

Chapter 6

The Balance of Payments

1. MAIN DEVELOPMENTS

The balance of payments showed a marked improvement in 1989: there was a surplus in the adjusted¹ current account of around \$1 billion (2 percent of GNP) compared with a deficit of \$150 million in 1988. Moreover, the net external debt declined by \$2.4 billion, or 6 percent of GNP (Table 6.1). The net reduction in the external debt was mainly on the asset side, with the reserves rising by \$1.4 billion and commercial bank assets abroad rising by \$650 million.

In volume terms, exports rose faster than imports this year: excluding trade in diamonds, which contracted, exports rose by 7 percent and civilian imports by no more than 2 percent. Net interest payments to the rest of the world were also down this year; the steep rise in fuel prices, however, reduced the drop in import surplus. All in all, the civilian import surplus declined by \$600 million, about half of the improvement in the current account; the rest is accounted for by a steep (\$450 million) increase in private transfers from abroad and a reduction in payments for direct defense imports (by \$100 million).

This year's improved balance-of-payments situation is in part due to transient factors—the recession reduced the import surplus, and the weakening of devaluation expectations (compared with 1988) increased private transfers from abroad. The time-series data indicate that the current account has balanced since the stabilization program, as against a large deficit in the years preceding it.

The sheqel was devalued (against the currency basket) at the end of December 1988 and at the beginning of January 1989, by 13.4 percent altogether. At the same time, a band of variation (of ± 3 percent) was introduced, with the new rate serving as midpoint. The midpoint rate was raised by 6 percent in June and on average for the year, the rate rose by 16.3 percent, compared with 2.4 percent in 1988.

Import and export prices (in local-currency terms) were also affected by a number of measures designed to unify exchange rates. At the beginning of the year, tariffs were reduced on a wide range of imports, with further reductions in the course of the year; so that the effective exchange rate of civilian imports (excluding interest) was 3 percent

¹ The adjusted current account records defense flows on a cash basis, since defense imports are subject to sharp annual fluctuations while the payments for them are much more regular, as is the military aid which finances them.

Table 6.1
Selected Balance-of-Payments Indicators, 1977-89

	1977-81	1982-84	1985	1986	1987	1988	1989
<i>Billions of current \$</i>							
Total current account	-0.6	-1.7	1.1	1.6	-0.9	-0.6	1.2
Adjusted current account ^a	-0.7	-1.8	1.0	1.0	-0.1	-0.1	1.0
Import surplus							
Total	3.3	4.6	3.8	3.8	5.8	5.2	3.7
Civilian ^b	1.8	3.3	2.0	2.6	3.3	3.1	2.5
Civilian, excl. capital services	1.2	2.1	0.3	1.0	1.8	1.4	1.1
Net unilateral transfers							
To public sector	1.6	1.9	4.2	4.2	3.3	3.2	3.1
To private sector	1.1	0.9	0.8	1.2	1.6	1.4	1.8
Implied private capital imports ^c	-0.9	-0.1	0.7	-1.6	0.4
External debt							
Gross	10.2	17.2	18.4	18.2	18.2	18.8	16.4
Net	18.5	28.6	29.4	30.6	31.8	31.3	31.1
Foreign reserves	3.0	3.8	3.8	4.9	6.0	4.8	6.1
<i>Annual change, percent (volume)</i>							
Exports ^d	9.0	4.8	5.3	1.4	8.7	-3.2	6.8
Civilian imports ^d	5.8	5.4	-7.3	12.5	11.9	-1.2	1.8
World trade	3.6	3.1	3.3	4.9	6.5	9.0	7.6
Selected indicators							
Exchange rate							
Against the dollar	0.004	0.12	1.18	1.49	1.59	1.60	1.92
Against the 5-currency basket	0.005	0.11	1.07	1.47	1.68	1.72	2.00
Net external debt as percent of							
GNP	58.8	67.9	80.0	63.3	53.2	45.1	38.4
Exports	128.6	165.2	169.0	154.0	130.6	122.9	98.5
Relative prices (1980 = 100)							
Exports/domestic resource use ^e	100	87	93	80	79	72	70
Imports/domestic resource use ^e	102	93	93	82	79	75	74
Terms of trade ^f	105	109	109	114	111	116	113

^a Corrected for advances on defense imports. See note 1 in the text.

^b Excluding direct defense imports.

^c Calculated from the last row of Table 6.A2.

^d Excluding diamonds and capital services.

^e Implicit price index of exports (imports) + by implicit price index of domestic use of resources (from the national accounts). Excludes direct defense imports and diamonds.

^f Excluding capital services, diamonds, and direct defense imports.

SOURCE: Based on Central Bureau of Statistics data.

lower than it would otherwise have been. On the export side, the exchange-rate insurance premium was raised, thereby lowering the effective exchange rate on exports by close to 2 percent.

In spite of the year's accelerated devaluation, import and export prices were down by respectively 3 and 1 percent relative to domestic prices (implied prices of domestic use of resources).² The index of unit labor costs in industrial exports, however, declined by 3 percent (Table 6.8). In other words, exports have become more profitable, although the improvement by no means makes up for the erosion of the preceding few years. In the last two years industrial production has become more export-oriented, with exports rising while total output is down. This year's recovery of exports is therefore to be explained chiefly by market developments—the domestic market contracted and world trade expanded rapidly.

Capital flows continued to be subject to sizable speculative cycles. The devaluations of late 1988 and early 1989 brought a first-quarter inflow of \$1.5 billion, which followed an outflow of about the same size in the preceding quarter. Net capital outflows resumed before the June devaluation, but expectations failed to moderate when it materialized and continued to intensify until the end of the year, as did the capital outflow. The speculative swing of the end of 1989 was modest compared with that at the beginning of the year. Thus the year as a whole shows a net inflow of \$400 million.

The speculative cycles dominate the other features of the capital account. These cycles apart, the decline in local-currency interest rates and the rise in world rates increased the relative yield of foreign-currency denominated assets and the relative cost of foreign credit, and resulted in capital outflows.

This year's steep decline in the net external debt carries on the last few years' downward trend of the debt/GNP ratio—from 80 percent in 1985 to 45 percent in 1988 and 38 percent in 1989. Close to half of the improvement reflects contraction of the debt and expansion of GNP, the rest being due to the change in GNP prices in dollar terms—the weakening of the dollar and the appreciation of the sheqel against the currency basket. The debt/export ratio dropped from 169 percent at the end of 1985 to 99 percent at the end of 1989.

The contraction of the debt and the balanced current account of the last few years provide a sound basis for economic growth, although at the investment stage growth is liable to be accompanied by a current-account deficit and a temporary rise in the debt. Once the investment becomes productive, the debt should contract again—but it will do so only if the prices confronting investors reflect the full cost of the incremental debt. In this context, immigrant absorption can be regarded as an investment which will bear fruit in the future, and as such it justifies a rise in the external debt.

Liberalization of capital movements, which should accelerate these processes, has been under way since early 1988. There are two obstacles to the more rapid removal of restrictions: the risk of exacerbating the speculative swings and the magnitude of the

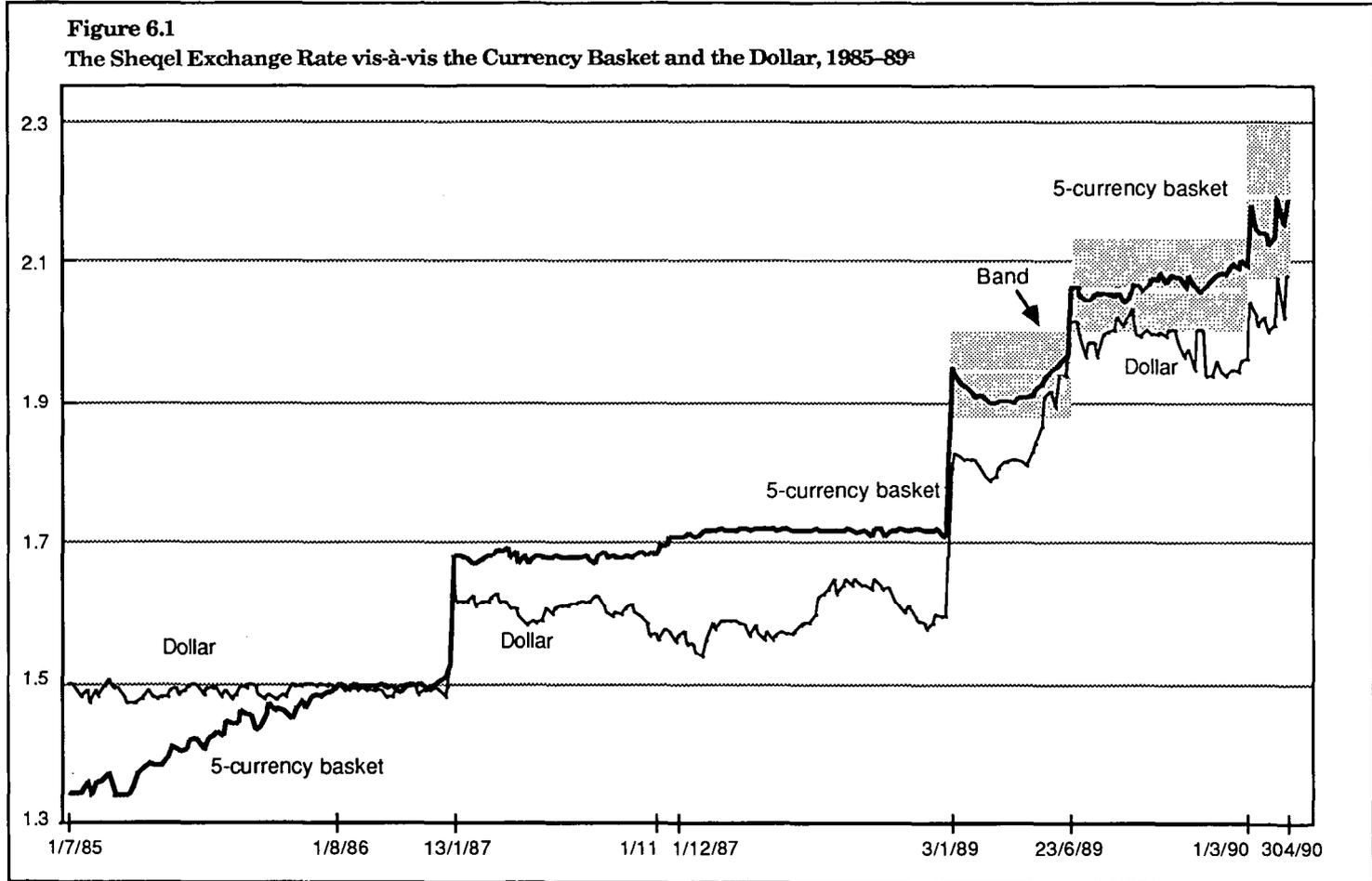
² These figures exclude trade in diamonds, which have little effect on other imports and exports.

domestic public debt. The speculative cycles are generated by devaluation expectations due to the high rate of domestic inflation relative to that in the country's trading partners. Thus the persistence of inflation at its present level prevents faster liberalization. A solution of this problem would not eliminate the need to take account of the prominence of government bonds in the public's portfolio. Once restrictions are relaxed, the public will want to adjust its portfolio in favor of foreign assets—and the government will have to find alternative sources of finance and increase its foreign indebtedness. The reluctance to allow individuals to do so stems, as said, from the magnitude of the domestic public debt.

Further liberalization of foreign trade is also required. Although unification of exchange rates was embarked upon this year, administrative restrictions are evidently still extensive, and interfere with the functioning of the exchange-rate regime as an anchor for domestic prices as well as holding back the improvement of economic efficiency in general. Administrative protection permits producers to raise domestic prices with impunity. The emergence of import monopolies has similar effects. Current procedures frequently favor large or exclusive importers for reasons of administrative convenience and this area would therefore appear to be ripe for reform.

2. THE EXCHANGE-RATE REGIME

The stable exchange-rate was introduced in July 1985 as part of a comprehensive economic program designed to bring down inflation, which did indeed drop from well into three digits to the 16–20 percent level of the last few years. But this is still too high to keep the exchange rate fixed for very long, and the rate has been adjusted several times. (Figure 6.1). Until July 1986 the sheqel was kept more or less stable against the dollar, but depreciated markedly against the European currencies as the dollar weakened. A five-currency basket was therefore adopted as the peg, which initially consisted of \$ (60 percent), DM (20 percent), £ (10 percent), FF_r (5 percent), and ¥ (5 percent), the weights approximating these currencies' share of Israel's trade. Since then the weights have changed in accordance with changes in cross rates. The first devaluation against the basket occurred in January 1987, when the rate was raised by 10 percent. In the last quarter of 1987 there was an unannounced devaluation of 2.5 percent, after which the rate was steady until the end of 1988, when a preliminary devaluation of 5 percent in late December was followed a few days later (in January 1989) by an 8 percent devaluation, the first instalment being the response to particularly heavy purchases of foreign exchange. The January devaluation was coupled with the introduction of a 6 percent range of variation; that is, the rate was to be permitted to move from the midpoint rate by up to 3 percent in either direction, and it was announced that rate fluctuations within this band would be set in accordance with short-term capital movements. The large capital inflow of early 1988 is reflected in a first-quarter decline of the exchange rate to almost



^a Weekly data (Mondays), in NIS per \$ or NIS per currency-basket unit.

the lower limit and a subsequent slow rise. The actual average exchange rate was (until the next devaluation) about 1½ percent below the midpoint, with a much higher variability than in the year before (Table 6.2). The midpoint rate was raised by 6 percent in June 1989, but devaluation expectations failed to dissipate and even intensified towards the end of the year. Over the last six months of 1989, the rate remained in the vicinity of the midpoint, with a slight upward trend, and it became less variable. The midpoint rate was again raised by 6 percent in February 1990 and the band was widened to ±5 percent. The day before devaluation the rate was within the new band, and on the day after there were substantial sales of foreign exchange; the actual exchange rate was therefore unaltered. It then rose, with some minor fluctuations, but at the end of April 1990 it was still below the midpoint rate.

Table 6.2
The Exchange Rate, 1985–90^a

	Average exchange rate	Coefficient of variation ^b (percent)	Midpoint rate ^c	Band (percent)	Maximum deviation	
					Up	Down
1.7.85–31.7.86	1.49	0.6				
1.8.86–12.1.87	1.50	0.4				
13.1.87–30.10.87	1.68	0.2				
1.12.87–25.12.88	1.72	0.2				
3.1.89–22.6.89	1.92	1.1	1.95	±3.0	+1.6	-2.6
23.6.89–28.2.90	2.07	0.7	2.07	±3.0	+1.9	-1.1
1.3.90 ^d	2.14	0.7	2.19	±5.0	..	-4.3

^a November 1987 and the week starting 26.12.1989, during which devaluation occurred, are omitted. Dollar rate until 31.7.86 (first line); thereafter the rate quoted is against the 5-currency basket.

^b Calculated from daily data.

^c The band was announced on 13.1.89.

^d Minimum deviation calculated on data for 1.3.90–30.4.90. The rate did not rise above the midpoint during this period.

SOURCE: Bank of Israel.

Thus since June 1989 there have been sizable changes in exchange-rate management, which can be said to have gained flexibility in two respects since the beginning of 1989. First, devaluations have become more frequent (at 6–8 month intervals) and smaller (of the order of 6 percent). The second point is the introduction of the band. Some comments on the way this increased flexibility relates to inflation and the speculative cycle are in order.

The rate of devaluation and changes in import prices in the domestic market show much greater annual variation than does the level of inflation. The persistence of the rate of inflation suggests that the correlation between devaluation and inflation is quite weak in the short run in spite of the strong long-run correlation. This can be explained by the

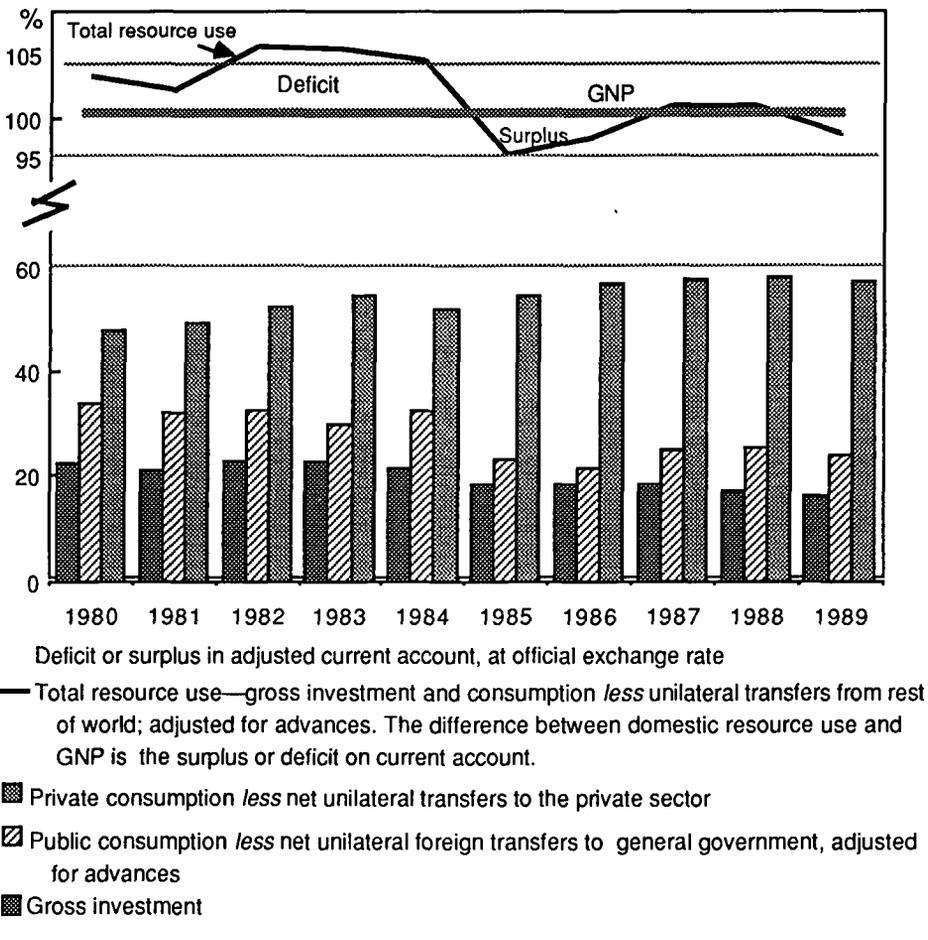
Table 6.5
Goods and Services Account, 1986-89^a

	\$ million				Annual percentage change					
					Price			Quantity		
	1986	1987	1988	1989	1987	1988	1989	1987	1988	1989
Imports										
Goods excl. fuel and diamonds	6,385	7,992	8,374	8,460	9.8	9.5	1.0	14.0	-4.4	0.0
Fuel	924	1,148	1,062	1,247	22.0	-20.3	22.2	1.8	16.1	-3.9
Diamonds	1,598	1,901	2,415	2,580	3.5	8.8	36.1	14.9	17.5	-21.5
Services, excl. capital services	2,616	3,172	3,561	3,848	9.7	1.9	2.2	10.5	9.8	5.7
From Judea-Samaria and Gaza	727	973	827	871	20.5	23.9	-4.4	11.1	-31.4	10.2
Subtotal: Civilian imports	12,250	15,185	16,239	17,005	10.4	5.7	6.5	12.3	1.2	-1.7
Capital services	2,501	2,438	2,632	2,646						
Direct defense imports	1,202	2,472	2,106	1,225						
Total imports	15,954	20,095	20,977	20,877						
Exports										
Goods, excl. diamonds	5,211	6,078	6,913	7,580	8.5	10.3	0.7	7.5	1.7	8.9
Diamonds	1,665	2,059	2,547	2,738	1.4	21.0	17.3	22.0	2.3	-8.3
Services, excl. capital services	3,430	4,141	4,467	4,745	8.5	9.0	-0.2	11.3	-1.3	6.4
To Judea-Samaria and Gaza	970	1,148	869	819	10.9	16.8	0.8	6.7	-35.2	-6.5
Subtotal	11,276	13,426	14,796	15,882	7.6	12.0	2.9	10.7	-2.3	4.3
Capital services	850	861	1,000	1,269						
Total exports	12,126	14,288	15,796	17,151						
Surplus on services account	814	969	906	897						
Import surplus										
Civilian, excl. capital services	974	1,759	1,442	1,123						
Civilian import surplus	2,625	3,335	3,074	2,500						
Total import surplus	3,827	5,807	5,180	3,726						

^a Imports c.i.f., exports f.o.b.

SOURCE: Based on Central Bureau of Statistics data.

Figure 6.2
Domestic Use of Resources and the Adjusted Current Account, 1980-89^a



^a Percent of GNP at the official exchange rate.

SOURCE: Based on Central Bureau of Statistics data.

is ascribable to increased unilateral transfers to both the private and public sectors, and the rest to the decline in the ratio of civilian import surplus to GNP.

The civilian import surplus dropped by \$570 million in 1989: excluding diamonds and interest payments, there was a \$290 million decline in the surplus; net interest payments to the rest of the world fell steeply, by \$250 million, and there was a small increase in the export surplus of diamonds. In volume terms, higher exports and lower imports reduced the gap between them by \$600 million, but about half of this gain was offset by

terms-of-trade deterioration. This contrasts with 1988, when a terms-of-trade improvement of \$600 million was offset by volume changes in the opposite direction.

The 1989 deterioration in the terms of trade stemmed chiefly from the 22 percent rise in oil prices (which declined by a similar figure in 1988) and from the extremely unfavorable movement of relative diamond prices. Prices of other commodities rose more slowly, at about the same rate for imports and exports. The terms of trade worsened slightly for services and improved for trade with the administered territories. The terms of trade have not been stable in the last few years, but they are still better than at the beginning of the decade.

Trade in diamonds contracted sharply (by 21 percent for imports and 8 percent for exports), but the effect on other industries is small. Excluding diamonds, the volume of merchandise exports rose by 9 percent, and there was virtually no change in imports. Most of the quantitative improvement in the civilian import surplus therefore stemmed from the contraction of the trade deficit (excluding diamonds).

The export surplus of services (excluding interest) did not grow this year, the volume of imports and exports rising by roughly 6 percent. Exports of transport services were hit by the recession, while tourism showed partial recovery, with an 11 percent increase—in 1988, this item was down by 12 percent, presumably because of the *intifada*. Trade with the administered territories has also suffered drastically: the volume of trade fell by more than 30 percent in 1988, and in 1989 exports were down by 7 percent, while imports rose by 10 percent; the \$210 million trade surplus of 1986–87 has thus become the \$40 million surplus of 1988 and the \$50 million deficit of 1988–89.

The contraction (in volume terms) of the import surplus means that the gap between GNP and domestic resource use has narrowed. In years of full employment annual variations in the import surplus are determined primarily by domestic resource use. It follows that the explanation of changes in the current account lies chiefly on the demand side (Figure 6.2).

Table 6.6

Composition of the Change in the Volume of Exports, 1976–89^a

	(percent change over preceding year)				
	1976–85	1986	1987	1988	1989
Industrial	4.0	2.6	3.9	1.6	3.9
Agricultural	0.3	0.6	-0.4	-0.8	0.2
Diamonds	0.0	3.3	3.2	0.4	-1.4
Tourism and exports to					
Judea–Samaria and Gaza	1.0	-1.5	2.2	-4.2	0.5
Other services (excl. capital services)	1.3	-0.1	1.8	0.7	1.1
Total change in exports	6.6	4.9	10.7	-2.3	4.3

^a The rate of change in each export category weighted by exports in the preceding year.

SOURCE: Based on Central Bureau of Statistics data.

The last two years have witnessed the emergence of unemployment, which reached 9 percent in 1989. In these conditions, expansion of domestic demand ceases to militate against current-account improvement and the onus of explanation shifts to the supply side, particularly in view of the modest rise in demand of 1988 and the decline of 1989: the question is why—in spite of the release of factors of production and the favorable demand conditions, both foreign and domestic—exports failed to increase more than they did. In 1988, exports fell by over 2 percent, and this year's 4.3 percent rise falls short of the average growth rate of the 10 years preceding the stabilization program.

These developments are analysed in Table 6.6. The effects of the *intifada* are prominent in the 1988 slack, as evidenced by the decline in tourism and in exports to the administered territories, but the performance of industrial exports is also well below that of 1976–85. In 1989 the slump in diamond exports pulled down the average and explains a good part of the slowdown. The contribution of industrial exports to the total export increment more than doubled in 1989, but in spite of the favorable demand conditions, it was still no higher than the average for the decade preceding the stabilization program.

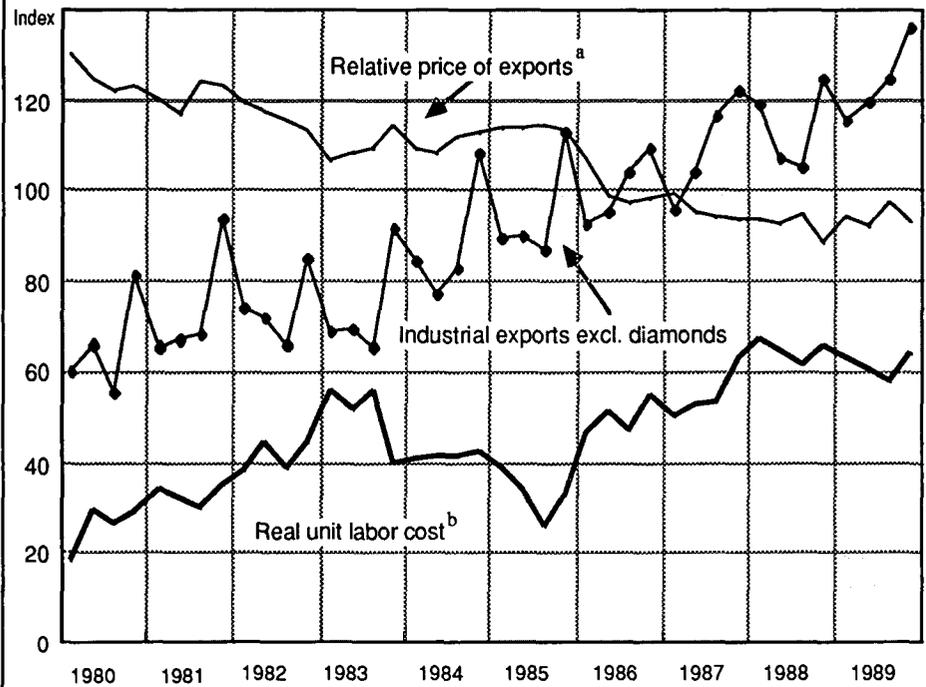
Merchandise exports

Merchandise, which accounts for two thirds of total exports, came to \$10.3 billion (\$7.6 billion excluding diamonds) in 1989, most of it industrial products (Table 6.7). Exports to the administered territories came to \$0.6 billion.

Industrial exports

Industrial exports other than diamonds rose by 9 percent in 1989 (compared with 4 percent in 1988), or a little faster than the 1980s average of 7.5 percent. The expansion of world trade and the contraction of domestic demand both helped; however, past performance suggests that given the favorable demand conditions, industrial exports should have grown faster. As we saw, the explanation for its failure to do so must be sought on the supply side. Several indicators of export profitability are shown in Tables 6.1 and 6.8, and two of them are also shown in Figure 6.3 together with a volume index of industrial exports. The ratio of export prices to the implicit price of domestic resource use shows that relative export profitability trended downwards during the decade: it was fairly steady in 1984–85, declined in 1986–88 and levelled off in 1989. The index of real unit labor costs, estimated directly from data for industry and industrial exports, shows a similar picture (the higher the unit labor costs, the lower is profitability). The volume of exports, on the other hand, rises at an annual average rate of 7.6 percent in 1980–85 and 6.9 percent in 1986–89, though with marked annual fluctuations. At the same time there is a steady rise in the share of exports in total industrial output, which rose by an annual 2.6 percent in 1980–85 and no more than 0.8 percent in 1986–89. In the last two years exports continued to rise while total industrial output contracted (a result still obtained

Figure 6.3
The Profitability of Industrial Exports, 1980-89



^a Relative to domestic use of resources.

^b See Table 6.8.

SOURCE: Based on Central Bureau of Statistics data.

when the figures are corrected for the effects of the *intifada*; see *Annual Report 1988*). By the end of the period 47 percent of industrial production was exported. The expansion of industrial exports and the increased export orientation of industrial output are thus not consistent with the indicators of export profitability mentioned earlier.

One cannot of course conclude from this that exporting firms are not guided by profit considerations. Furthermore, export-oriented firms have by no means been exempt from the profitability crisis of the last few years. This is not the place to go into its causes, but the marked rise in real wages was undoubtedly one of them and it was particularly severe in exporting firms. Thus in 1984-88 real daily wages in industry rose by 40 percent when deflated by output prices of exports and by only 18 percent when deflated by domestic output prices; the corresponding figures for unit labor costs are 25 and 3 percent.

In 1989 profitability, as measured here, rose by 2-3 percent (for both destinations), and this falls far short of the cumulative deterioration of the preceding years. These figures assume that daily wages and gross value added per man-day rose at the same rate

Table 6.7
Merchandise Exports (f.o.b.), 1986–89^a

	\$ million				Annual percentage change					
					Price			Quantity		
	1986	1987	1988	1989	1987	1988	1989	1987	1988	1989
Agricultural exports	560	609	567	527	17.1	14.6	-11.5	-7.1	-17.9	5.1
Citrus	174	201	175	131	14.0	12.4	-4.7	1.1	-21.6	-21.9
Other	386	409	391	397	18.1	14.5	-13.6	-10.4	-15.3	17.2
Industrial exports ^b	4,709	5,534	6,336	7,023	7.5	9.9	1.9	9.3	3.9	8.8
Metals, machinery, electronics	2,204	2,413	2,834	3,187	6.1	5.6	1.3	3.2	10.4	11.0
Chemicals, rubber, plastics	975	1,260	1,390	1,579	6.6	6.9	4.2	21.2	3.5	9.1
Other	1,530	1,861	2,112	2,257	10.1	18.6	1.0	10.5	-4.4	5.8
Diamonds (net)	1,665	2,059	2,547	2,738	1.4	21.0	17.3	22.0	2.3	-8.3
Ships and aircraft	5	10	12	74						
less Returned exports	6	10	16	27						
<i>subtotal: FTS definition</i>	6,933	8,201	9,445	10,335	6.7	13.0	4.6	10.9	1.8	4.6
Balance-of-payments adjustments	-57	-64	14	-17						
To Judea-Samaria and Gaza	798	928	650	600	10.7	17.1	1.0	5.0	-40.2	-8.6
Total	7,674	9,065	10,110	10,918	7.1	13.2	4.4	10.3	-2.4	3.5
Total excl. diamonds and exports to Judea-Samaria and Gaza	5,211	6,078	6,913	7,580	8.5	10.3	0.7	7.5	1.7	8.9

^a New classification introduced in 1988. The rates of change for 1988 are based on the old classification.

^b Excluding diamonds, ships and aircraft, and Judea-Samaria and Gaza.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.8
Relative Wholesale Prices, Israel and Trading Partners, 1986–89

(1986 = 100)

	Relative prices ^a at							
	Official exchange rate (NIS)		Official exchange rate			Effective exchange rate (exports)	Unit labor cost ^c	Real daily wage ^d
	Against dollar	5-currency basket (basket 5)	US + Israel	Basket 4 ^b countries + Israel	Basket 5 countries + Israel			
1986	1.488	1.446	100.0	100.0	100.00	100.00	100.00	
1987	1.595	1.678	91.5	103.9	95.62	104.93	110.01	
1988	1.599	1.719	81.3	95.7	85.07	114.69	122.40	
1989	1.916	1.995	85.9	92.6	85.17	111.44	123.70	
1988								
I	1.575	1.717	82.4	100.5	87.66	116.83	120.78	
II	1.578	1.718	81.0	97.8	86.17	114.59	121.56	
III	1.638	1.717	82.6	91.7	84.41	111.57	119.39	
IV	1.605	1.722	79.3	92.6	82.05	115.77	127.87	
1989								
I	1.809	1.912	84.4	94.3	85.64	112.98	119.95	
II	1.880	1.941	85.8	90.1	84.20	110.52	123.82	
III	1.995	2.055	87.8	92.4	86.07	108.11	122.51	
IV	1.982	2.073	85.7	93.6	84.78	114.15	128.52	
1990								
I	1.967	2.104	85.5	97.1				

^a The NIS exchange rate *multiplied* by the index of foreign wholesale prices *divided* by the index of wholesale prices of manufacturing output for the domestic market (excluding food).

^b The 5-currency basket excluding the \$, that is, DM, £, FF_r, and ¥.

^c Unit labor cost = $W/(P_x EY)$, where W is the nominal daily wage, P_x is the dollar price exports, Y is daily output (all for industry excluding diamonds); and E is the effective exchange rate for industrial exports excluding diamonds.

^d Daily wage = $W/(P_x E)$.

SOURCE: Exchange rates—Bank of Israel; other Israeli data, CBS; foreign prices, *IFS*.

for both exported and domestic output, since the two cannot be separated—the only indicator which enables us to distinguish between locally sold and exported output is the different price (in local-currency terms) obtained in the domestic and foreign markets. Such data as are available indicate that the faster growth of exports cannot be explained by differences in proceeds.

The explanation of the rising trend of exports must therefore be sought elsewhere. One possibility is specialization: entering the world market makes industry less dependent on the small domestic market with its relatively variable demand and enables it to enjoy economies of scale. A complementary development is shown by imports, which during the 1980s grew faster than total resource use by an annual average of about 2 percent. This is not peculiar to Israel; in the past four years world trade has expanded about twice as fast as world output, demonstrating the importance of specialization in stimulating world trade.

The recovery programs undertaken in several large plants stress raising efficiency, closing down less profitable lines, and expanding more profitable ones—in other words, specialization. The rise in real wages was among the principal causes of the difficulties encountered by such firms, but because of the downward rigidity of wages recovery can only be achieved by raising labor productivity (see Chapter 4). Recovery is accompanied by lay-offs and—sometimes—by an initial fall in output together with rising productivity and profits. As we saw, specialization favors exports because of the small size of the domestic market.

Another way in which profitability can be raised is to shift to products with a higher profit margin. These are as a rule innovative and special-purpose products resulting from R&D, which enable the producer to obtain better prices than for standard items mass-produced by cheap labor. The higher profit is associated with the cost of market penetration and the premium on the risk entailed by shifting to this type of product. Again, such products are intended for export from the outset, because the domestic market is too small (see *Annual Report 1988*, Chapter 6). The investment data, however, show little evidence of any marked shift to new products; since the export share of hi-tech products did rise, the inference is that there was a comparatively low proportion of hi-tech firms among the closures.

Specialization and a rise in the proportion of hi-tech products should both be reflected in the labor productivity figures (product per man-day). This ratio rose slightly in 1988 (by 1.7 percent, while industrial product declined by 3 percent). The full effect of recovery programs (which were started by some firms in 1988) is probably not visible because of the decline in productivity of other firms. The recovery process gathered momentum in 1989, and its effects are already discernible in the average data available, with product per man-hour rising by 4 percent. On this reading, the rise in export orientation is thus not a response to a rise in (even relative) export profitability. It is rather the result of specialization and of concentrating on products which are pre-eminently suited for export—in response to the excessive rise in labor costs. The still-low level of profits explains why industrial output failed to grow, and in particular, why

the rise in the growth rate of exports falls short of what is called for by the expansion of world trade and the contraction of domestic demand.

The duration of the adjustment process, with drastic measures being taken only at the point of crisis, may be connected with the learning process characterizing the response of producers and consumers to changes in government behavior after the 1985 stabilization program—and hence to the considerable changes in domestic and foreign demand of the period.

In the last few years world trade has expanded rapidly, although this year it did slow down slightly—from 9 percent in 1988 to 7.6 percent in 1989 (Table 6.1). Trade in industrial products expanded even faster, by 10.5 percent in 1988 and 8.3 percent in 1989. By-industry details are not available, but information on a marked increase in investment by the industrial countries implies an even greater increase in demand for producer durables.

Domestic demand conditions have also altered considerably: private consumption rose substantially in 1986–87 and contracted in 1988–89. Defense consumption has been steady throughout the period. The weakening of the dollar in 1986–87 also affected export industries in accordance with the geographical distribution of exports.

The combination of factors involved affected the various export industries very differently. As early as 1986–87, the electrical and electronics industry was hit by the decline in foreign and domestic demand for armaments, as well as by the weakening of the dollar (the relevant currency for these exports). This industry therefore began to respond quite early, and the result is a marked rise in exports in 1989, helped by increased world demand for capital goods.

Industries whose exports consist chiefly of consumer goods and whose main destination is Europe (an outstanding example is textiles and clothing) benefited from a strong rise in demand (both domestic and foreign) and from the strengthening of the European currencies in 1986–87; and they were particularly hard hit in 1988–89, as domestic demand shifted and foreign cross rates steadied, and their exports fell steeply. These industries responded comparatively late and the streamlining process is at present in full swing.

The development of the chemicals and plastics industries, which export both to Europe and to the dollar area, comes somewhere between these two extremes.

Civilian merchandise imports

The last four years' business cycle is strongly reflected in imports of merchandise. Thus an average increase of 15 percent in 1986–87 was followed by an average decline of 2 percent in 1988–89 (Table 6.9). If some items affected by special factors (fuel, diamonds, and imports from the administered territories) are excluded, we get a 4 percent decline in 1988 and no change in 1989.

Imports of consumer durables and motor vehicles purchased by firms, were down by

Table 6.9
Merchandise Imports (c.i.f.) by Economic Destination, 1986–89^a

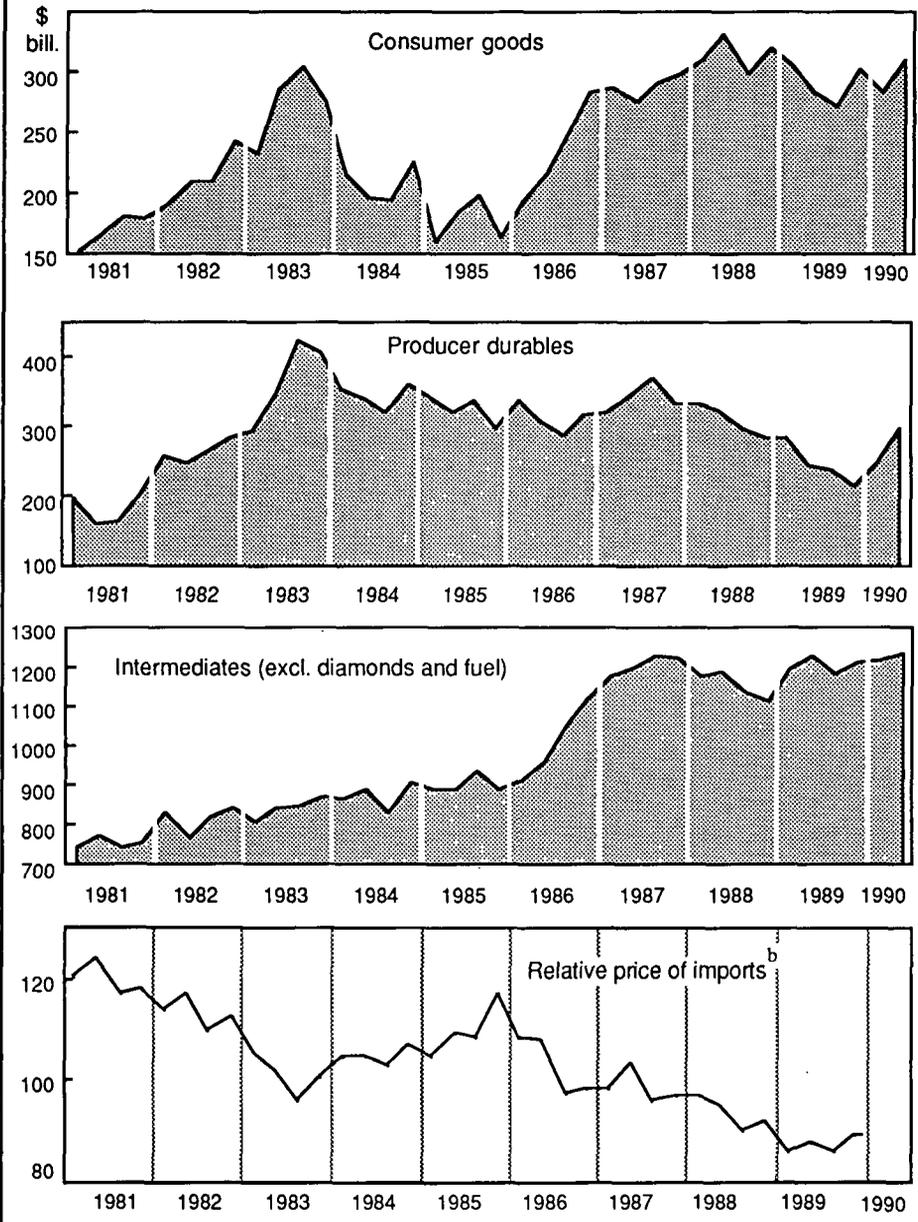
	\$ million				Annual percentage change					
					Price			Quantity		
	1986	1987	1988	1989	1987	1988	1989	1987	1988	1989
Consumption	1,029	1,337	1,463	1,326	14.4	2.6	-0.9	13.5	12.9	-8.5
<i>of which</i> Durables	454	627	727	559	19.1	1.4	-4.1	16.0	15.5	-19.9
Investment	1,604	2,148	1,971	1,614	15.5	4.2	-3.1	15.9	-7.5	-15.5
<i>of which</i>										
Machinery and equipment	1,295	1,539	1,361	1,235	13.6	4.2	-1.9	4.6	-8.4	-7.4
Land transport equipment	302	486	511	327	22.6	3.6	-19.3	31.0	-0.2	-20.7
Intermediates	6,846	8,216	9,112	9,840	7.7	9.6	9.6	11.4	-0.7	-1.4
Fuel	924	1,148	1,062	1,247	22.0	-20.3	22.2	1.8	16.1	-3.9
Diamonds (net)	1,598	1,901	2,415	2,580	3.5	8.8	36.1	14.9	17.5	-21.5
Other	4,324	5,168	5,635	6,014	6.5	13.8	2.5	12.2	-7.4	4.1
Merchandise n.e.s. ^b	-195	-246	-259	-44						
<i>subtotal: FTS definition</i>	9,285	11,455	12,287	12,737	9.8	7.7	6.7	12.4	-0.4	-2.8
Balance-of-payments adjustments	-378	-415	-437	-450						
From Judea–Samaria & Gaza	275	304	170	200	4.7	8.5	-3.3	5.7	-48.4	21.6
Total	9,181	11,344	12,021	12,486	9.7	7.7	6.5	12.7	-1.6	-2.5
Total excl. diamonds and imports from Judea–Samaria & Gaza	6,385	7,992	8,374	8,460	9.8	9.5	1.0	14.0	-4.4	0.0

^a New classification introduced in 1988. The rates of change for 1988 are based on the old classification.

^b Net of returned imports.

SOURCE: Based on Central Bureau of Statistics data.

Figure 6.4
Merchandise Imports, 1981-89^a



^a Quarterly data, seasonally adjusted, at 1986 prices.

^b Relative to domestic use of resources.

SOURCE: Based on Central Bureau of Statistics data.

20 percent this year, while other producer durables and consumer goods declined by less. Imports of intermediates (excluding fuel and diamonds), on the other hand, rose by 4 percent; imports from the administered territories, which halved in 1988, rose by 22 percent in 1989.

Table 6.10
Import Taxation, 1980-89^a

	(percent)			
	1980	1986	1988	1989
Average tax rate				
Consumer nondurables	25	25	27	23
Consumer durables	120	97	98	74
Intermediates	3	7	6	4
Producer durables				
Machinery and equipment	9	11	11	10
Motor vehicles	43	83	73	64
Total imports	8	16	16	11
Coefficient of variation of effective exchange rate	20	21	23	17
Change^b				
In average tax rate, due to				
Tax rates		+3	-2	-3
Composition of imports		+5	+2	-2
In coefficient of variation of exchange rate, due to				
Tax rates		-4	-3	-2
Composition of imports		+5	+5	-4

^a Customs, purchase tax, and other imposts.

^b The calculations are based on the 28-commodity breakdown of Table VIII/10 of CBS, *Statistical Abstract of Israel*.

SOURCE: Based on Central Bureau of Statistics data.

The development of final imports is, as mentioned, explained entirely by the domestic demand cycle. In the last few years there has been no correlation between these imports and their relative prices. In 1986-87 the rise in dollar prices counteracted the effect of exchange-rate stabilization, and their sheqel prices rose to the same extent as those of their domestic substitutes. In 1988 the rise in consumer imports slowed down and imports of producer durables fell off in spite of the decline in the relative price of imports. This trend intensified in 1989, with a moderate decline in import prices and a fairly steep fall in the volume of final imports.

Dollar prices of intermediates, on the other hand, rose in 1989: fuel by 20 percent and other items by 2.5 percent. Purchasers' prices, however went up by less because of tariff cuts.

These developments are depicted in Figure 6.4. A prominent feature is the sharp upswing in imports of producer durables in the last quarter of 1989 and the first quarter of 1990, after declining steadily for nine quarters. The other series, however, show no clear trend.

The latest stage in the free trade agreements with the European Community and the United States came into effect in early 1989, with the abolition of duties on imports from the Community (except for Spain and Portugal) and the reduction of duties on imports from the United States, Spain, and Portugal. In 1989 there was almost no offsetting increase in purchase tax (except for passenger cars).

The details are shown in Table 6.10. The tax rate on imports doubled from 1980 to 1986, in spite of tariff reductions in accordance with the long-term agreement with the EEC. The change in the average tax rate is due both to the increase in purchase tax which more than offset tariff reductions and the increased weight of highly-taxed items. The next stage in tariff reduction came into effect in 1987, but since purchase tax was raised the average tax fell by only 2 percentage points as a result; this decline was offset by the change in import composition, so that in 1986–88 the average rate did not change. In 1989 tax rates again fell, and this time there was a shift out of highly taxed items.

Unilateral transfers

In 1989 unilateral transfers to the private sector rose by \$450 million while transfers to general government fell by \$140 million (Table 6.11). The principal source of the latter is U.S. government aid (Table 6.A8), which in recent years has consisted of a military grant of \$1.8 billion and a civilian grant of \$1.2 billion used for servicing the debt to the United States. The 1989 (calendar year) figures show a \$140 million decline in military aid, but this is a statistical artifact; in terms of U.S. fiscal years (October–September), there is no decline. The remaining transfers to the public sector are from the UJA, and came to \$330 million, about the same as in 1988.

Private transfers have shown marked fluctuations which are correlated with the speculative cycles. When corrected for the cycles, there is a clear upward trend, the average level in 1988–89 being double the 1984–85 level. Private transfers to the rest of the world have been steady in the last few years, in spite of the removal of some of the restrictions on them.

4. THE CAPITAL ACCOUNT AND THE EXTERNAL DEBT

Private capital movements

For the last few years the capital account has been subject to speculative cycles, with outflows when devaluation is expected and inflows when it occurs. The capital flows are

Table 6.11
Unilateral Transfers, 1985–89^a

	(\$ million)				
	1985	1986	1987	1988	1989
Private sector					
Restitutions from Germany	328	424	531	557	584
Personal transfers	316	630	826	583	754
By immigrants	82	354	500	348	624
Others	234	277	328	235	130
Transfers in kind	16	21	24	25	23
Private nonprofit institutions	170	186	290	290	535
Personal transfers to rest of world	-73	-65	-86	-90	-80
Total	757	1,198	1,587	1,366	1,817
General government					
National Institutions	397	411	314	337	333
Intergovernmental transfers ^b	3,843	3,772	2,940	2,861	2,727
Total	4,240	4,183	3,254	3,198	3,060
Total unilateral transfers	4,997	5,382	4,839	4,564	4,876

^a Figures may not add owing to rounding.

^b Includes U.S. Government aid.

SOURCE: Based on Central Bureau of Statistics data.

large and are reflected in all relevant series.⁴ The characteristics of the speculative cycles are described below, followed by an attempt to locate the underlying trend.

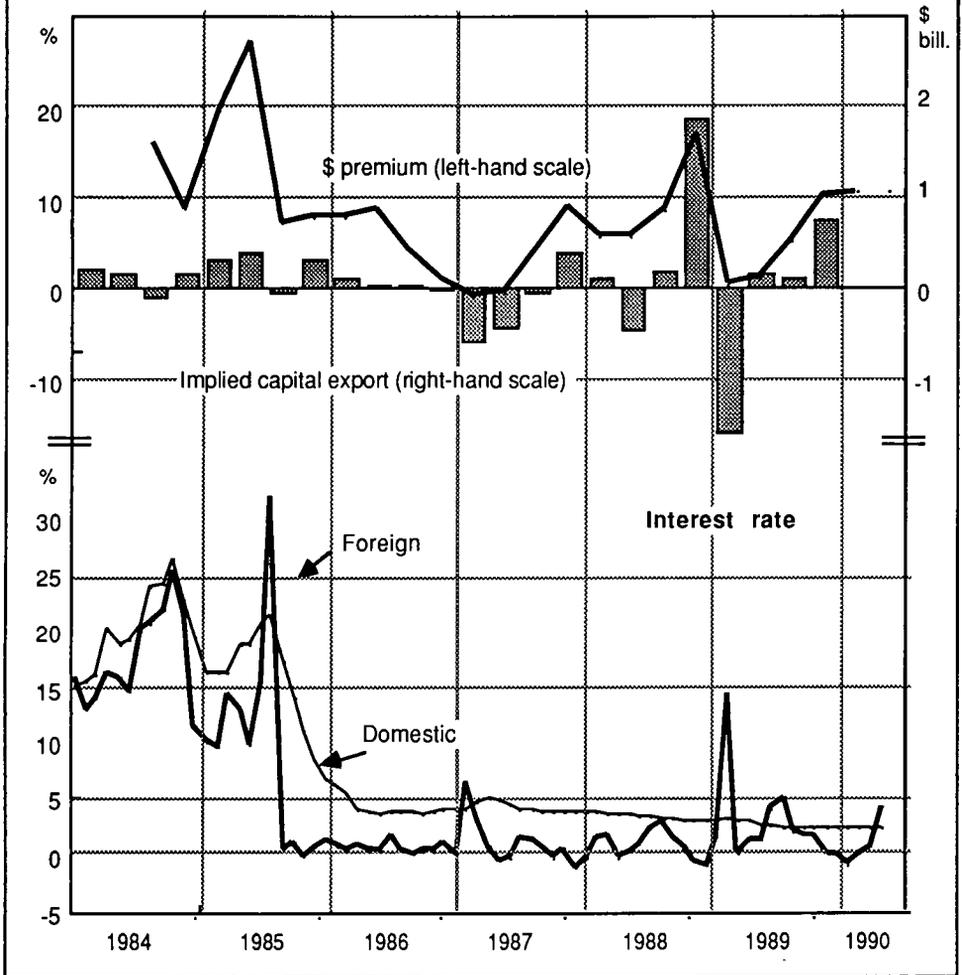
A necessary preliminary to a discussion of speculative cycles is to distinguish between the current and capital transactions of the private sector and general government. This is by no means easy, either conceptually or in practice, and the figures of Table 6.A2 must therefore be regarded as approximate.

Private capital imports are here defined as the difference between the private sector's purchases of foreign exchange from the central bank and its current account deficit (this aggregate is henceforth referred to as 'implied private capital imports'). As can be seen from Table 6.5, the series exhibits marked cycles during 1987–89, which are explained by the course of devaluation expectations. One indicator of expectations is the premium on the black market dollar, and, as is evident in Figure 6.5, it correlates very closely with capital movements from 1987 on.⁵ The public reacted to the January 1987 devaluation with large-scale capital imports, which were reinforced by high domestic interest rates and the belief that there would be no devaluation in the near future. A new expectations cycle emerged at the end of 1987; this died down when no devaluation was

⁴ Speculative patterns also affect the current account. They are obvious in private unilateral transfers and can also be seen in several import categories.

⁵ The fixed exchange-rate regime was introduced in mid-1985 as part of the economic stabilization program, and the period from then to the end of 1986 can be regarded as a learning period.

Figure 6.5
Capital Movements, 1984-89^a



^a Black market dollar premium on the representative rate. For implied capital export, see p/ 149 of the text. Interest rates—foreign: 3-month Eurodollar rate calculated in NIS on a monthly basis; domestic: effective interest on overdraft facilities, in monthly terms.

in fact announced. The devaluation of end-1988 was associated with particularly sharp swings, since its timing was connected with elections and the formation of a new government, and it was easily foreseen. The cycle surrounding the June 1989 devaluation was short and mild; expectations for devaluation at the end of the year or the beginning of the next did not, however, fade. The principal cycles are captured by the six-monthly figures (Table 6.12).

When expectations rose towards the end of 1988 and the end of 1989, the Bank of Israel allowed interest rates to rise, but the result was a large rise in the interest on the central bank's discount-window auction loans, with only a moderate rise in the rate on bank credit to the public (see the monetary chapter in this and the 1988 issue of the Report). The interest rate on domestic assets reacted more sharply. Detailed data indicate a rise in late 1988; for example, the rate on CDs and SROs (self-renewing overnight deposits) rose from 11 percent in August to 23 percent in December. The rate then declined to 9 percent in August 1989, to rise again until it stood at 15.5 percent just before the February 1990 devaluation. Swings of this order have very little effect on relative yields during a speculative cycle as strong as that surrounding the end-1988 devaluation. At the time of the cycles of the middle and end of 1989, however, the rise in interest rates was more effective, since the rate of devaluation was lower and its precise date more difficult to forecast.

Table 6.12
Composition of Implied Private Capital Imports, 1987-89

	(\$ million)					
	1987		1988		1989	
	First half	Second half	First half	Second half	First half	Second half
Foreign investment	41	117	68	130	6	74
Credit						
Long and medium-term	219	100	-14	-130	40	-142
Short term	33	30	29	-127	36	-210
Via banking system ^a	489	-366	222	-1,333	574	-653
Errors and omissions	262	-242	105	-560	691	-12
Total	1,043	-360	410	-2,019	1,348	-943
Premium on black market dollar (percent)	-0.1	6.8	6.0	12.7	2.1	8.0

^a See Table 6.A10 for details.

SOURCE: CBS and Bank of Israel.

The response of the exchange rate itself (within the band introduced in early 1989) is more effective in moderating the effects of devaluation expectations—when the devaluation is not large and its timing uncertain.

It should be borne in mind that in the last two years a rise in interest rates in response to expected devaluation has conflicted with the principal target of monetary policy, namely the lowering of interest rates, at a time of recession (for a detailed discussion see Chapter 7).

The decline in domestic interest rates which began in early 1987 should result in a net capital outflow over the period. The speculative cycles make it difficult to find out if this has in fact happened. It is, however, possible to identify the trend by an appropriate choice of interval which neutralizes the cyclical effects.

1. If predevaluation capital outflow is compared with the capital inflow of the next quarter, we see a net outflow of \$500 million near the January 1989 devaluation; the outflow began in the third quarter of 1988 and intensified in the fourth quarter, whereas the inflow came to an end in the following quarter. In the last three quarters of 1989 the outflow amounted to \$1.1 billion.

2. The level of expectations, as measured by the premium on the black dollar (9–10 percent), was about the same at the end of 1989 as at the end of 1987. The net outflow between these two dates came to \$1.2 billion.

Table 6.13
Domestic and Foreign Interest Rates, 1987–89

	(percent p.a.)		
	1987	1988	1989
Overdraft credit	61.9	46.2	34.3
CDs and SROs	12.9	14.1	11.6
U.S. money market (in \$ terms)	6.7	7.6	9.2
Average rate of devaluation (1986–89)	10.0	10.0	10.0
U.S. money market (in NIS terms)	17.4	18.4	20.1
Domestic/foreign interest-rate gap			
Credit	37.9	23.4	11.8
Financial assets	-3.8	-3.6	-7.1

SOURCE: Table 7.2 (domestic interest rates) and *IFS* (foreign interest rate).

3. Since in the last two years domestic interest rates fell appreciably while world rates rose, it has become relatively less profitable to borrow abroad and more profitable to hold foreign assets. This is consistent with the net capital outflow—repayment of foreign credit and an increase in foreign asset holdings. The process is illustrated in Table 6.13, in which domestic interest rates are represented by overdraft facilities, CDs, and SROs. Foreign rates are represented by the credit rate paid by banks in the United States, which is roughly equal to the average of the credit-side and asset-side rates in the U.S. money market. The interest-rate gap is calculated on the assumption of an annual devaluation rate of 10 percent (the average for 1986–89).⁶ Note that the (absolute) interest gap is overstated by the banks' margin between the rate shown in the table and the rate on credit to and assets held by the public in the United States. The figures nevertheless clearly show a motive for capital exports: on the credit side, the gap narrows—which is consistent with repayment of foreign credit; and on the asset side it widens—which favors foreign assets.

⁶ The expected-devaluation assumption can be varied within a reasonable distance of the average devaluation rate without affecting the conclusions.

The external debt and the reserves

In 1989 the country's external debt declined by the exceptionally large amount of \$2.4 billion. Most of the decline is due to a rise in assets: the gross debt went down by \$190 million, while reserves rose by \$1,370 million and the banking system's assets abroad by \$670 million. Exporters' credit to foreign buyers also rose, by \$130 million (see Table 6.14).

Table 6.14
Assets and Liabilities in Foreign Currency, 1985-89^a

	(million \$)				
	1985	1986	1987	1988	1989
1. Net liabilities (2 - 3 - 4) ^b	18,392	18,206	18,171	18,814	16,408
2. Liabilities	23,106	24,050	25,325	24,553	23,695
Government	15,511	16,187	16,544	16,648	16,579
Nonfinancial private sector	3,681	3,980	4,791	4,540	4,411
Banking system, net	3,914	3,883	3,990	3,366	2,705
3. Foreign reserves	3,794	4,867	5,962	4,764	6,135
4. Exporters' credit to foreigners	921	977	1,193	975	1,152
5. Current liabilities	4,847	3,979	4,413	4,203	4,798
Banking system (short term)	2,301	1,197	1,190	1,138	1,191
Nonfinancial private sector (short term)	1,046	1,131	1,425	1,390	1,407
Direct government debt (short term)	2	25	0	100	0
Medium and long term debt repayable within a year	1,498	1,626	1,798	1,575	2,200
6. Net current liabilities (5 - 3 - 4)	133	-1,865	-2,742	-1,535	-2,489
7. Current debt as percent of net debt	1	-10	-15	-8	-15
8. Gross liabilities	29,362	30,625	31,772	31,328	31,137

^a Differences in totals are due to rounding.

^b The debt figures in this table are consistent with those published by the Central Bureau of Statistics. The data published by the Controller of Foreign Exchange are slightly different because they were revised on different dates.

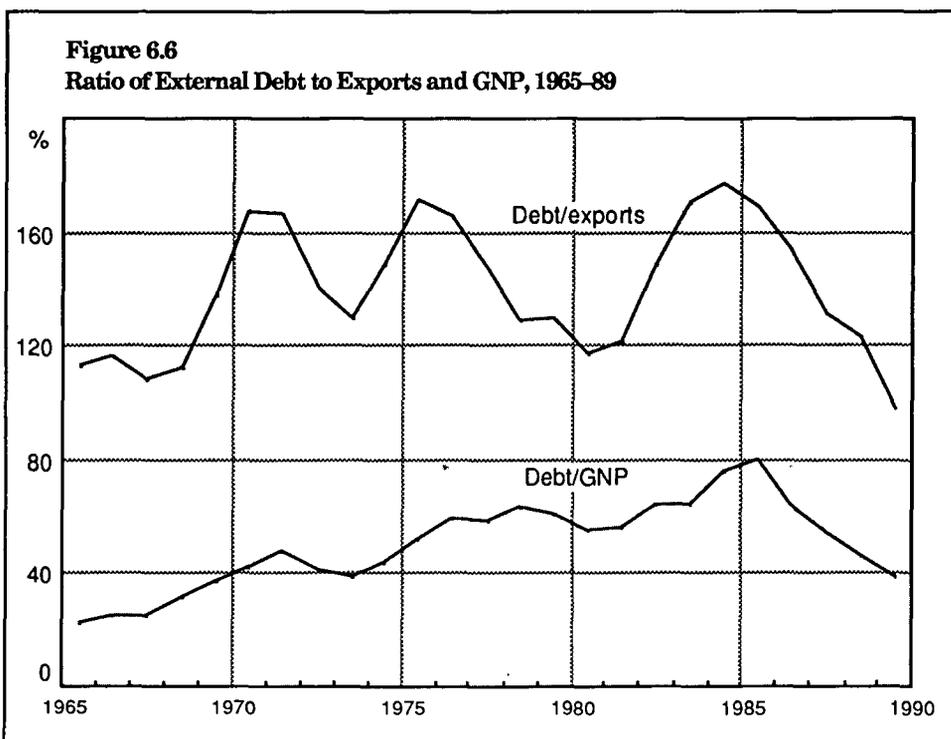
SOURCE: Based on Central Bureau of Statistics data.

The surplus on current account came to \$1 billion, and helped to reduce the debt. The change in the debt is not equal to the current account balance, because of both statistical and definitional discrepancies.

1. The debt figures include revaluation differentials stemming from changes in cross-rates, whereas these have been netted out of the current account.

2. Investment from the rest of the world is not included in the gross debt, but affects the net debt via the reserves. These investments are not included in the current account.

3. Only a small part of the nonfinancial private sector's foreign asset holdings is included in the asset statistics, but their effect on the reserves is captured and they



SOURCE: Based on Central Bureau of Statistics data. For definitions, see Table 7.1.

therefore affect the external debt. The change in assets is of course not included in the current account.

In spite of this, the cumulated current account for 1985-89 comes to a net surplus of \$2.8 billion, while the end-1989 debt is \$2.5 billion below the end-1984 debt. These figures are reasonably close.

The debt/GNP ratio has declined steeply in the last four years, from 80 percent at end-1985 to 38 percent at end-1989 (Figure 6.6 and Table 6.1). The decline in the debt and the growth of GNP account for 17 percentage points of the decline; another 8 points are due to the weakening of the dollar vis-à-vis the currency basket, and the remaining 17 percent reflects appreciation of the sheqel vis-à-vis the currency basket. The debt/export ratio is less subject to price effects, and it too has declined steeply, from 169 to 99 percent.

The debt burden was alleviated this year: the average interest rate fell because of the decline in the debt and the rise in the short term rate, which increased interest receipts (Table 6.15). The ratio of interest payments to exports also fell, as did the debt servicing burden. The term composition of the debt and the sectoral distribution of domestic borrowers and foreign lenders all remain favorable (Table 6.A13).

Table 6.15
The External Debt Burden, 1985-89^a

	1985	1986	1987	1988	1989
<i>\$ million</i>					
Interest payments	2,578	2,370	2,286	2,504	2,499
Interest receipts	891	828	811	968	1,235
Net interest payments	1,687	1,541	1,474	1,536	1,264
Other capital services					
Debit	123	132	152	127	148
Credit	26	24	35	32	34
Repayment of principal	1,230	1,498	1,626	6,576	2,298
Total net debt servicing ^b	3,014	3,147	3,219	3,430	2,953
<i>Percent</i>					
Net interest/net external debt ^c					
Nominal	9	8	8	9	7
Real ^d	4	6	5	5	3
Interest/income at disposal of economy ^e	6	5	4	3	3
Net interest/exports ^f	17	14	11	11	8
Net debt servicing/exports ^f	30	29	25	24	19
Net debt servicing/(exports ^f + transfers ^g)	20	19	18	18	15
Net debt servicing/GNP	13	11	10	8	7

^a Figures may not add owing to rounding.

^b The 1988-89 totals are net of conversion of the debt to the U.S. Government.

^c The denominator is the debt lagged six months.

^d The nominal figure (preceding line) deflated by the rate of inflation in industrialized countries (5-year average), as an indicator of long-run inflationary expectations.

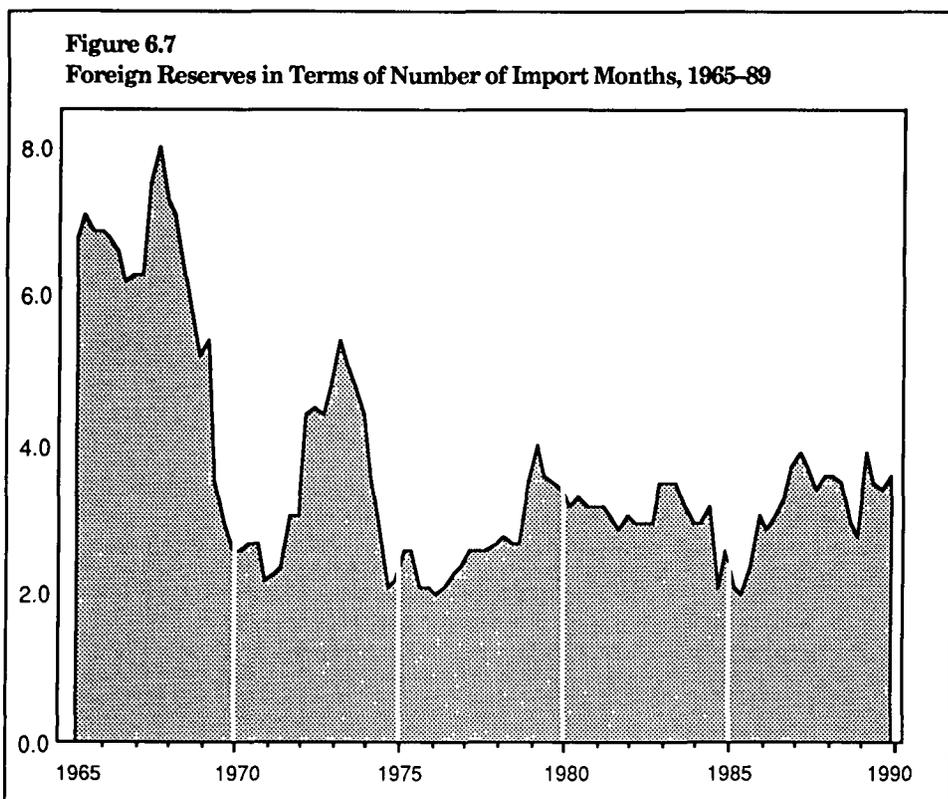
^e GNP (in dollars) + net unilateral transfers.

^f Exports f.o.b. excluding capital services.

^g Net unilateral transfers.

SOURCE: Based on Central Bureau of Statistics data.

The conversion of part of Israel's debt to the U.S. government was completed in 1989. The converted amount was in 20-30 year fixed-interest loans (at the going market rate, which was 12-13 percent when the loans were granted). By a special arrangement with the U.S. government (which was also offered to two other countries receiving military aid at the same time—Turkey and Egypt) these loans were paid off (\$4.8 billion in 1988 and \$0.7 billion in 1989) and replaced by bonds issued by the Government of Israel and 90-percent guaranteed by the Government of the United States; the remaining 10 percent was secured by the purchase of U.S. treasury bills which were deposited as collateral. The Government of Israel's bonds thus became tradable bonds fully guaranteed by the Government of the United States and were taken up at a yield to maturity very close to that of U.S. government bonds issued in the same period. The conversion arrangement has reduced this year's interest payments on the converted debt



SOURCE: Based on Central Bureau of Statistics data.

by \$150 million. The annual saving will decline gradually. The value of the U.S. treasury bills is included in 'assets of the central monetary authorities' but not in the reserves held by the central bank. It must be stressed that the arrangement does not alter the amount of principal to be repaid—unlike in the case of several South American countries who have defaulted in recent years.

The foreign reserves rose during 1989, returning to the end-1987 level in terms of import months (Figure 6.7 and Table 6.A12). The low level of reserves at the end of 1988 reflected the trough of the speculative cycle, and by the end of the first quarter of 1989 they were rising again.

Table 6.A1
The Balance of Payments, 1984–89^a

	(\$ million)					
	1984	1985	1986	1987	1988	1989
1. Net goods and services account	-4,581	-3,893	-3,752	-5,702	-5,190	-3,725
Private sector	-2,043	-688	-1,276	-1,938	-1,771	-1,444
Public sector ^b	2,538	-3,205	-2,476	-3,764	-3,419	-2,281
2. Net unilateral transfer ^c	3,282	4,997	5,382	4,839	4,564	4,876
Private sector	764	757	1,198	1,587	1,366	1,817
Public sector	2,518	4,240	4,184	3,252	3,198	3,059
3. Net current account (1 + 2)	-1,299	1,104	1,630	-863	-626	1,151
Private sector	-1,279	69	-78	-351	-405	373
Public sector	-20	1,035	1,708	-512	-221	778
4. Net medium and long term capital ^d	1,270	92	540	524	-529	-13
Private sector	168	89	194	477	-745	-22
Public sector	1,102	3	346	47	217	9
5. Net basic balance of payments (3 + 4)	-29	1,196	2,170	-339	-1,155	1,138
Private sector	-1,111	158	116	126	-1,150	351
Public sector	1,082	1,038	2,054	-465	-4	787
6. Net short-term capital movement	437	-265	-655	795	492	-395
Private sector	15	-143	-13	63	-98	-174
Public sector	422	-122	-642	732	590	-221
7. Capital movements of banking system	-142	-4	-118	0	-521	-633
8. Errors and omissions	-776	-529	-403	187	22	1,281
9. Increase (+) or decrease (-) in foreign reserves held in central institutions ^e	509	-398	-992	-644	1,163	-1,390

^a Figures may not add owing to rounding

^b The public sector deficit on goods and services account is defined as direct defense imports, government n.e.s., and net interest paid to rest of world *less* surplus on port services (excl. fuel) *plus* other imports financed by the government.

^c For details, see Table 6.11.

^d Public sector from Table 6.A9; private sector, 'nonfinancial private sector' in Table 6.A9 *plus* line 7 of Table 6.A11.

^e Adjusted for changes in cross rates.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A2
The Balance of Payments, by Sector, 1987-89^a

	(\$ million)						
	1987	1988	1989	1988		1989	
				First half	Second half	First half	Second half
Public sector							
Current account ^b	649	630	948	-279	909	-106	1,054
Medium and long term capital movements ^c	47	-583	9	-43	-541	-75	84
Basic account	696	47	957	-321	368	-181	1,138
Short-term capital movements	0	109	-47	-7	116	23	-70
Capital movements via banking system	-123	590	-554	-262	851	-215	-339
Errors and omissions	168	476	602	443	34	278	324
Effect on foreign reserves ^d	-741	-1,222	-957	148	-1,370	95	-1,052
Private sector							
Current account ^b	-780	-775	29	-210	-565	151	-122
Medium and long term capital movements ^c	477	55	-22	54	0	46	-68
Basic account	-303	-721	7	-156	-565	197	-190
Short-term capital movements	63	-98	-174	29	-127	36	-210
Capital movements via banking system	123	-1,111	-79	222	-1,333	574	-653
Errors and omissions	19	-455	679	105	-560	691	-12
Effect on foreign reserves ^d	97	2,385	-433	-200	2,584	-1,499	1,065
Capital imports of private sector ^e	683	-1,609	404	410	-2,019	1,348	-943

^a Figures may not add owing to rounding.

^b The current account is adjusted for intersectoral transactions and therefore differs from that given in Table 6.A1. Another difference is that the figures in this table are adjusted for advances on defense imports.

^c Redemption of the Arrangement bank shares held by foreign residents was deducted from the private sector's capital movements and added to the capital sector's capital movements.

^d Increase (+), decrease (-).

^e Defined as the difference between the private sector's purchases of foreign exchange and its current account.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A3
Current Balance of Payments with Judea-Samaria and Gaza, 1986-89^a

	\$ million				Annual percentage change ^a					
					Price			Quantity		
	1986	1987	1988	1989	1987	1988	1989	1987	1988	1989
Imports										
Merchandise	275	304	170	200	4.7	8.5	-3.3	5.7	-48.4	21.6
Services	453	669	657	671	29.3	28.6	-4.7	14.4	-23.6	7.3
<i>of which Wages</i>	432	643	644	659						
Total	727	973	827	871	20.5	23.9	-4.4	11.1	-31.4	10.2
Exports										
Merchandise	798	928	650	600	10.7	17.1	1.0	5.0	-40.2	-8.6
Services	172	220	219	219	11.9	15.9	0.3	14.7	-14.2	-0.4
Total	970	1,148	869	819	10.9	16.8	0.8	6.7	-35.2	-6.5
Export surplus										
Merchandise	524	624	480	400						
Services	281	449	437	452						
Total	243	175	43	-52						

^a New classification introduced in 1988. The rates of change for 1988 are based on the old classification.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A4
Industrial Exports (f.o.b.), 1986-89^a

	\$ million				Annual percent change					
					Price			Quantity		
	1986	1987	1988	1989	1987	1988	1989	1987	1988	1989
Mining and quarrying	233	235	252	288	-3.6	16.6	14.3	4.5	-10.9	-0.0
Food, beverages, and tobacco	333	436	527	567	13.0	30.5	-2.6	15.8	-8.3	10.7
Textiles	138	185	215	207	12.1	14.1	1.7	19.8	1.7	-5.2
Clothing and made-up textiles	320	400	416	419	15.6	23.0	-4.5	8.0	-15.4	5.6
Leather and leather products	7	7	10	8						
Wood and wood products	37	47	45	47	8.5	11.4	-1.8	19.0	-12.2	5.7
Paper and paper products	13	19	26	26	26.5	4.3	1.3	14.4	26.0	-1.7
Printing and publishing	17	23	22	22	26.5	4.3	1.3	7.8	-5.4	-1.3
Rubber and plastic products	183	221	275	312	9.2	5.6	4.9	10.4	-5.0	8.1
Chemicals and petroleum products	792	1,039	1,115	1,268	6.1	7.2	4.0	23.6	5.3	9.3
Nonmetallic mineral products	16	17	23	23	-0.1	13.2	-3.3	5.6	15.6	5.7
Basic metals	65	74	93	111	4.2	-6.8	5.1	9.1	47.9	13.9
Metal products	531	503	591	638	4.7	7.7	4.1	-9.4	23.2	6.9
Machinery	163	212	285	287	6.2	8.1	3.2	22.6	-14.7	-2.6
Electrical and electronic equipment	890	1,085	1,403	1,482	7.6	5.3	-0.0	13.2	23.5	5.7
Transport equipment	556	540	462	649	4.1	3.5	-0.8	-6.8	-21.6	41.5
Miscellaneous	378	446	535	616	10.2	7.3	3.0	7.1	12.4	11.8
Subtotal ^b	4,709	5,534	6,336	7,023	7.5	9.9	1.9	9.3	3.9	8.8
Diamonds, net	1,665	2,059	2,547	2,738	1.4	21.0	17.3	22.0	2.3	-8.3
Total ^b	6,374	7,592	8,883	9,761	5.7	13.2	6.7	12.7	3.1	3.0

^a New classification introduced in 1988. The rates of change for 1988 are based on the old classification.

^b Includes other merchandise of up to \$50 million.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A5
Services Account, 1986-89^a

	1986	1987	1988	1989	Annual percent change		
					1987	1988 ^b	1989
Imports							
Transport	909	1,078	1,216	1,258	18.6	15.6	3.5
Travel	799	1,041	1,161	1,288	30.2	8.5	10.9
Insurance	88	110	85	86			
Government services n.e.s.	93	107	111	125			
Other services	1,180	1,505	1,646	1,763	27.6	7.9	7.1
Subtotal	2,616	3,172	3,561	3,848	21.2	11.9	8.0
Capital services	2,501	2,438	2,632	2,646	-2.5	8.2	0.6
From Judea-Samaria & Gaza	453	669	657	671	47.9	-1.8	2.3
Total	5,570	6,279	6,850	7,165	12.7	9.0	4.6
Exports							
Transport	1,383	1,595	1,708	1,792	15.3	8.7	4.9
<i>of which Freight on imports^c</i>	358	423	446	441	18.1	5.3	1.1
Travel	972	1,347	1,346	1,468	38.6	-0.3	9.0
Insurance	23	35	48	50			
Government services n.e.s.	21	28	35	47			
Other services	1,203	1,355	1,548	1,607	12.7	11.8	3.8
Subtotal	3,430	4,141	4,467	4,745	20.7	7.6	6.2
Capital services	850	861	1,000	1,269	1.3	12.4	26.9
To Judea-Samaria & Gaza	172	220	219	219	28.3	-0.5	-0.0
Total	4,452	5,223	5,687	6,233	17.3	8.0	9.6
Deficit (+) or surplus (-)							
Total	1,118	1,056	1,163	932	-5.5	13.9	-19.8
Net capital services	1,651	1,576	1,632	1,377	-4.5	5.9	-15.6
Excl. Judea-Samaria & Gaza	-814	-969	-906	-897	19.1	-6.7	-0.9

^a Adjusted for c.i.f. valuation of merchandise imports.

^b New classification introduced in 1988. The rates of change for 1988 are based on the old classification.

^c Israeli carriers.

SOURCE: Central Bureau of Statistics.

Table 6.A6
World Exchange Rates, 1987-89

	(annual percent change)				
	1987	1988	1989	1988 ^a	1989 ^a
<i>Against the dollar, nominal</i>					
Deutschmark	-17.2	-2.3	7.1	12.6	-4.6
Sterling	-10.5	-8.0	8.6	3.4	12.7
Yen	-14.2	-11.4	7.7	1.9	14.0
French franc	-13.2	-0.9	7.1	13.5	-4.5
<i>Against the dollar, real^b</i>					
Deutschmark	-12.9	-0.1	9.0	14.7	-3.7
Sterling	-11.0	-8.6	8.6	2.3	11.5
Yen	-8.5	-7.3	10.2	7.0	14.0
French franc	-13.8	-0.1	8.7	14.2	-4.1
<i>Sheqel exchange rate against</i>					
U.S. dollar	7.2	0.3	19.9	4.2	22.2
Deutschmark	29.1	2.7	11.9	-6.1	23.0
Sterling	19.8	9.0	10.1	1.8	6.6
Yen	24.5	13.0	11.3	2.4	5.0
French franc	23.4	1.3	11.8	-6.9	23.0
Currency basket ^c	14.3	2.4	16.1	0.7	19.7
Wholesale price index ^d	18.9	17.4	17.6	14.1	15.7

^a End of year.

^b Exchange against the dollar, deflated by changes in wholesale prices in the respective countries.

^c Average of representative exchange rates of the five currencies, weighted by the composition of Israel's foreign trade.

^d Wholesale prices of industrial output for domestic market, excluding food, quarrying and mining.

SOURCE: Exchange rate and price indexes abroad—*IFS*; wholesale prices—Central Bureau of Statistics.

Table 6.A7
Merchandise Trade by Origin and Destination, 1984–89^a

	(percent of total)					
	1984	1985	1986	1987	1988	1989
Imports, by origin^b						
Europe ^c	56	59	63	64	55	54
North America	31	30	25	22	21	23
Other	13	11	12	14	24	23
Total	100	100	100	100	100	100
Exports, by destination^d						
Europe ^c	42	40	40	43	44	42
North America	24	29	29	28	27	27
Other	34	31	31	29	29	31
Total	100	100	100	100	100	100

^a Calculated from current price figures (in dollars).

^b Excludes diamonds and direct defense imports.

^c EEC and EFTA countries.

^d Excludes diamond exports.

SOURCE: Central Bureau of Statistics.

Table 6.A8
U.S. Government Aid, 1985–89^a

	(\$ million)				
	1985	1986	1987	1988	1989
1. Grants	3,885	3,817	2,981	2,907	2,769
a. Military	1,935	1,867	1,781	1,707	1,569
b. Civilian ^b	1,950	1,950	1,200	1,200	1,200
2. Medium and long term loans	0	405	270	156	0
3. Repayment of medium and long term loans	1,055	1,081	1,129	5,943	1,826
a. Principal ^c	109	135	165	4,867	987
b. Interest	946	946	964	1,076	839
4. Total gross aid (1 + 2)	3,885	4,222	3,251	3,063	2,769
5. Total net aid (4 – 3)	2,830	3,141	2,122	-2,880	943
Net receipts from loans (2 – 3a)	-109	270	105	-4,711	-987
Grants less interest payments (1 – 3b)	2,939	2,871	2,017	1,831	1,930

^a Figures may not add owing to rounding.

^b Includes the emergency grant of \$750 million in each of 1985 and 1986.

^c Includes the redemption of \$4,704 million in 1988 (under the conversion agreement with the U.S. government; see text) and \$723 million in 1989.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A9
Long and Medium Term Loans, 1984-89^a

	(\$ million)					
	1984	1985	1986	1987	1988	1989
Receipts						
Public sector	1,740	739	1,236	1,086	5,918	1,661
<i>of which</i>						
State of Israel Bonds	471	525	618	620	713	819
Bonds guaranteed by U.S. government	-	-	-	-	4,778	723
U.S. government loans	898	0	405	270	156	0
Nonfinancial private sector	579	485	671	913	732	544
Total receipts	2,318	1,223	1,907	1,999	6,650	2,205
Repayment						
Public sector	637	736	891	1,039	5,701	1,652
<i>of which</i>						
State of Israel Bonds	313	312	375	475	510	404
U.S. government loans	124	109	135	165	4,867	987
Nonfinancial private sector	395	495	607	588	875	646
Total repayment	1,033	1,230	1,498	1,626	6,576	2,298
Net receipts						
Public sector	1,102	3	346	47	217	9
<i>of which</i>						
State of Israel Bonds	157	213	243	145	203	415
Bonds guaranteed by U.S. government	-	-	-	-	4,778	723
U.S. government loans	774	-109	270	105	-4,711	-987
Nonfinancial private sector	184	-10	64	325	-144	-102
Total net receipts	1,286	-7	409	372	73	-93

^a Excluding loans of the banking system. Figures may not add owing to rounding.

SOURCE: Based on Central Bureau of Statistics data.

Table 6.A10**Capital Movements of the Private Sector via the Banking System, 1988-89**

(\$ million)

	1988		1989	
	First half	Second half	First half	Second half
Change in resident deposits ^a	-421	648	-730	406
Change in nonresident deposits of Israelis	-9	419	-120	442
<i>less</i> Reserve deposits with the Bank of Israel	-218	309	-740	615
1. Effect of changes in deposits on capital movements	212	-758	110	-223
Change in nondirected credit ^b to the public	-205	-323	214	-173
Change in directed credit to the public	114	-257	210	-212
2. Effect of changes in credit	-91	-580	424	-385
3. Effect of other items	100	-17	40	-35
Total (1 + 2 + 3)	222	-1,333	574	-653

^a Including restitutions deposits.^b Denominated in foreign currency.

SOURCE: Bank of Israel, Controller of Foreign Exchange.

Table 6.A11**Foreign Investment in Israel and Israeli Investment Abroad, 1983-89^a**

(\$ million)

	1983	1984	1985	1986	1987	1988	1989
1. Investment by foreign residents	1,363	183	218	316	410	424	425
Quoted securities ^b	1,220	80	51	83	118	84	99
Direct investment	72	76	134	193	273	320	312
State of Israel Bonds ^c	1	5	10	8	4	2	3
In goods	47	3	5	14	-6	0	0
Reinvestment of profits	22	20	17	18	21	16	11
2. Repatriation of investments by foreign residents	520	222	129	133	213	954	270
of which Quoted securities ^d	465	171	61	66	163	855	118
3. Net investment of foreign residents	842	-39	89	183	197	-530	155
4. Investment abroad by Israelis	382	55	81	136	120	107	178
Securities	259	22	30	12	39	23	54
Direct	123	34	51	124	81	84	124
5. Repatriation of investment by Israelis	3	78	91	83	75	35	103
6. Net investment abroad by Israelis	379	-23	-10	53	46	71	75
7. Net private foreign investment (3 - 6)	463	-16	99	131	152	-602	80
8. Foreign securities held by bank ^e	1	-88	-57	-64	-36	44	99
9. Total net foreign investment (7 - 8)	462	72	156	195	188	-646	-18

^a Figures may not add owing to rounding.

^b In 1983, includes investment in bank shares by associated companies of Israeli banks.

^c Bonds redeemed for reinvestment.

^d In 1988, includes \$800 million redemption of bank shares.

^e Includes investment in foreign stocks by the banking system.

SOURCE: Bank of Israel and Central Bureau of Statistics.

Table 6.A12
Reserves Held by Central Monetary Institutions, 1980–89

	Central monetary institutions	Bank of Israel		Import months covered ^b
		Total	Net ^a	
1980	3,526	3,394	2,781	3.2
1981	3,814	3,542	2,847	3.1
1982	4,317	3,836	2,993	3.5
1983	3,780	3,694	2,873	3.0
1984	3,255	3,098	2,601	2.6
1985	3,794	3,719	3,190	3.1
1986	4,867	4,703	4,153	3.7
1987	5,962	5,924	5,329	3.6
1988	4,764	4,091	3,432	2.8
1989	6,135	5,330	4,430	3.6
1986				
I	3,575	3,510	3,000	2.9
II	3,736	3,618	3,098	3.1
III	4,236	3,632	3,103	3.3
IV	4,867	4,703	4,153	3.7
1987				
I	5,289	4,838	4,290	3.9
II	5,354	5,159	4,600	3.7
III	5,205	5,115	4,532	3.4
IV	5,962	5,924	5,329	3.6
1988				
I	6,060	5,841	5,210	3.6
II	5,881	5,781	5,199	3.5
III	5,108	4,789	4,194	3.0
IV	4,764	4,091	3,432	2.8
1989				
I	6,524	5,887	5,246	3.9
II	5,921	5,309	4,633	3.5
III	5,829	5,117	4,441	3.4
IV	6,135	5,330	4,430	3.6

^a Total *less* reserve deposits on foreign residents' accounts.

^b First column *divided by* average monthly imports.

SOURCE: Based on data of the Central Bureau of Statistics and the Bank of Israel.

Table 6.A13
The Structure of the Net Foreign Debt, 1985-89^a

	(percent, end-of-year)				
	1985	1986	1987	1988	1989
Total net debt	100	100	100	100	100
By borrower					
Public sector ^b	64	62	58	63	64
Private sector	36	38	42	37	36
Private nonfinancial sector	15	16	20	19	20
Banking system	21	21	22	18	16
By lender					
Foreign public sector ^c	60	64	66	38	37
Foreign private nonfinancial sector ^d	52	57	62	92	114
Banking system abroad ^e	-11	-21	-29	-31	-53
By term^f					
Long and medium	107	119	125	117	129
of which Payable within 1 year	8	9	10	8	13
Short	-7	-19	-25	-17	-29

^a Figures may not add owing to rounding.

^b Government and the Bank of Israel.

^c Foreign governments and international institutions.

^d Consists mainly of foreign deposits and State of Israel bonds; from 1988 also includes bonds guaranteed by U.S. government.

^e Includes the country's foreign reserves and loans from foreign banks and overseas offices of Israeli banks.

^f Short-term loans are for less than 1 year.

SOURCE: Based on Central Bureau of Statistics data.