

## BANK OF ISRAEL

The Government and  
Finance Committee of the Knesset  
Jerusalem

In accordance with sections 59 and 60 of Bank of Israel Law, 5714-1954, I respectfully submit herewith the Annual Report of the Bank of Israel for 1979

During the year surveyed inflation accelerated to more than 100 percent, and the deterioration in the balance of payments became more acute. The latter was largely due to the steep rise in world fuel prices, a development that will probably continue to burden the world economy and constitutes a long-term problem for Israel.

Labor productivity rose by only one percent, making this the fifth consecutive year without any significant progress in this area. Real unit labor costs, on the other hand, increased by about 10 percent, at a time when the state of the economy and the energy crisis called for a reduction in such costs.

The various policy measures introduced during the year—particularly the restriction of credit, indexation of development loans, abolition of subsidies, and freezing of public sector employment—resulted in some (apparently temporary) cooling of inflation and strengthening of the balance of payments at the end of 1979 and beginning of 1980. But in the prevailing circumstances it is imperative that the government implement a balanced economic policy, comprising public spending cuts, continued monetary restraint, and a stabilizing incomes policy.

If the necessary contractionary fiscal measures are not implemented, monetary policy may well have too adverse an effect on business sector activity, thereby preventing, in the longer run, the structural change required for stable economic growth.

Without a proper incomes policy geared to the existing conditions in the Israeli and the world economy this country may slide into stagflation, i.e. an increase in unemployment without any significant slowing of inflation. A balanced implementation of the various policy instruments will arrest the inflationary spiral in the short run and bring about a structural change and steady growth in the longer run.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'a. Gafny', with a long horizontal stroke extending to the right.

Arnon Gafny  
Governor  
Bank of Israel

Jerusalem, 14 Sivan, 5740  
May 29, 1980