	5.2	0.9	12.2	16.9
Clothing and footwear	72	72	12.8	11.0	4.1	3.1	8.2	9.2
Total excl. housing	835	835	20.4	16.1	17.8	13.4	15.7	12.2
Total excl. controlled goods	**869**	**805**	20.3	16.4	18.1	16.8	18.4	11.3
Total excl. housing and controlled goods	**704**	**640**	21.3	16.2	14.4	11.6	14.1	11.3
Total excl. housing, fruit and vegetables	771	771	20.7	16.0	18.9	14.3	15.9	12.0
Total excl. fruit and vegetables	936	936	19.8	16.2	21.3	18.2	19.4	11.7
Total excl. fruit and vegetables, etc.[c]	**568**	**505**	22.1	16.7	17.0	13.8	14.9	11.0

[a] Old definitions were in use until the end of 1990, and new definitions were introduced at the beginning of 1991.

[b] Controlled goods include subsidized essentials and goods and services supplied by public authorities, government enterprises, or supported corporations (e.g. Bezeq—Israel Telecommunication Corp. Ltd.).

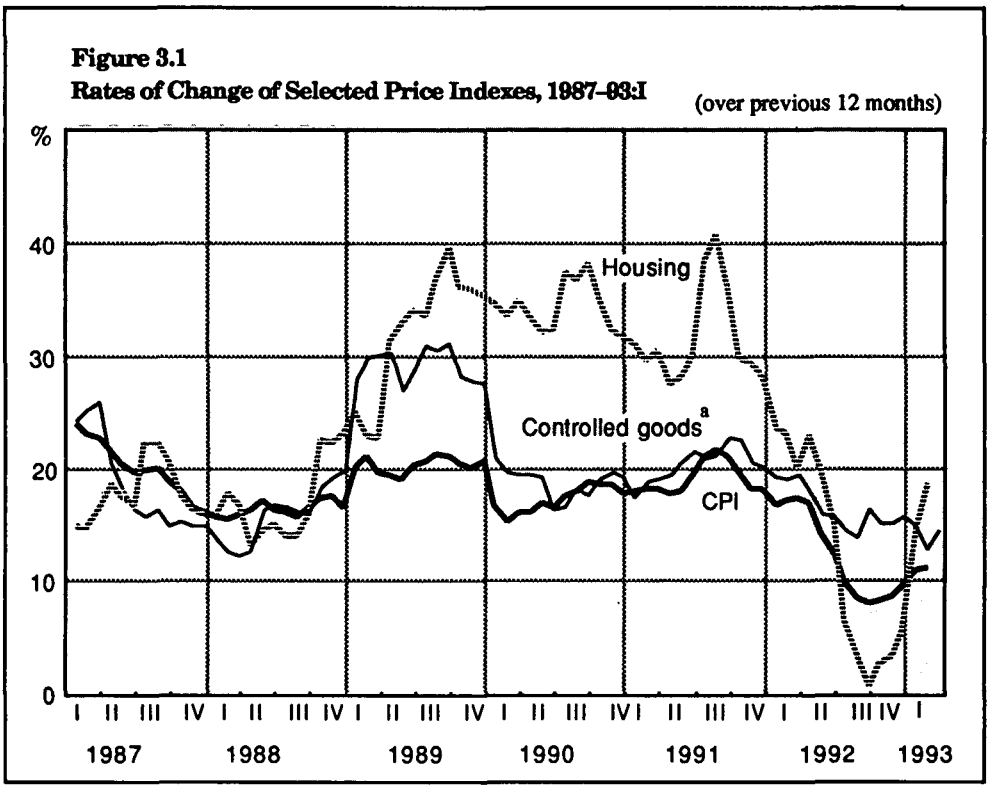
[c] Total excluding fruit, vegetables, controlled goods, housing, clothing and footwear.

SOURCE: Based on Central Bureau of Statistics data.

The slowdown in the rate of price increases was not reflected in the CPI before 1992. The significant rise in demand for housing and the expectation of its further acceleration in the wake of the influx of immigrants caused an exceptionally steep price rise in this item after 1989. As the housing component has a high weighting in the CPI, this increase caused a significant change in the total index, whereas the index excluding housing rose more slowly. The unprecedented expansion of the supply of apartments, and the slowdown in the rate of immigration, resulted in a turnaround in the housing market, starting in the last quarter of 1991; there was a sharp decline in the rate of increase of housing prices, reflected by a significant slowdown in the total index. This effect on the

CPI, on which the attention of all economic agents is focused and which acts as a general indicator, contributed greatly to the major change in inflationary expectations, which in turn influenced the continued process of price determination.

Figure 3.1
Rates of Change of Selected Price Indexes, 1987–93:I



[a] The definition of controlled goods was changed in 1991 (for details see text).

Inflationary expectations are formed on the basis of many factors. In the period following the ESP, expectations were fairly constant, and were based on the assumption that prices would continue to rise within the 18–20 percent range, and that households, firms, and the government would act in a way which would keep the inflation rate at the same level. At the end of 1991, the Bank of Israel and the Ministry of Finance made a joint statement, the first of its kind, to the effect that the rate of inflation in the following year would be no more than 14–15 percent, despite the fact that the 1991 inflation rate was still high—18 percent. This statement, together with the introduction of the 'sloping band' exchange-rate regime, created a climate of stability in monetary policy and, supported by the basic economic backdrop and the actual slowing of inflation, brought inflationary expectations down during 1992.

In spite of the crucial importance of the exchange rate and its effect (together with the rise of world prices) on prices of tradables, it has not completely succeeded in the past

Table 3.3
Prices of Tradables and Nontradables, 1986–92

(annual change, percent)

	CPI[a]					Implicit price indexes[b]					
	Nontradables			Tradables							
	Total	Excluding housing	Excluding controlled goods and housing	Total	Excluding controlled goods	Domestic resource use[c]	Narrow domestic business resource use[d]	GDP	Business product	Imports[e]	Exports[f]
Change during period[g]											
1986	21.6	31.6	31.0	14.0	13.8	23.0	18.3	24.2	20.3	3.3	6.4
1987	19.4	20.8	20.0	12.3	13.5	19.7	18.7	18.5	17.1	19.1	16.9
1988	21.6	21.2	24.4	10.8	10.5	17.8	14.2	22.4	20.1	2.5	11.3
1989	24.7	20.3	16.8	13.7	14.2	19.5	18.4	17.5	15.4	21.7	19.1
1990	21.2	16.0	13.2	13.0	12.4	16.1	12.8	15.3	11.3	15.3	11.1
1991	21.3	17.3	14.4	13.4	14.1	16.4	15.0	21.5	21.9	3.5	14.1
1992	8.7	11.5	9.7	8.7	8.8	10.0	8.7	10.5	9.1	10.3	11.2
Average change											
1986	52.0	64.2	62.6	42.3	41.5	47.5	44.7	48.5	46.6	26.4	30.7
1987	24.0	27.2	27.5	13.1	13.7	20.5	18.4	20.3	18.1	19.0	17.5
1988	19.7	20.7	22.4	11.6	11.9	17.4	15.3	19.7	18.2	7.6	11.6
1989	24.9	22.1	20.9	13.3	13.5	20.4	18.6	20.4	18.4	16.2	18.5
1990	20.6	14.9	11.4	11.6	11.7	16.4	13.3	16.1	12.7	12.4	10.3
1991	22.2	17.6	15.0	13.3	13.4	18.1	15.6	21.3	19.7	8.5	14.8
1992	12.6	13.3	11.7	10.9	10.9	10.9	10.4	11.6	11.2	6.9	8.0

[a] Nontradables comprise services other than foreign travel, fruit and vegetables, butter and cheese, eggs, breads and bakery products, gas and electricity. Tradables are all other CPI items. The weights in the CPI are 58 and 42 for nontradables and tradables respectively.
[b] National accounts data.
[c] Excluding direct defense imports.
[d] Narrow domestic business resource use is domestic resource use excluding public services wages, housing services, and nonprofit institutions.
[e] Excluding defense imports and diamonds.
[f] Excluding diamonds.
[g] Quarterly averages
SOURCE: Based on Central Bureau of Statistics data.

Table 3.4
Selected Price Indexes and Exchange Rates, 1990–93: I

(rates of change of averages)

	CPI		NIS against			Nontradables		Housing	
	A[a]	B[b]	Basket	Dollar	Tradables	A	B[c]	A[d]	B[e]
1990									
I	3.0	3.7	1.5	–0.8	1.7	3.7	3.8	7.9	3.7
II	4.9	5.1	3.3	3.1	4.0	5.5	4.1	10.1	9.3
III	4.5	3.9	4.0	1.0	2.7	5.5	2.8	7.7	11.5
IV	4.7	4.0	1.5	–1.3	4.0	5.0	4.4	2.8	6.6
1991									
I	2.8	3.6	1.3	2.2	1.3	3.5	4.5	5.8	1.0
II	5.2	7.3	7.7	13.3	5.2	5.4	4.6	16.3	5.6
III	7.0	3.7	0.1	0.4	2.2	9.5	4.4	3.0	21.3
IV	2.4	2.3	3.3	0.4	4.0	1.5	2.8	–1.6	–1.3
1992									
I	1.4	2.4	–0.4	–0.6	1.6	1.4	4.4	–0.1	–4.8
II	2.9	3.0	4.0	3.7	2.7	3.0	2.3	4.7	4.5
III	1.6	1.1	4.4	0.6	1.8	1.5	0.3	1.3	4.0
IV	2.4	3.9	3.1	7.0	2.2	2.5	4.1	6.9	–1.1
1993									
I	3.5	3.4[f]	4.5	6.7	1.0	4.7	2.3	8.3[f]	9.8
1990	17.2	17.5	10.6	5.2	11.6	20.6	14.9	34.7	36.2
1991	19.0	19.1	12.3	13.0	13.3	22.2	17.6	30.2	31.0
1992	11.9	12.0	10.2	7.9	10.9	12.6	13.3	9.8	10.0

[a] CPI.

[b] Adjusted CPI–reflecting the development of consumer prices, with housing prices based on final quarterly survey results.

[c] Nontradables excluding housing.

[d] Actual prices of owner-occupied homes.

[e] CPI prices of owner-occupied homes.

[f] Provisional figure.

SOURCE: Central Bureau of Statistics and Bank of Israel.

in keeping down the prices of nontradables, which rose faster than those of tradables in 1986–91. In 1992, however, the rate at which nontradables prices rose slackened too, i.e., the increase was 9.7 percent during 1992 compared with 20.2 percent in 1991 and an average annual rate of 22 percent in the three preceding years. Both the difficulty in curbing prices of nontradables in past years and the appreciable decline in their rate of increase in 1992 can be explained by two phenomena which have characterized the Israeli economy in recent years: the first is the nominal rigidity which derives from the power of the unions and institutional wage agreements—the results of the inflationary past—and the second is excess demand, especially in construction.

First, the nominal rigidities, principally in the area of wages, were particularly severe immediately after the ESP, but eased with time, due among other things to the high unemployment rate prevailing since 1989. In that year, even before the influx of immigrants, unemployment rose to 9 percent. In 1990 and 1991, with the increase in immigrant arrivals, unemployment continued to rise. In the labor-market conditions of 1989–91, nominal wage increases lagged behind price increases, and the real hourly wage fell by an annual average 3 percent (see Table 4.13). These trends were even more pronounced in the nontradables sector, as it is labor-intensive. The cumulative effect reached its peak in 1992, when high unemployment and the continued reduction in wages brought about a change in expectations, a fall in production costs, and a decline in inflation.

Second, in the last few years demand for goods and services has outstripped output. The gap, most noticeable in construction, contributed to persistent real appreciation. This trend peaked in 1991. In 1992, due to the unprecedented increase in housing supply and the steep drop in both the immigration rate and the expected demand for housing, the trend was reversed, and there was a marked slowing of the rise in housing prices. The annual average increase in the housing component of the CPI dropped from 34.2 percent in 1990 to 11.2 percent in 1992. The adjusted index of housing prices, which reflects true prices of apartments more accurately, shows (Table 3.4) that although the slowdown began in mid-1991, the housing component in the CPI reflected this only after some delay (see Housing, below).

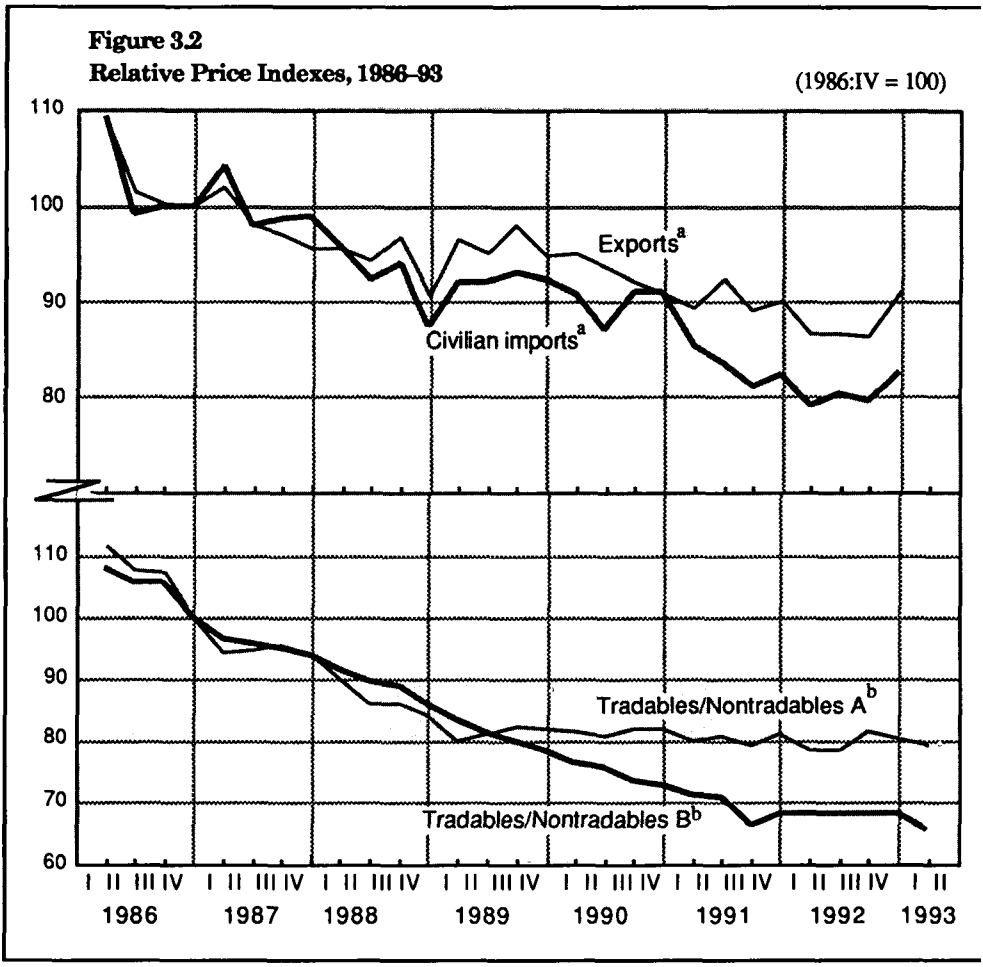
In product prices, too, there was considerable real appreciation, particularly until 1991, with prices of nontradables, especially construction, rising by far more than tradables. In 1992 product prices rose by 4 percentage points more than those of imported and exported goods (see Chapter 2). In the context of the relatively stable rate of devaluation, this slowdown made a valuable contribution to holding back the overall rate of price increases.

2. DETERMINANTS OF PRICES

Exchange-rate policy and prices

Underlying the ESP was the view that exchange-rate policy has a decisive effect on inflation. Prices of imports and exports and their substitutes, as well as other, nontradable, goods, were regarded as being affected by the exchange rate, which had become an anchor for prices and other nominal variables. In December 1991 the sloping band exchange-rate regime was introduced. The midpoint rate would be changed by an annual 9 percent, and the actual exchange rate would vary within a band set at ±5 percent around the midpoint. The decision was accompanied by the announcement that the inflationary target for 1992 was a maximum 14–15 percent, despite the actual rate of 18 percent in 1991.

Figure 3.2
Relative Price Indexes, 1986–93



[a] Prices of exports (imports) excluding diamonds, relative to implicit prices of domestic resource use, excluding direct defense imports.

[b] Variant A, all CPI items; Variant B, excluding controlled goods and housing (quarterly averages).

The new system has advantages and disadvantages. The most notable of the advantages are the reduced probability of speculative foreign-currency purchases—which entail a cost to the economy—and greater economic certainty. The reduced need for discrete adjustments of the midpoint rate, which had become a focus for speculative purchases, and the announcement regarding the slope of the exchange-rate band, extended the planning horizon for firms and households. The disadvantages arise from the restrictions which the system is likely to impose on reducing inflation. Nonetheless, the new regime did not give rise to unduly high inflationary expectations; inflation fell below the declared maximum, and even below the level of devaluation against the currency basket. It is clear, therefore, that the actual exchange-rate path is not enough to

explain the fall in inflation. Although the adoption of the diagonal band helped to reduce uncertainty, other factors also contributed to the substantial decline in inflation.

Changes in the actual exchange-rate, which significantly affect inflation, play a major role in determining price trends for both tradables and nontradables. The forces which determine the prices of tradables also have a marked effect on those of nontradables. Furthermore, the Israeli economy was experiencing real appreciation, i.e., a rise in the ratio of nontradables to tradables prices (Figure 3.2).[2] Prices of imports and of GDP reveal that this trend, which has prevailed for many years (Table 3.3), eased markedly in 1992, reflecting among other things a change in the composition of demand relative to output, particularly the turnaround in construction (see Chapter 2). A comparison of the tradables and nontradables components of the CPI shows that the latter edged up slightly more than the former; the difference in the rates of change of the two components contracted from about 11 percentage points in 1988–89, and 7–8 percentage points in 1990–91, to about 1–2 percentage points in 1992. Other indexes, e.g., import or export prices as a ratio of output price, confirm this finding (see Chapter 2).

Inflationary expectations

Expectations play a vital role in the inflationary process which has characterized the Israeli economy since the ESP. The stability of the rate of price changes from 1986 to 1991 cannot be explained without focusing on the effect of expectations, and hence it is worthwhile examining their development since the second half of 1991.

Certain factors have contributed to the stability of inflationary expectations since 1986, while others have acted against it. The government contributed to this stability both by assuming an almost constant rate of inflation in the budget, and by implementing a comprehensive fiscal policy appropriate to the actual inflation rate. The exchange-rate policy, which for a long time has resulted in annual devaluation against the currency basket of 10–12 percent, also contributed to the sense that things would go on in the future as they had in the past. Monetary policy in recent years supported the exchange-rate policy as an anchor for prices; monetary aggregates proceeded along lines dictated by the interest rate to which the Bank of Israel aspired, and their growth rate generally corresponded to the rise in nominal output and the continued increase in the demand for local-currency assets.

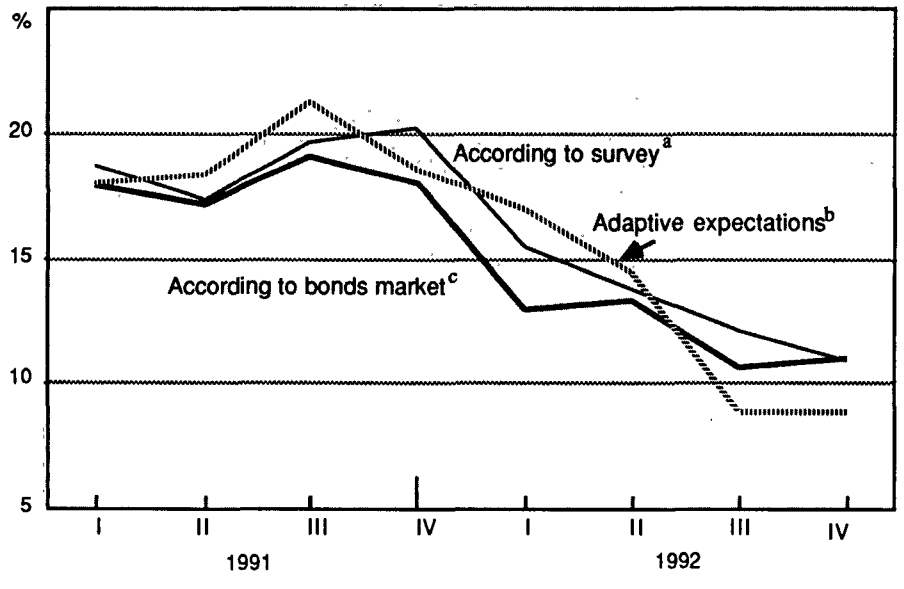
Factors which add to inflationary pressure and increase inflationary expectations include labor-market conditions which cause exceptional wage increases (as in 1987 and 1988). Unemployment, the resulting fall in real wages, and reduced costs, are likely to have the opposite effect. Exceptional increases in prices of controlled and supervised

[2]Real appreciation does not necessarily impair the competitiveness of tradables, whose relative profitability is also affected by unit cost. Thus, if appreciation is accompanied by a concomitant change in relative wages and/or productivity, the relative competitiveness and profitability of tradables will not change.

goods in the past apparently had an effect beyond their direct contribution to the CPI, adding to both inflation and inflationary expectations. Trends in the housing market affect prices in the housing component of the CPI, which, because it has relatively heavy weighting, has a significant effect. These forces contributed to inflationary pressures in 1989–91, and also fuelled inflationary expectations, which in turn affect and are affected by inflation.

Different indicators of inflationary expectations show (Figure 3.3) that after a period when the expected rate of inflation remained steady at 18–20 percent, there was a change, and that since the last quarter of 1991 inflationary expectations have fallen. In the first half of 1992 they settled at 14–15 percent, declining further in the third quarter to 10–12 percent.

Figure 3.3
Expected Annual Inflation, 1991–92



[a] Survey based on questionnaires about their expectations completed by managers of firms.
[b] Actual annual rate of inflation over preceding twelve months.
[c] Expected inflation according to Monetary Department of the Bank of Israel; taken from data of financial assets in the Israeli capital market.

Inflationary expectations were apparently affected by the introduction of the sloping band exchange-rate regime, and the announcement issued jointly by the Bank of Israel and the Ministry of Finance of a defined maximum inflation rate, lower than that prevailing hitherto. These two factors created a new situation, with more stable monetary variables and a firmer commitment by policy-makers to a lower rate of inflation.

The basic factors which affect the actual inflation rate also help to change inflationary expectations; chief among these are housing, continued unemployment and a contractionary fiscal policy. In the third quarter of 1991, after three years during which housing prices had risen by more than the CPI, the trend was reversed and the effect was felt, after a certain lag, in the CPI itself. It seems reasonable to assume that the change in housing prices also affected the public's expectations regarding future inflation. Developments in the labor market in 1992, specifically the continued rise in unemployment, which resulted in a fall in real hourly wages, helped to moderate expectations. Fiscal restraint—especially notable as 1992 was an election year—as well as the slowdown in the rate at which controlled and supervised prices rose, also contributed to the fall in inflation and to a reduction in inflationary expectations.

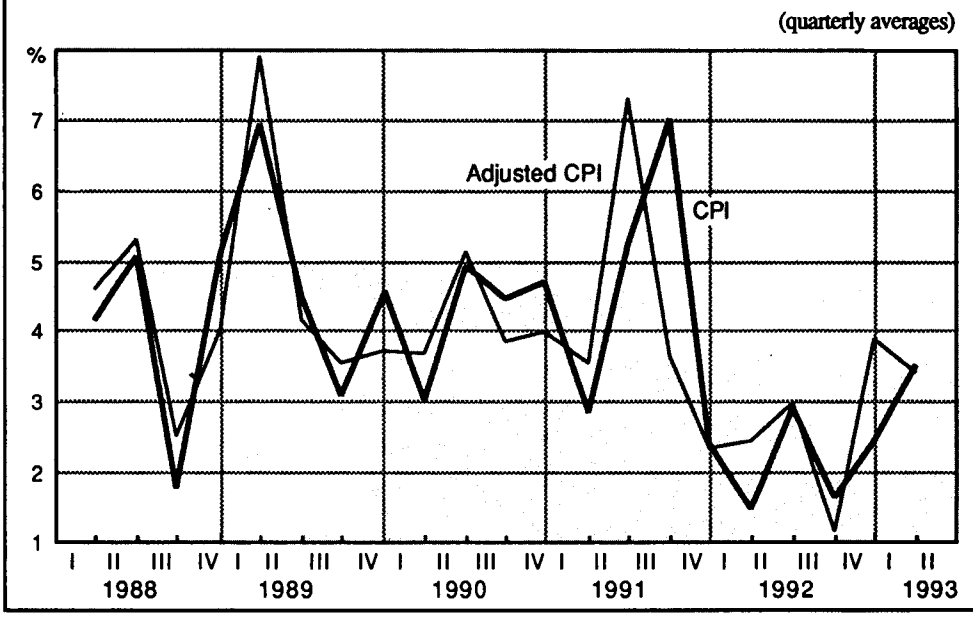
Housing

If demand and its composition develop out of step with output, there is pressure to change the prices of tradables, which are linked to world prices and the exchange rate, relative to those of nontradables, which are determined solely by domestic forces. Investment in housing rose by 4–5 percent in 1992, following the dramatic 76 percent jump of 1991. The increase in demand in 1990–91, particularly in construction, over and above the rise in output, contributed to real appreciation. In 1992, the expansion of construction was checked, reflecting the appreciable decline in immigration, and the trend was reversed. Prices of owner-occupied homes rose by only 3.4 percent during the year (10 percent annual average), after soaring by an annual average of 30 percent during each of the years from 1988 to 1991.

In the last quarter of 1991 and the first quarter of 1992 the housing component of the CPI fell by an annual rate of 15.4 and 12.7 percent respectively. This fall played an important role, after a short delay, in holding back the index excluding the housing component, which rose by 10.7 and 18.5 percent respectively in those quarters. In the second and third quarters the housing component rose by 18.6 and 17.5 percent respectively (in line with the previous overall level of about 18 percent), while the CPI excluding housing went up by only 3 and 10.2 percent. There are a number of possible causes for the slowdown in the rate at which the CPI excluding housing rose during this period, and it is a reasonable assumption that the adjustment of the expectations of households and firms played a significant role. It can be claimed that housing made a valuable contribution to curbing inflation, in both the timing and the rate of fall. Once inflation, as measured by the CPI, had started declining, in the last quarter of 1991 and the first quarter of 1992, the role played by housing in the continued fall was relatively less significant, with the exception of the last quarter.

Using data from housing price surveys, which are published with some months' delay, to calculate an adjusted index which takes into account the correct quarterly change in housing prices as published with a one-month delay, we found that the actual

Figure 3.4
The CPI and the Adjusted CPI, 1988-93[a]



[a] Rates of change. For definitions, see text.

price increases reflected by the CPI in the first quarter of 1992 had a downward bias: the CPI rose on average in that quarter by 1.4 percent, whereas the adjusted index rose by 2.4 percent (Figure 3.4). The same can be seen in the last quarter. Inflation in 1992 as measured by the adjusted index is higher than that shown by the CPI (Table 3.4). The adjusted CPI is a good ex post indicator of the actual movement in prices, hence its importance for purposes of analysis; but it is clear that the CPI, which is published regularly, is the index referred to by economic agents, and which influences the reactions of households.[3] The marked rise in actual housing prices in the last quarter (6.9 percent quarterly average) despite the large supply of apartments, is due, among other things, to the substantial change in the exchange rate during this period. Particularly notable was the change in the NIS/dollar exchange rate, in view of the fact that most prices in the housing market are still quoted in dollars. This upward trend in housing prices continued in the first quarter of 1993.

The rent index rose faster than that of housing prices in 1992, due to the shortage of rental accommodation in the main population centers, where demand soared. This demand results from the facts that immigrants are still waiting for solutions to

[3] This is not intended as criticism of the way the CPI is calculated. This is done in the best possible way in real time, but ex post it is possible to calculate an index based on actual price data received after a delay.

their problems of finding appropriate employment, that there are difficulties in the housing loans market, and that immigrants' patterns of demand for accommodation may differ from those of the established population.

Cost variables

Changes in wages, in the number of hours worked per employee, and in productivity are all reflected in unit labor costs, which rose by 10.1 percent in 1992—less than in 1991 and more than in 1990 (Table 3.5). Unit labor costs are an important measure of economic costs, and can help to explain inflation. In recent years the inflationary process has shown a high degree of inertia; as a result of nominal rigidities in the labor market, wages in the past rose very rapidly, faster than price increases, pulling prices of nontradables, which are labor-intensive, after them.

The relatively high rate of unemployment prevailing since 1989, even before the influx of immigrants began, played a part in reducing these rigidities in 1989–91, and real hourly wages in the business sector fell by a cumulative 9 percent. The 1989 decline in real wages offsets the exceptional increases which followed the introduction of the ESP, while the continued reductions in 1990 and 1991 were due mainly to the increase in the actual and potential labor supply arising from immigration, which was not matched by a rise in the demand for labor. Moreover, from 1988 to 1991 the increase in nominal wages per employee post in the business sector continued to slow down, even though the inflation rate was stable. In 1992 real hourly wages continued to fall, while total real wages rose. This can be explained by the considerable increase in the number of man-hours in 1992. In terms of 'cost inflation,' the decline in wages, with its immediate or delayed effect, partly explains the fall in inflation.

Production profitability rose during 1992. The decline in unit labor cost which resulted from, among other things, the abolition of employers' tax in mid-1992, and the moderation of the rate at which prices of imported intermediates rose, reduced production costs, while real financing costs were similar to those in the previous year: both long- and short-term real interest rates (ex post) remained basically unchanged (see Chapter 7).

Controlled and supervised goods

Commodities whose prices are controlled by the government include those which are subsidized (currently only bus travel) or are supplied by public authorities The relative weight of these items in the CPI has declined since the ESP, and they currently account for some 13 percent. The share of supervised goods fell to about 10 percent.

Prices of controlled and supervised goods have had less effect on the inflation rate in recent years, as their weighting in the CPI has declined. The signals broadcast by the

Table 3.5
Price Developments: Related Indicators, 1989–92

(annual change, percent

	Average				During period[a]			
	1989	1990	1991	1992	1989	1990	1991	1992
Price changes								
Imports								
Intermediates[b,c]	20.8	7.9	7.9	3.5				
Consumer goods[c]	6.3	12.3	9.7	11.6				
Producer durables[d]	15.8	8.4	14.9	10.8	20.0	4.8	15.3	12.9
Exports (excl. diamonds)[d]	18.0	9.7	11.1	8.4	18.6	10.8	11.0	11.2
Real change in GDP and use of resources								
GDP[d]	1.3	5.8	6.2	6.6	2.0	7.8	9.3	0.1
Domestic use of resources[d,e]	–0.4	8.0	12.2	7.0	0.0	11.8	14.4	0.9
Exports (excl. diamonds)[d]	7.4	5.2	1.3	14.6	10.3	1.6	14.6	4.1
Unit labor cost	–0.8	–2.5	–6.0	–0.5				
Nominal change in labor costs								
Public-sector wages								
per employee post	20.7	17.3	20.8	11.5	14.5	20.5	16.2	10.9
Business-sector wages								
Wage per employee post	18.3	15.5	12.8	14.0	15.0	16.4	13.0	12.6
Wage per employee post excl. COLA[f]	13.3	9.8	7.0	11.8				
Wage per man-hour	15.0	15.2	15.4	11.2				
Wage per man-hour excl. COLA[f]	5.8	6.2	4.9	5.4				
Unit labor cost	16.1	8.5	12.2	10.1				
General government deficit (percent of GNP) (-)								
Total	–6.1	–4.0	–4.3	–2.4				
Domestic	–8.3	–6.9	–7.3	–5.7				
Monetary indicators								
Change in M1	25.8	26.8	28.2	19.0	37.2	29.8	15.0	33.4
Change in M2	17.9	24.6	35.1	24.1	35.0	37.7	26.9	21.2
Interest rate								
Bank credit	31.2	26.4	26.4	19.9				
Overdraft facilities	34.3	29.6	29.9	22.0				
Long term[g]	1.7	1.2	2.1	2.3				
Unemployment rate	8.9	9.6	10.6	11.2				
Change in exchange rates								
Currency basket	16.1	10.6	12.3	10.2	20.3	10.6	12.8	11.5
Dollar	19.9	5.2	13.0	7.9	23.5	2.0	16.7	10.9

[a] Change from fourth quarter of preceding year to fourth quarter of current year.
[b] Excluding fuel and diamonds.
[c] Foreign trade data at effective exchange rate, including tariffs.
[d] National accounts data.
[e] Excluding direct defense imports.
[f] Nominal wage increase not due to increase in prices. COLA = Cost of Living Allowance.
[g] Real gross yield to maturity on 5-year CPI-indexed government bonds.
SOURCE: Based on Central Bureau of Statistics data.

increases in prices effectively determined by the government, and especially of controlled goods, have in the past been consistent with inflationary expectations. The public assessed that the government intended raising prices under its control at a slightly higher rate than that of inflation, and this influenced its expectations. In this sense controlled goods played a similar role in 1992, too: the rate at which their prices increased slowed, but was still above the inflation rate. Prices rose mainly in services, education, and health funds; excluding the latter, prices of supervised items rose by an average of only 11.7 percent.