CHAPTER III

# PRICES

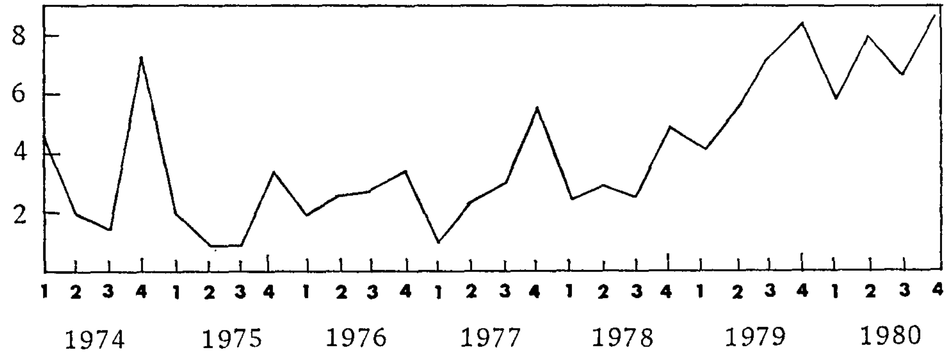
## 1. MAIN DEVELOPMENTS

The rapid mounting of prices in the past few years carried over through 1980 despite the slackening of economic activity, and the average level in the various markets stood 2.25 to 2.5 times higher than in 1979. Nevertheless, the acceleration of inflation which had characterized the two preceding years was checked in the year reviewed. During 1980 prices moved up at an irregular pace, ranging between 4 and 11 percent a month, depending on the timing of increases in controlled commodity and fuel prices. The average monthly inflation rate was 7.5 percent, about the same as in the second half of 1979. The rises were especially steep in food and fuel, and relatively mild in housing and consumer durable goods.

The high inflation got underway in 1973 when, in the wake of the Yom Kippur War and the world fuel crisis, the public sector demand surplus and balance of payments deficit swelled noticeably. Subsequently some retrenchment set in, with inflation running at a 30–40 percent annual rate. Toward the end of 1978 it doubled, following a cyclical upswing in demand coupled with the devaluation of the currency and the expansion of financial wealth which accompanied the foreign currency reform at the end of 1977. The advance of prices gathered further momentum in the course of 1979.

**Figure III-1**

**QUARTERLY MOVEMENT OF CONSUMER PRICES, 1974–80**
(Percent change during the quarter, at monthly rates)



In the middle of 1979 the buoyant level of economic activity began to flag. In early 1980 the slump was aggravated by the government measures introduced at the end of the previous year, including the almost total scrapping of subsidies on basic commodities, a steep jump in oil prices, the freezing of nondirected (free market) credit, and the imposition of a 10 percent deposit requirement on imports. Despite the softening of both the commodity and labor markets, inflation retreated for only a brief spell at the beginning of 1980, following which it reverted to its former level.

It should be emphasized that the inflationary process of the last few years is a complex matter, influenced by many factors, including the structure of the economy, external forces, and the policy measures pursued during this period. It is hard to quantify the effect of each factor separately, and several explanations can be offered for these developments.

The persistence of rapid inflation despite the contraction of demand and economic activity can be mainly attributed to the strong inflationary expectations in an economy experiencing a steady monetary expansion, which quickly translated these expectations into price increases. The public became more conscious of the price-wage-exchange rate spiral, and the inflationary expectations were further intensified by the frequent increases in basic commodity and fuel prices, the exchange rate, and the compensation awarded under the existing wage agreements.

Total liquid assets expanded in real terms in the year reviewed, although the annual average level dipped slightly, in line with the decline in real wages and other income. This development is explained by the public sector liquidity injection and the almost full automatic appreciation of these assets, most of which are now indexed. The liquidity injection increased after mid-1979, when the economic slowdown sharply depressed tax revenue while public sector expenditures were not pruned to the same extent. The amount of money absorbed through the balance of payments also shrank appreciably during this period. A demand-side factor which induced the public to hold more liquidity was the uncertainty which prevailed in 1980 regarding the rate of inflation, the employment situation, and relative price movements. Nevertheless, the acceleration of inflation was checked. The wage agreements for 1980 were probably a contributory factor, as they were signed at a time when the labor market was cooling off, and they provided for a fuller adjustment of wages to the price rise than in the past. By contrast, hefty pay increases had been awarded at the beginning of 1979, and this further stoked inflation at the time.

Because of the protracted rapid advance of prices most of the payment arrangements have been gradually adjusted for this development. In the money market indexed bonds have been issued for many years, while wages have been protected for an even longer time against erosion through cost-of-living adjustments. These devices have been strengthened in recent years with the persistence of the inflationary process, giving rise to a complex mechanism covering, in addition to wages and bonds, the exchange rate (through creeping devaluations and subsequently the introduction of a floating exchange rate regime), controlled commodity prices, and some taxes. Since the foreign currency reform in the final part of 1977 the public can own liquid assets linked to the exchange rate, and this has resulted in larger holdings of assets that are automatically adjusted to the rise in prices. The worsening of inflation has led to the improvement of the inflation-proofing devices—including institutional arrangements and other measures—through more frequent adjustments and at higher rates. These adjustments, however, still lag behind the rise of prices, mainly in the case of wages, taxes, and controlled goods.

It should be noted that wages and financial assets were originally indexed in order to hedge wages and savings against the erosion of their real value, and it was this that has enabled the economy to function despite the galloping inflation of the past few years. Were it not for the adjustment (formal or through a competitive market mechanism) of wages and part of the monetary system to the change in prices, savings could not have been maintained at their present level, and the flight from money that would very likely have developed would have further fueled inflation and created other distortions. At the same time the availability of linked money substitutes permits a quick change in the pace of inflation and hampers the convergence of the price system in response to an external shock. The lagged adjustment of wages, taxes, and controlled goods, for instance, inhibits the effort to cool inflation even when demands and economic activity shrink.

## 2. THE INFLATIONARY PROCESS

Inflation changed in character in the year reviewed: although economic activity moved into lower gear, prices continued to mount at the rapid pace reached in the second half of 1979. This constituted another stage in the inflationary process which has beset Israel during the past few years, and in order to understand it one has to examine the earlier stages, beginning in 1973. A number of arrangements which grew out of the protracted inflation have a feedback effect on this process. The reference is to formal arrangements, such as the indexation of wages and parts of the tax system; other adjustments, such as the shift from money to linked liquid assets; and adjustments which were introduced at a relatively late stage or are still being mooted, such as the indexing of unlinked credit and the taxing of inflationary profits.

### (a) **The Period 1973–79**

The inflationary process has its roots in the cost-push on prices engendered in the wake of the Yom Kippur War in 1973 and the oil price shock, which resulted in the swelling of the public sector's demand surplus and the balance of payments deficit. These developments led to repeated attempts by the government to reduce its demand surplus through taxation and to arrest the grave deterioration in the balance of payments by means of devaluations. The strengthening of the balance of payments in 1976–77 was achieved at the price of stagnation in economic growth and a 30–40 percent annual inflation rate. The latter was due both to the generation of cost pressure (the stiffening of taxes and a series of devaluations), which intensified the wage-price spiral and permitted these cost increases to be expressed in price rises, even when demand was ebbing.

In the final part of 1977 there was a change of trend in domestic demand, which began with the rebounding of the housing market from its prolonged slump and was accentuated by the foreign currency reform, which expanded individual wealth and the amount of liquidity in the economy, as well as the volume of directed credit. Public spending also rose during this period, and since tax revenue lagged behind the rate of inflation, the public sector's demand surplus grew. These developments occurred against the background of a high, protracted inflation, whose basic causes varied from time to time but whose overall impact was quite similar, with the result that inflationary expectations became a permanent feature. There was almost full employment in the labor market, since the public sector expanded its personnel during the business slump, and when economic activity perked up a full employment situation soon prevailed; the manpower constraint spurred claims for wage hikes. The fact that wages were not fully protected against erosion under the cost-of-living allowance arrangement in a period of rapid inflation led to the awarding of steep pay increases in the wage pacts signed for 1978. To be sure, the aggravation of inflation eroded these gains, with the consequence that real earnings fluctuated sharply.

The growth of economic activity, against the backdrop of persistent inflation, devaluation, rising employment and wages, and monetary expansion, drove prices up steeply, from a 3 percent monthly rate to double this figure toward the end of 1978. The revival of the housing market, which sparked the turnabout in domestic demands, was also responsible for the accelerated mounting of prices in 1978, for a heavier demand for homes always pushes their prices up precipitately because of short-run supply limitations. This happened at the end of 1977, and during the following year demand for housing grew livelier, driving prices up further. What is more, until 1978 the public's financial assets portfolio had expanded appreciably, and the switch to physical assets—homes and consumer durables—sent their prices spiraling higher still.

The special character of the Israeli monetary system, which permitted the procurement of unlinked credit and the purchase of linked liquid assets, was another telling factor in the worsening of inflation in the last few years. The existence of linked money substitutes made it possible to reduce the inflation tax to a minimum, while the unlinked private sector debt to the public sector yielded capital gains; these too stimulated demand, further stoking inflation.

**Table III-1**
**SELECTED PRICE INDEXES, 1977–80**
(Percent increase, at annual rates)

| | 1977 | 1978 | 1979 | 1980 | 1979—quarterly I | II | III | IV | 1980—quarterly I | II | III | IV |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Consumer price index | | | | | | | | | | | | |
| General index | 42 | 48 | 111 | 133 | 66 | 93 | 133 | 168 | 96 | 154 | 116 | 174 |
| Housing[a] | 29 | 57 | 159 | 107 | 119 | 213 | 173 | 142 | 78 | 129 | 81 | 149 |
| Food[a] | 50 | 39 | 162 | 161 | 71 | 71 | 208 | 243 | 137 | 153 | 159 | 161 |
| Electricity, water, and fuel[a] | 56 | 28 | 169 | 169 | 120 | 20 | 278 | 426 | 78 | 146 | 125 | 180 |
| 2. Wholesale price index of industrial output | 50 | 47 | 114 | 138 | 62 | 110 | 132 | 165 | 116 | 141 | 129 | 169 |
| 3. Index of dwelling prices[b] | 22 | 144 | 101 | 124 | 160 | 136 | 90 | 53 | 65 | 117 | 146 | 185 |
| 4. Official exchange rate | | | | | | | | | | | | |
| Against the dollar | 76 | 22 | 82 | 118 | 36 | 119 | 71 | 113 | 98 | 96 | 109 | 176 |
| Against the basket of currencies[c] | 94 | 40 | 89 | 103 | 35 | 110 | 98 | 125 | 61 | 137 | 107 | 113 |
| 5. Import prices in dollars[d] | | | | | | | | | | | | |
| Total imports, excl. diamonds | 7 | 11 | 36 | 10 | 29 | 27 | 72 | 18 | 45 | 5 | 3 | –4 |
| Total imports, excl. diamonds and fuel | 7 | 11 | 18 | 6 | 15 | 11 | 33 | 15 | 22 | 8 | 7 | –9 |
| Oil imports | 8 | –1 | 119 | 23 | 110 | 122 | 290 | 26 | 125 | 0 | –6 | 10 |
| 6. Index of input prices | | | | | | | | | | | | |
| Housing construction | 40 | 58 | 117 | 134 | 68 | 193 | 129 | 95 | 89 | 197 | 109 | 155 |
| Housing construction, excl. wages | 47 | 55 | 119 | 141 | 89 | 134 | 118 | 136 | 93 | 156 | 135 | 194 |
| Road construction | 61 | 66 | 124 | 152 | 92 | 110 | 135 | 164 | 97 | 156 | 151 | 209 |
| Agriculture[e] | 45 | 46 | 115 | 150 | 55 | 110 | 176 | 138 | 135 | 178 | 121 | 170 |

[a] The weights of these items in the index for the base year (1976) are as follows: housing—20.5 percent; food—19 percent; electricity, water, fuel—3.6 percent.

[b] Homes purchased from the private sector, based on the quarterly survey of dwellings.

[c] Basket of 15 currencies, weighted according to the percentage of imports from these countries.

[d] Quarterly figures represent the difference between the average prices in the current and the previous quarter (at annual rates); annual figures represent the difference between final-quarter prices in the current and the previous year.

[e] Excluding service inputs purchased from other sectors.

The previous years' trends carried over into early 1979: prices continued upward at about the same rate, the public continued to shift from financial to physical assets, demand for homes and consumer durables remained lively, as did business demand for investment goods and the buildup of stocks of inputs.

In mid-1979 the picture changed, as the housing market softened; by the end of the year the whole economy was showing signs of a slowdown. The increase in real interest and the restrictions put on the growth of nondirected (free market) credit during 1979 reduced liquidity and made it more expensive to hold inventories, thus contributing to the easing of demand in the second half of the year. This reversal in demand did not have the same effect in all segments: the uptrend in home and durable goods prices slowed, mainly because of the need to draw down stocks, whose maintenance had become dearer, but in other segments prices moved up even more rapidly in the second half of 1979. This acceleration is explained primarily by the strong impact of supply-side factors during this period—an exceptional rise in fuel prices from the beginning of 1979, the awarding of hefty wage increases in the early part of the year, the faster devaluation of the Israeli currency (after a mild change at the beginning of the year), and a sharp increase in controlled products following the abolition of most subsidies toward the end of 1979. In this connection it is interesting to compare the cumulative growth of real ages per employee in the business sector in recent years with the negligible improvement in productivity during this period. In addition to these factors, the worsening of the terms of trade due to the jump in oil prices over the past two years intensified the upward pressure on the price level.

The fact that wages were linked only 70 percent to the consumer price index and were adjusted with a half-year lag during a period of rapidly mounting prices in itself fueled inflation. This was clearly evident in the development of wages in 1979. Since the cost-of-living adjustments account for only part of the growth of wages, with the balance being determined in the biennial agreements, compensation at the rate of only 70 percent of the increased cost of living during a period of high inflationary expectations led to the granting of steep pay rises in the new wage pacts in order to avert a serious erosion of real wages. These increments, payable as soon as the agreements go into force, in themselves set the lower bounds of the price advance and may even accelerate it. The awarding of large nominal pay hikes in 1979 is partly explained by the prevailing boom atmosphere and expectations of sustained vigorous economic growth during this period, but to some extent it can also be ascribed to the failure to adjust the cost-of-living allowance for the full increase in the inflation rate. Most of the wage agreements for 1978–79 were signed in 1978, when inflation was still running at an annual rate of around 40 percent. When it jumped to twice this level in the final part of 1978, the fact that labor was compensated for only 70 percent of the rise in the cost of living, and this only after half a year, led to the reopening of wage agreements and the granting of another round of increases in the first half of 1979. These included compensation for the unforeseen price advance at the end of 1978 and beginning of 1979, and apparently also allowed for the prospective continued aggravation of inflation; this of course gave another twist to the wage-price spiral. As it turned out, the expected continuation of the boom did not materialize and productivity increased but slightly; in addition, there was a grave deterioration in the terms of trade, which in itself called for a reduction of real wages. Eventually real wages did decline in the last quarter of 1979, due to the further escalation of inflation. The wage agreements for 1980 provided for a higher rate of indexation and more frequent adjustments, as described in the following section; this apparently helped to calm the labor market and to arrest the acceleration of inflation.

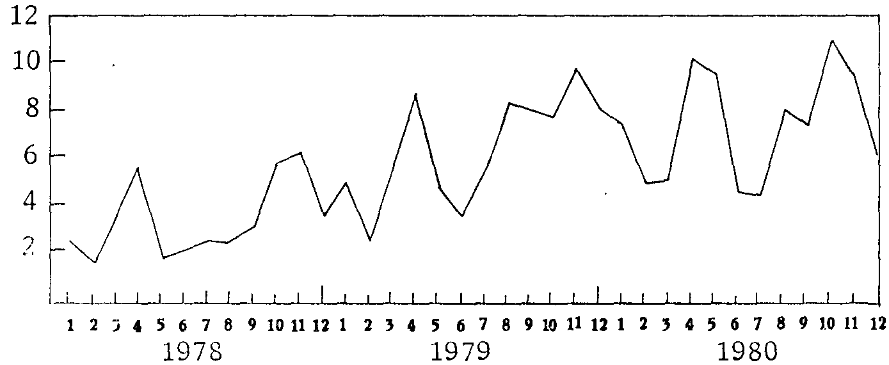
### (b) The Inflationary Process in 1980

At the beginning of 1980 domestic demands subsided further, but gradually picked up in the course of the year. The slowdown of activity did not lead to a dampening of the price advance, but it did keep it from gathering momentum, for the first time in two years. There were sharp month-to-month fluctuations, in line with the hiking of oil and basic commodity prices (see Figure III-2), and this makes it hard to accurately analyze the trend during the year. The average monthly rise came to about 7.5 percent. The wage agreements, which were due to be renegotiated in 1980, were frozen for a year, and in their stead a framework agreement was concluded, to which only plant but no branchwide increments were added. This agreement provided for a 7.5 percent pay increase in April and another 7.5 percent in November; the cost-of-living adjustment was raised to 80 percent, payable every three months. In 1980 the

**Figure III-2**

**MONTHLY CHANGE IN CONSUMER PRICES, 1978-80**

(Percentages)



wage pacts were influenced both by the growing slack in employment and the higher rate of wage indexation, which moderated specific wage claims. Consequently, real wages declined 3.5 percent on an annual average, with the level turning down very slightly in the business sector and quite sharply in the public sector, where wages had gone up appreciably in the previous year, largely due to retroactive payments (for details see Chapter IV, "Employment and Wages").

The slowdown in economic activity, as stated, did not retard the rise of prices, since the protracted inflation had led to the development of inflation-proofing devices in many areas of the economy. Some of these have become institutionalized, such as the cost-of-living allowance arrangement; the adjustment of tax brackets, pensions, and tax credit points; the linkage of bonds, local residents' foreign currency accounts, and long-term savings. In addition, there are various flexible arrangements as regards both the rate and timing of the adjustments. In the latter category are the country's exchange rate, government purchases, basic commodity prices, etc. The sharpening of inflation led to an increase in the rate and frequency of the formal linkage arrangements and other adjustments, while in areas that have not adjusted to the persistent mounting of prices (such as nonindexed credit and the taxation of inflationary profits) resources were wasted and the working of the economic system inhibited. With the linkage of development loans and housing mortgage credit (partial linkage during a transition period and full linkage thereafter), the problem of unlinked credit was in 1979 confined mainly to the stock of outstanding loans granted in the past, for nearly all the new loans were linked; this effect too is diminishing, since unlinked old debts are rapidly eroding in real value, and with it their impact on prices and demands.

The problem of inflationary taxation arises from the fact that most businesses keep their accounts on a historic cost basis (i.e. at book or nominal values), with the tax being charged on the difference between recorded income and expenses. This difference includes, in addition to actual profits, an element of "inflation profits", which is related for the most part to the timing of purchases and sales. The failure to adjust the system of taxing such profits has had undesirable results in several spheres, the most glaring of which are as follows:

(a) Additional pressure to increase prices, so that producers will be left with a real profit after paying the tax on inflation profits.

(b) Withdrawal of equity capital from firms and its replacement by borrowed funds. The equity capital has been transferred from business to other activities offering a hedge against inflation-induced erosion (such as the purchase of bonds, whose indexation increments are tax-exempt). The use of credit enables the firms to treat the interest charges and indexation increments as tax-deductible expenses.

(c) Strong pressure for general tax concessions, such as that granted on inventories, as compensation for the inflation tax; these, however, do not really solve the basic problem of taxation under inflationary conditions.

This problem and the various devices for circumventing it have inhibited the channeling of houshold savings for financing business activities, and led to greater government intervention in financial intermediation. This phenomenon has developed gradually, growing more conspicuous with the aggravation of inflation. The freezing of nondirected (free market) credit at the end of 1979 and the restriction of its expansion during 1980, coupled with the raising of its price, apparently contributed directly to the poorer performance of the economy, since for the most part it presently requires more credit than before for financing current operations. As opposed to this, household income apparently shrank; however, the liquidity of this sector was not impaired since most of its liquid assets are indexed, and so it was able to adjust to the rapid advance of prices during this period of stagflation as well.

As long as the inflationary process persists, there is no escaping the need to gear the entire monetary system to it. The adjustments made via the market mechanism, such as the switch to linked liquid assets, have been going on for several years, and in 1979–80 real money balances were halved. The institutional arrangements were also adjusted to the persistent inflation: in 1979 loans granted under the Law for the Encouragement of Capital Investments were linked, as were a large percentage of new mortgage loans. Wage indexation was fortified by the payment of cost-of-living adjustments at more frequent intervals and at a higher rate: in 1979, in addition to two such increments, three advances were paid on account of future adjustments; in 1980 the rate of indexation was raised to 80 percent of the increase in consumer prices and the number of adjustments was increased to four during the year. Moreover, tax brackets were updated four times in 1980, and at the full rate of the price advance, as opposed to two adjustments at a 70 percent rate in previous years. These changes apparently go a long way to explain the checking of the accelerated rise of prices in 1980. Social benefits (except the child allowance) were frequently adjusted in 1980, after lagging behind the consumer price index and hence eroding in value the year before. The child allowance and tax credit points were changed only twice in 1980, and so they fell steeply in real value, but beginning in 1981 they will be updated four times a year. A committee was set up to deal with the taxing of inflationary profits, and its recommendations should basically solve the problem; these have even been spelled out in a bill submitted to the Knesset.

As for the adjustment of controlled product prices, there was a change of policy in November 1979, when subsidies on most products were totally abolished. In early 1980 there was a lull in the hiking of such prices, but they were raised several times in the course of the year (for a detailed discussion see sections 3a and 3e). Fuel prices were also increased several times during the year, in line with the rise in their world prices and the exchange price (see section 3b).

As regards the exchange rate, the sheqel continued to be devalued, at a rate rougly equal to the difference between domestic and world inflation (see section 3b).

## 3. PRICE INDEXES

### (a) **Consumer Price Index**

In 1980 the consumer price index rose 133 percent (December levels), following increases of 111 percent in 1979 and 48 percent in 1978. During the year reviewed there were sharp monthly fluctuations in the rate, ranging from 4–11 percent. Domestic demands, including that for housing, slackened, and the index moved up fastest in those months when the government revised basic commodity and fuel prices; the increases were quite steep because of the lag in adjusting these items. These adjustments had both a direct effect, on the products and inputs that became dearer, and an indirect effect, by intensifying inflationary expectations. The almost total scrapping of basic commodity subsidies in November 1979 was immediately expressed in a steep jump in prices. At the beginning of 1980 signs appeared of a slowing of inflation; this was due partly to a marked weakening of demands and the running down of inventories and partly to the government's refraining from hiking fuel and basic commodity prices during that period. In April, when these prices were again revised upward, inflation accelerated anew, and the downtrend in inflationary expectations was reversed. The price advance was relatively moderate in June and July, but in August it again picked up steam, this time too in connection with the raising of fuel and basic commodity prices. In October there was another round of steep increases, and in the last quarter the level rose at a 9 percent monthly rate (see Figure III-2). The upsurge of food and fuel in the final part of 1979 and throughout 1980 stood out, after they had moved up at a below-average pace in the preceding period. Since the middle of 1979 the relative price of homes has retreated, after it had soared at an unusually fast rate since the beginning of 1978 (see section d). Consumer durables, in particular motor vehicles, also trailed behind the other items; this trend has been evident since the beginning of 1979, and is typical of the cyclical demand and price pattern of these products.[1] The decline in the relative price of durables was even sharper this time because of the exceptional increase in the price of credit, which made it necessary to quickly reduce stocks of such goods; since this took place in a period of depressed demand, the relative price of these items dipped precipitously.

[1] The decline in the relative price of motor vehicles reflects the slump in the used car market. In determining the weight of this item in the consumer price index, the data used are not purchases of vehicles but consumption of the services provided by the entire stock; hence used cars carry considerable weight.

**Table III-2**

**CHANGES IN CONSUMER PRICES BY MAJOR COMPONENTS, 1977–80**

(Percent annual increase)[a]

| | Weight in 1976 | 1977 | 1978 | 1979 | 1980 |
|---|---|---|---|---|---|
| Total | **1,000** | **42.5** | **48.1** | **111.4** | **132.9** |
| **Goods** | | | | | |
| Agricultural products | 76 | 33 | 63 | 88 | 169 |
| Fresh fruit and vegetables[b] | 52 | 32 | 74 | 79 | 167 |
| Other | 24 | 35 | 40 | 112 | 174 |
| Industrial products | 463 | 49 | 46 | 99 | 137 |
| Food | 174 | 53 | 39 | 135 | 148 |
| Clothing and textiles | 74 | 32 | 50 | 63 | 136 |
| Leather, rubber, and plastics | 27 | 42 | 45 | 86 | 113 |
| Wood and wood products | 27 | 45 | 45 | 83 | 125 |
| Metal and machinery | 9 | 46 | 48 | 81 | 126 |
| Transport equipment | 29 | 69 | 84 | 37 | 70 |
| Electrical equipment | 45 | 55 | 45 | 55 | 115 |
| Chemicals | 19 | 46 | 52 | 101 | 141 |
| Petroleum and petroleum products | 29 | 53 | 35 | 160 | 175 |
| Paper and publishing | 15 | 52 | 46 | 102 | 146 |
| Miscellaneous | 15 | 48 | 50 | 99 | 146 |
| **Services** | | | | | |
| Construction and housing services | 207 | 30 | 58 | 156 | 107 |
| Other services | 254 | 44 | 42 | 110 | 137 |
| Electricity and water | 25 | 57 | 26 | 171 | 166 |
| Transport and postal services | 48 | 43 | 32 | 146 | 143 |
| Education | 25 | 29 | 15 | 89 | 133 |
| Health | 32 | 52 | 66 | 97 | 147 |
| Hotels | 36 | 52 | 43 | 96 | 137 |
| Other business services | 6 | 21 | 52 | 147 | 106 |
| Personal services | 50 | 51 | 51 | 96 | 127 |
| Insurance and taxes | 31 | 31 | 46 | 77 | 101 |

[a] Change in December levels.

[b] Since fresh fruit and vegetables are subject to frequent seasonal fluctuations, it is preferable to compare annual averages; these went up 27 percent in 1976, 32 percent in 1977, 41 percent in 1978, 79 percent in 1979, and 163 percent in 1980.

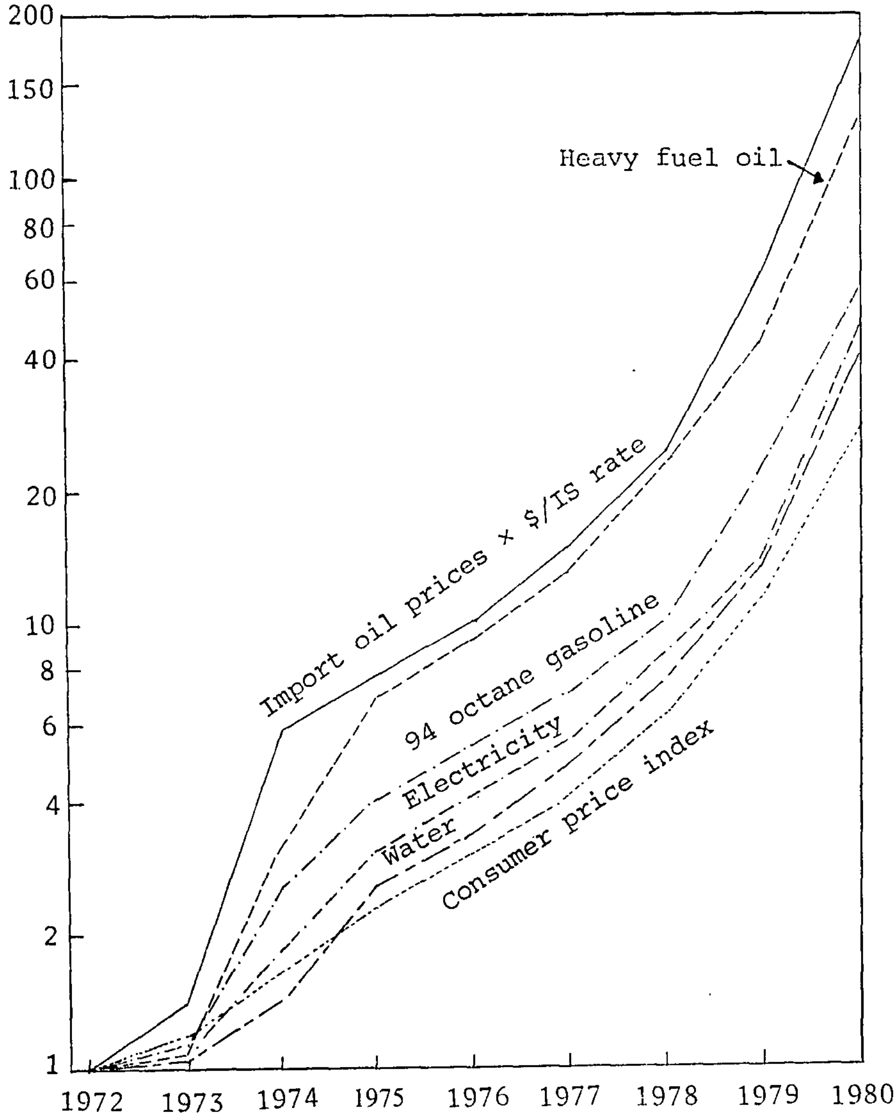
SOURCE: Central Bureau of Statistics, *Price Statistics Monthly*, January 1981.

## (b) Import Prices

The price of the dollar soared 118 percent in 1980, after rising 82 percent the year before. In 1979 and the beginning of 1980 the world market price of oil shot up at an exceptional rate. Exclusive of oil and diamonds, import

**Figure III-3**

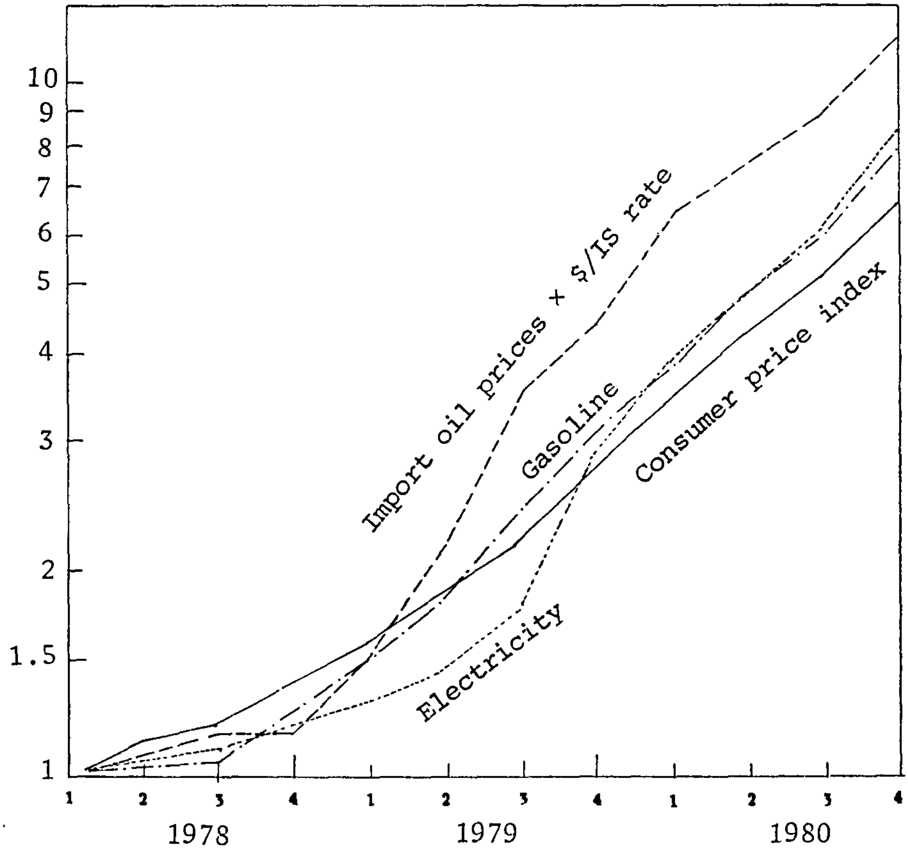
**MOVEMENT OF OIL AND ENERGY-RELATED PRODUCT PRICES COMPARED WITH CONSUMER PRICES, 1972-80**




Semilogarithmic scale.

Figure III-4

**MOVEMENT OF OIL AND ENERGY-RELATED PRODUCT PRICES COMPARED WITH CONSUMER PRICES, QUARTERLY, 1978–80**




Semilogarithmic scale.

prices moved up only 6 percent during 1980,[2] after an 18 percent increase in the previous year; the slower rise this year was due mainly to the strengthening of the dollar against other currencies. Oil import prices continued to climb rapidly in early 1980 and then tapered off. Thus import prices including oil but excluding diamonds went up 133 percent during 1980, similar to the rise in domestic prices. Because of the modest increase in the domestic price of fuel in 1979, a differential arose between it and the price of oil to the economy (see Figure III-4). It should be pointed out that some disparity between the two is "justified" in a period when relative prices abroad are changing, for the price of fuel includes, in addition to its import component, a local expenditure component as well as a tax or subsidy component, which is a policy tool that lends itself to flexible adjustment. In conformity with the

[2] The fourth quarter of 1980 compared with the same period the year before.

government's policy pursued since the end of 1979, the local prices of all the various types of fuel were raised during 1980 in line with the rise in their world prices and in the exchange rate.

The multiyear picture is presented in Figures III-3 and III-4. Several distinct subperiods can be discerned: After the 1973 OPEC shock fuel prices were hiked steeply in the local market, but not to the full extent of their cost to the economy. From that point until 1978 prices went up in line with their cost; in 1979, when there was another OPEC shock, local prices were raised sharply but still lagged behind the cost to the economy. In 1980 prices were revised upward to cover all the extra cost. It will thus be seen that the gap was not closed, but neither did it widen. It should be pointed out that gasoline is heavily taxed, while other petroleum products were and still are quite heavily subsidized. To reduce this subsidy, prices were adjusted at differential rates for the various types of petroleum products.

### (c) Wholesale Prices of Industrial Output for the Domestic Market

Wholesale industrial prices shot up 138 percent in 1980, with the curve ascending more steeply as the year wore on, after it had tailed off a bit in the early months. These prices slightly outpaced the consumer price index, a development typical of a period of flagging demand and falling profit margins (see Table III-3). This trend was apparent in all branches in 1979 and in most of them in 1980. In 1978, on the other hand, the trend had been mixed, with

**Table III-3**

**ANNUAL AVERAGE CHANGE IN CONSUMER PRICES AND IN WHOLESALE PRICES OF INDUSTRIAL OUTPUT FOR PRIVATE CONSUMPTION,[a] 1978–80**

(Percentages)

| | 1978 | | 1979 | | 1980 | |
|---|---|---|---|---|---|---|
| | Wholesale prices | Consumer prices | Wholesale prices | Consumer prices | Wholesale prices | Consumer prices |
| Food | 43.4 | 46.9 | 80.5 | 78.0 | 165.2 | 164.9 |
| Furniture | 51.6 | 51.4 | 85.0 | 63.8 | 109.3 | 103.0 |
| Clothing and textiles | 45.3 | 49.8 | 67.1 | 61.6 | 100.3 | 97.8 |
| Paper and publishing | 69.1 | 54.2 | 88.6 | 70.0 | 97.9 | 98.4 |
| Chemicals | 67.9 | 51.2 | 82.1 | 77.9 | 130.4 | 133.8 |
| Metal, machinery, and | | | | | ETAOIN | ETA |
| electrical equipment | 57.8 | 57.3 | 60.2 | 74.5 | 102.2 | 95.5 |
| Transport equipment | 80.4 | 102.0 | 63.1 | 45.3 | 129.9 | 34.8 |
| Miscellaneous | 64.4 | 53.0 | 78.2 | 66.9 | 141.3 | 142.7 |

[a] The changes in consumer prices relate to the industrial products included in the consumer price index, while the changes in wholesale prices relate to those categories of industrial output intended for private consumption.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

consumer prices outstripping wholesale prices in some branches and lagging behind in others because of demand pressure. A comparison of semiannual data indicates a slump in the second half of 1979 and first half of 1980 and a recovery in the second half of 1980.

### (d) Housing Prices

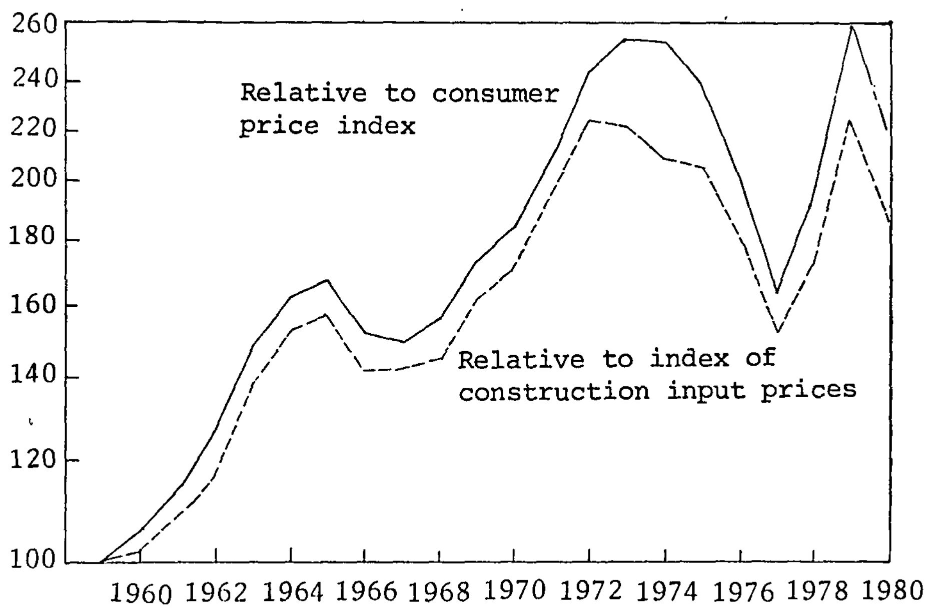
Since mid-1979 dwelling prices have moved up more slowly than other items, after they far outraced the latter during the previous year and a half. This reflects the turnabout in construction activity, as the heavy demand for homes in 1978 and the beginning of 1979 ebbed during the latter year and even more so in early 1980.

The survey of dwelling prices shows that the advance began to slacken in mid-1979 and slowed more noticeably at the end of the year and during 1980. For technical reasons changes of trend in the housing item are reflected in the consumer price index after some time lag, and so it was only at the end of 1979 that the downswing in the relative price was registered, a decline that grew sharper at the beginning of 1980. The long-term movement of the relative price of housing is depicted in Figure III–5, and during the latest business

**Figure III–5**

**RELATIVE PRICE OF HOUSING,[a] 1959–80**

(1959=100)



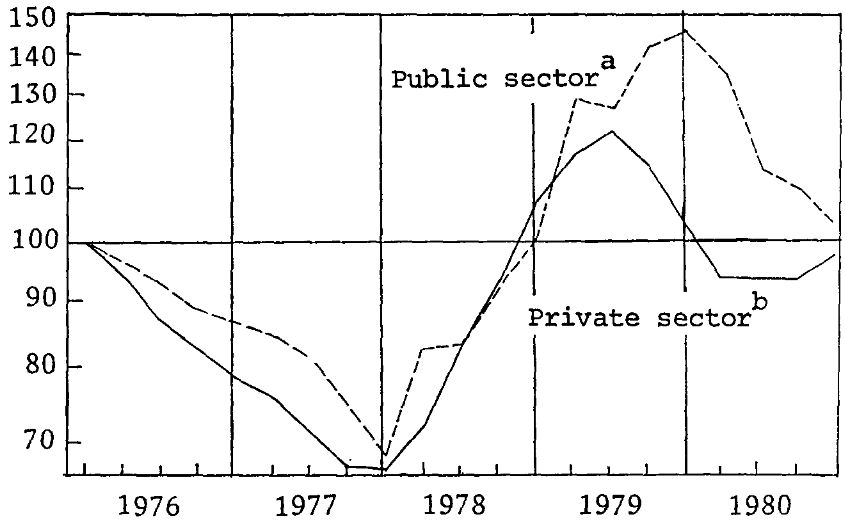

[a] From the CBS survey of dwelling prices, which covers homes purchased from the private sector and under the public housing program.

Semilogarithmic scale.

Figure III-6

HOUSING PRICES RELATIVE TO CONSUMER PRICE INDEX, 1976–80

(1976I=100)




[a] Price of homes purchased under the public housing program relative to the consumer price index.

[b] Price of homes purchased from the private sector relative to the consumer price index.
Semilogarithmic scale.

cycle in Figure III-6. From these diagrams it will be seen that at the end of 1980 the level was similar to that in 1976, which characterized the first years of the decade. Another striking feature was the sharp rise in the relative price of publicly sponsored housing in 1979 as a whole, whereas in private building the curve began to turn down in mid-year in response to the weakening of demand.

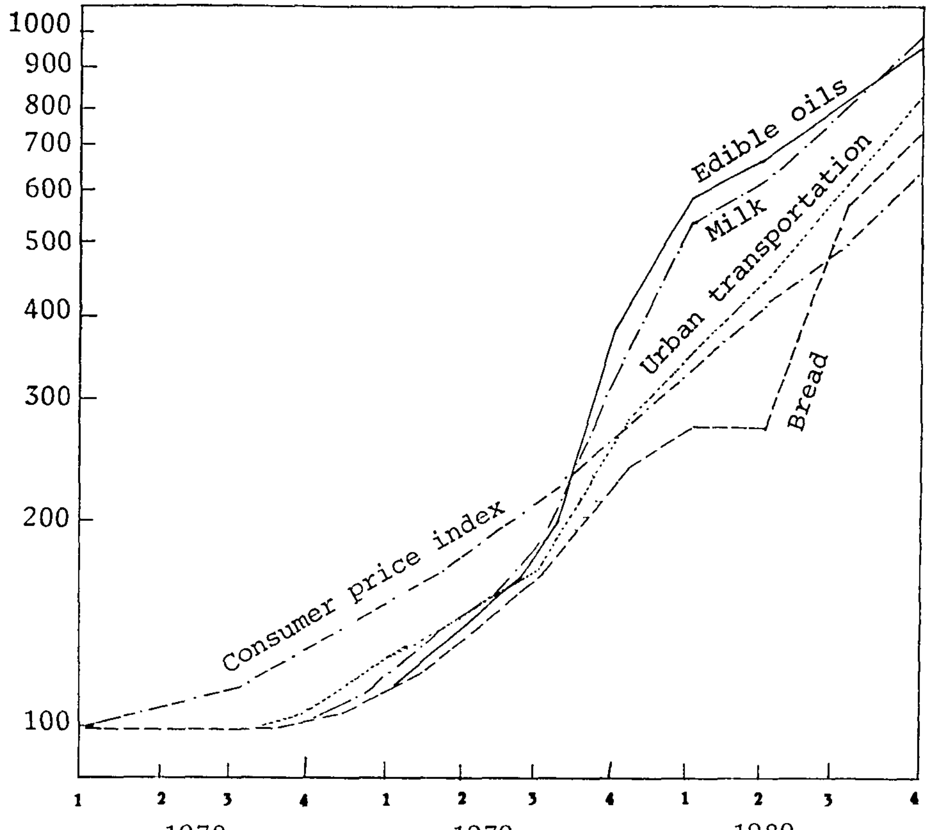
As opposed to this, the index of residential construction input prices continued to mount at a pace matching that of other prices (128 percent on a yearly average, 134 percent in December levels). It should be noted that this index does not include the price of land, which became much cheaper in real terms this year, or builders' profits, which apparently were also squeezed. Among the various inputs the increase in the price of haulage stands out (170 percent), a result of the dearer cost of gasoline and lubricants. Wages rose 124 percent, roughly the same as the national average.[3]

[3] For a detailed discussion of the housing market see the section on construction in Chapter VI.

### (e) Controlled Commodity Prices

Until November 1979 the subsidy policy with respect to basic commodities was to partially adjust their prices from time to time in proportion to the rise in the general index. In reality the adjustments were not made at fixed intervals, and their frequent postponement for various reasons resulted in an unplanned heavier subsidization of these commodities. The delays in adjustment and the acceleration of inflation, especially in 1978, called for a bigger price rise than that eventually decided upon. Over the years the list of subsidized items shrank to a small number of food products and public transport, but the shortcomings of the system were apparent here too, and it was therefore decided in November 1979 to completely lift most of these price supports, leaving a substantial subsidy only on bread and public transport and a small one on frozen fowl. As a consequence of this change, the prices of the desubsidized items shot up at a stroke (most of them even doubled, as may be seen in Figure III-7). It

**Figure III-7**
**INDEX OF SELECTED CONTROLLED PRICES, 1978–80**
(1978I=100)



Semilogarithmic scale.

**Table III-4**

**RATES OF CHANGE IN SELECTED INDEXES, 1968–80**
(Percent annual averages)

| | Average | | | | | |
|---|---|---|---|---|---|---|
| | 1968–70 | 1971–73 | 1974–77 | 1978 | 1979 | 1980 |
| Consumer price index | 3 | 15 | 36 | 51 | 78 | 131 |
| Wholesale price index of industrial output[a] | 4 | 14 | 40 | 53 | 79 | 136 |
| Index of agricultural input prices[b] | 5 | 14 | 41 | 51 | 78 | 146 |
| Index of housing construction input prices | 6 | 18 | 34 | 57 | 87 | 128 |
| Index of road construction input prices | 6 | 15 | 40 | 75 | 92 | 145 |
| Exchange rate against the dollar[c] | 5 | 6 | 26 | 67 | 46 | 102 |

[a] Excluding printing and publishing.
[b] Excluding agricultural services.
[c] The official exchange rate until October 1977 and the representative rate thereafter.

should be stressed that, despite the abolition of subsidies, price control on these items has been retained, and any revision must be officially approved. In 1980 prices were upped from time to time to allow for the rise in their cost of production; the impact of this on inflation was greater than the weight of these items in the consumption basket. In early 1981 the policy was again altered: it was decided to adjust these prices at a moderate rate only, as part of the attempt to retard the advance of prices by tempering inflationary expectations. As a result, in 1981 subsidies will be partially restored on those products which had been desubsidized in November, 1979.

### (f) Price of the Consumption Basket of Various Population Groups

The price of the consumption basket of families in the lowest decile rose during 1980 by 144 percent, compared with 128 percent in the highest decile. This difference stemmed from a relatively modest increase in dwellings and private vehicles, whose weight is greater in the highest decile, and from an above-average rise in food, public transport, and household fuel, whose weight is especially high in the lowest decile. In 1979 the prices of the consumption baskets of the two extreme income groups went up at a similar rate.[4] The disparate rates of change in the year reviewed are not indicative of any lowering of the standard of living of families in the bottom decile, for while they were hit by inflation, they also received compensation in the form of increased direct support.

[4] For details see CBS, *Price Statistics Monthly*, December 1980.