

CHAPTER XV

THE MONEY SUPPLY

1. THE EXPANSION OF THE MONEY SUPPLY

THE MONEY supply amounted to IL.517.3 million at the end of 1956 as compared with IL.419.7 million at the end of 1955 (see table XV-II); it rose therefore by IL.97.6 million or 23.3 per cent. This rate of expansion was about 3 per cent greater than in 1954 and 1955, though somewhat smaller than in 1953 (see table XV-I and diagram XV-1).

The average volume of the money supply was 18 per cent larger during 1956 than in the preceding year¹.

TABLE XV-1
The Money Supply, 1948-1956
(in IL. millions)

<i>Year</i>	<i>Currency outside banks</i>	<i>Current deposits</i>	<i>Money supply</i>	<i>Increase in money supply (in per cent)</i>
1948	30.6	70.2	100.8	—
1949	43.3	96.9	140.2	39.1
1950	64.8	125.0	189.8	35.4
1951	91.0	150.5	241.5	27.2
1952	106.0	151.2	257.2	6.5
1953 ^a	128.0	192.3	320.3	24.5
1953 ^b	128.0	162.1	290.1	—
1954	146.6	201.9	348.5	20.1
1955	172.5	247.2	419.7	20.4
1956	228.3	289.0	517.3	23.3

^a Computed according to former series, which included foreign currency deposits by the public.

^b Computed according to new series, which exclude foreign currency deposits by the public.

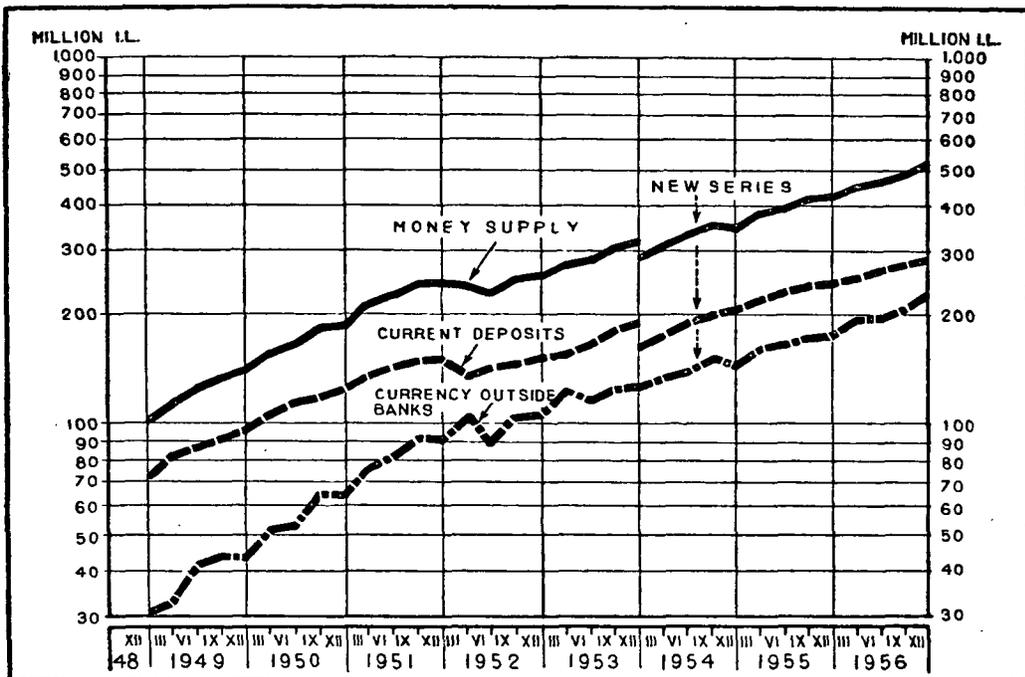
SOURCE: The Central Bureau of Statistics and the Bank of Israel.

The expansion of the money supply during 1956 may in fact have been somewhat more rapid than shown by table XV-1, as the new inter-bank

¹ The increase in the average money supply during 1956 was smaller than the difference between the total money supply at the end of 1955 and at the end of 1956, because the major expansion of the money supply occurred in 1955 during the first half, whereas they occurred in 1956 during the second half of that year.

clearing system, introduced in May 1956, reduced the amount of balances in transit between banking institutions. The reduction of balances in transit caused a decline in the recorded amount of the money supply, which was in part purely statistical and did not represent a reduction of the total liquid assets actually held by the public. (See section 2(e) below).

DIAGRAM XV-1
Money Supply, 1948-1956
(in million IL.)



An analysis of the seasonal fluctuations of the money supply in recent years² demonstrated that the tendency to expand the means of payment is strongest during the first quarter. The reason for this is the seasonality of the factors directly responsible for changes in the quantity of money: during the first quarter, foreign currency conversion is usually at its peak, due to the seasonal rise in foreign currency revenues from exports and other sources. Credit granted to the public is especially liable to increase at this time, after having been reduced deliberately by some banking institutions prior to the drawing up of their annual balance sheets. Credit granted to the Government generally

² The analysis has been made for 1954 and the subsequent years, owing to changes in the definition of the money supply and in banking statistics introduced towards the end of 1953.

money supply to a limited extent only, since most of these Government purchases were financed by additional credit obtained from the Bank of Israel.

(b) *The Government's Debt to the Banking System*

The Government's local currency accounts with the banking system show an increase of net indebtedness amounting to IL.76 million in 1956 (see table XV-7, column 2)—almost entirely with the Bank of Israel. Government debt, the variation of which affects the fluctuations of the money supply, includes current advances, Treasury Bills, and Government securities, after deduction of the paid-up capital of the Bank of Israel, ordinary Government deposits, and Government deposits earmarked for loans but from which no disbursements have yet been made.⁶

The Government's debt to the banking system fell by about IL.17 million during the first quarter of 1956, but rose at an accelerated rate during the second and third quarter. In the last quarter, the rate of expansion slowed down somewhat. This development is contrary to the movements of previous years, when Government debt increased at a progressively slower rate during the latter part of the financial year. During the second half of 1956, the Government's debt increased to the considerable extent of about IL.80 million.

(c) *Bank Credit to the Public*

Local currency credit, granted to the public from the resources of the banking system,⁷ was expanded by IL.35.9 million during 1956, as against only IL.22.8 million in 1955. Of the former sum, IL.10.3 million were given in the form of re-discounts by the Bank of Israel, and IL.25.6 million were granted from the resources of the banking institutions (see table XV-4).

During the first four months of the year, additional credit of more than IL.10 million was granted to the public. In contrast to previous years the expansion did not level off during the following months, but continued at an increasing rate. Between May and October 1956, local currency credit was expanded by some IL.35 million, in November and December, however, the banking institutions reduced their outstanding credit balances to the considerable extent of some IL.14 million. On the other hand, the amount of bills discounted by the Bank of Israel during these last two months increased by more than IL.4 million; the total out-

⁶ The difference between the Government debt which affects the money supply and total Government debt (described in Chapter XVII below) consists of credits given to the Government in foreign currency, which do not increase the money supply, and of Government deposits in foreign currency, which decrease the net credit extended to the Government, but do not affect the money supply.

⁷ Credit in foreign currency has not been included when computing the effect of credit on the money supply, as it is impossible to isolate the increase in foreign currency deposits arising from the granting of such credit.

stated, appreciably different at the end of 1956 from the end of 1955, but their fluctuations during the course of 1956 had a considerable influence on the development of the money supply (see table XV-3).

TABLE XV-3
Conversion of Foreign Currency, 1955 and 1956
(in IL. millions)

<i>Month</i>	<i>1955</i>	<i>1956</i>
January	1.8	10.0
February	9.5	2.0
March	17.2	28.3
April	6.4	- 9.0
May	6.5	- 0.7
June	- 8.9	6.4
July	- 5.1	-21.3
August	27.0	- 2.5
September	-17.3	-16.3
October	-10.0	-11.0
November	16.0	13.0
December	7.5	7.4
<i>Total</i>	50.6	6.3

SOURCE: Calculations of the Bank of Israel.

During the first quarter of 1956, the net positive conversion of foreign currency amounted to IL.40.3 million. Though the amounts converted were particularly high during the first quarters of 1955 and 1956, when incomes from exports reached their peak, the conversions effected during the first quarter of 1956 exceeded by far those of the corresponding period of 1955, which amounted to IL.28.5 million only. However, in 1955, positive conversion was also continued during most of the remaining nine months of the year, so that by the end of December a further IL.22 million had been converted, while during the corresponding period of 1956, there was a negative conversion of approximately IL.34 million.

During 1956 the public⁵ converted foreign currency to the amount of IL.85 million, of which about IL.65 million were converted during the first half of the year. On the other hand, the Government reduced the amount of foreign currency assets by IL.79 million. The entire contraction of the foreign currency reserves took place between April and October. The conversion of foreign currency by the public—mainly during the first six months of the year—was an important cause of the expansion of the money supply during that period. On the other hand, the acquisition of foreign currency by the Government decreased the

⁵ Including, in this instance, the Jewish Agency, the National Institutions and other public bodies, but excluding the Government.

TABLE XV-2
The Money Supply, 1956
(in IL. millions and in per cent)

	<i>The money supply in IL. millions</i>	<i>Change</i>			
		<i>in IL. millions</i>		<i>in per cent</i>	
		<i>monthly</i>	<i>quarterly</i>	<i>monthly</i>	<i>quarterly</i>
1955—December	419.7	—	—	—	—
1956—January	417.1	-2.6	—	-0.6	—
February	424.9	7.8	—	1.9	—
March	448.7	23.8	29.0	5.6	6.9
April	455.3	6.6	—	1.5	—
May	458.9	3.6	—	0.8	—
June	466.0	7.1	17.3	1.5	3.9
July	475.2	9.2	—	2.0	—
August	483.6	8.4	—	1.8	—
September	486.5	2.9	20.5	0.6	4.4
October	491.6	5.1	—	1.0	—
November	507.9	16.3	—	3.3	—
December	517.3	9.4	30.8	1.9	6.3
<i>Total</i>			97.6		23.3

SOURCE: Bank of Israel.

and the changes in other types of liabilities. These factors (the most important of which are the conversion of foreign currency, changes in the volume of credit granted to the Government and to the public, and changes in time deposits) are both the result of the general trends operating in the economy, as well as of forces influencing these trends either independently, or by virtue of determining the fluctuations of the money supply.

(a) *The Conversion of Foreign Currency*

The conversion of foreign currency represents the acquisition of assets in foreign currency⁴ or gold by the banking system from the public or the Government, against payment in local currency. The opposite operation, namely the sale of foreign currency in the banking system against Israel pounds, is termed "negative conversion."

Foreign currency and gold reserves of the banking system increased by IL.6 million in 1956. The state's foreign currency receipts during this period by far exceeded those of 1955, when foreign currency reserves had increased by more than IL.50 million; during the year under review, however, foreign currency expenditure increased considerably (see table XV-3 and Chapter III of this report).

Total foreign currency assets of the economy were not, as has already been

⁴ Including, in addition to balances, loans and securities registered in foreign currencies.

tends to shrink during the last months of the fiscal year, as tax revenue is at its peak during this period, while the rate of expenditure remains virtually constant. This is, however, insufficient to offset the expansion of the money supply caused by the two foregoing factors.

April, May, June and July are months of relative stability as regards the direct factors influencing the money supply, except for credit to the Government, which tends to expand at the beginning of the financial year and causes a moderate increase in the quantity of money.

August and September leave all factors influencing the money supply comparatively unaffected. In October, conversion of foreign currency is increasing, due to the transfers by institutions and the sales of Independence and Development Bonds. However, the upward trend resulting from foreign currency conversion is usually offset in November and December by a seasonal contraction of credit to the public, an increase in time deposits, and the decline in advances to the Government which can be expected to start in November. Taking the combined effect of all the factors influencing the money supply, it appears that the last two months of the year are the most stable and, unless particularly strong influences of a non-seasonal character are in operation, they do not usually show a significant increase in the money supply.

A comparison of the seasonal fluctuations in the money supply in 1956 with previous years, shows that the rate of expansion was slightly different but—with the exception of the last quarter—the seasonal movements were generally similar to those of the preceding years. The largest increase occurred during the first quarter, while during the second and third quarters the pace slackened, as shown in table XV-2. However, after a relatively small rise in September and October, the money supply began to expand at a rapid rate during November and December, as the result of the larger volume of credit granted to the Government. This development was largely connected with the Sinai campaign.

2. THE DIRECT FACTORS AFFECTING THE MONEY SUPPLY

In Israel, as in most other countries, the money supply is defined to include the demand deposits of the public, and currency in circulation *less* cash held by banking institutions, exclusive of the banking system³ and the Government. The money supply is therefore made up of the liabilities of the Bank of Israel, in the form of the currency issued by it, and of the liabilities of the banking institutions represented by demand deposits. The direct factors responsible for the creation of these liabilities of the banking system may be traced by examining the fluctuations on the assets side of the banking system's balance sheets,

³ The banking system, as defined in this report, includes the banking institutions, i.e. the commercial banks and credit co-operatives, as well as the Bank of Israel.

standing credit to the public in local currency thus decreased by approximately IL.10 million.

TABLE XV-4
Bank Credit to the Public in Israel Currency, 1956
(IL. millions)

	Amount			Changes		
	Bank of Israel	Banking institutions	Total	Bank of Israel	Banking institutions	Total
1955—December	9.5	234.0	243.5	—	—	—
1956—January	9.9	235.1	245.0	0.4	1.1	1.5
February	9.8	236.6	246.4	-0.1	1.5	1.4
March	11.1	242.2	253.3	1.3	5.6	6.9
April	12.8	241.5	254.3	1.7	-0.7	1.0
May	13.9	246.3	260.2	1.1	4.8	5.9
June	14.0	253.5	267.5	0.1	7.2	7.3
July	15.7	256.5	272.2	1.7	3.0	4.7
August	15.1	262.9	278.0	-0.6	6.4	5.8
September	13.7	265.2	278.9	-1.4	2.3	0.9
October	15.7	273.3	289.0	2.0	8.1	10.1
November	16.4	268.7	285.1	0.7	-4.6	-3.9
December	19.8	259.6	279.4	3.4	-9.1	-5.7
<i>Change in IL. millions</i>				10.3	25.6	35.9
<i>Annual increase, in per cent</i>				108.4	10.9	14.7

SOURCE: Bank of Israel.

(d) *Time Deposits of the Public*

A considerable proportion of time deposits in the banking institutions, though not formally included in the money supply, do in fact constitute means of payment, since some of the banking institutions permit their clients to draw on them—usually without prior notice. Many owners of such deposits therefore consider them as assets not less liquid than demand deposits. The higher the liquidity of time deposits, the more do they resemble money and thus confer immediate purchasing power upon their owners. Yet, according to the definition of the money supply, every addition to time deposits reduces the amount of demand deposits or of currency held by the public, i.e. causes a contraction of the money supply.

The volume of the different types of time deposits expanded by IL.12.1 million during the year under review, representing an increase of 15 per cent. The fluctuations in the different types of time deposits at banking institutions are given in table XV-5.

TABLE XV-5
Deposits of the Public in Banking Institutions, 1955 and 1956
(in IL. millions)

<i>Type of Deposits</i>	<i>End of 1955</i>	<i>End of 1956</i>	<i>Change</i>	
			<i>in IL. millions</i>	<i>in per cent</i>
Demand Deposits	247.2	289.0	41.8	16.9
Time Deposits and Guarantee Deposits ^a	75.6	87.6	12.0	15.9
Deposits Earmarked for Loans ^b	5.3	5.4	0.1	1.9
<i>Total Deposits</i>	328.1	382.0	53.9	16.4
<i>Total Deposits Other than Demand Deposits</i>	80.9	93.0	12.1	15.0

^a Sums which had to be deposited by the banking institutions' clients for the implementation of certain transactions, such as the opening of letters of credit.

^b Third-party deposits, and deposits of public bodies earmarked for loans.

SOURCE: Bank of Israel.

At the end of 1955, certain banking institutions introduced saving schemes, in accordance with which interest at relatively high rates was allowed on deposits for extended periods. On the assumption that these schemes would encourage saving, the Government and the Bank of Israel made certain concessions both to the depositors (by limiting the deductible income tax to 25 per cent) and to the banking institutions concerned, the latter being required to invest at least 60 per cent of the amount of these deposits in securities approved by the Government, but permitted to utilize the remaining 40 per cent for the expansion of credit beyond the usual permissible ceiling (25 per cent of these additional credits were made subject to specific authorization by the Bank of Israel). In so far as these permissions to expand credit are not fully utilized, the banking institutions are obliged to deposit the surplus with the Bank of Israel.

The increase in time deposits, including saving schemes, which amounted to IL.12.1 million or 15 per cent, should be compared with the increase of some 17 per cent in the volume of demand deposits and the expansion of the money supply by more than 23 per cent. Accordingly, it cannot be concluded that the encouragement of time deposits changed the preference of the public for more liquid assets. Of the additional time deposits, IL.10.7 million were connected with saving schemes, i.e. were the least liquid of time deposits. However, it seems certain that some of the depositors transferred to these saving accounts that part of their demand deposits, or ordinary time deposits which was, in any case, utilized only in exceptional circumstances. Inasmuch as owners of saving deposits do not consider their liquidity to have lessened, these saving schemes have no effect on the general liquidity position of the public and thus on effective de-

mand. Hence, it is possible that the expansion of time deposits during 1956 did not reduce demand to any considerable extent—and indeed, may even have indirectly helped to increase the money supply by enabling banks to purchase securities and expand credit.

An additional factor diminishing the money supply—according to the balance sheets of the banking institutions—were various loans received by the banks from public bodies, or the participation of public bodies, such as the Jewish Agency, in loans granted by the banking institutions. These loans may also be deducted from the total volume of credit granted to the public, but for statistical and technical reasons their effect on the money supply was computed similarly to that of time deposits.

The total amount of loans of this type increased by IL.4.2 million during the year. Other factors that reduced the quantity of money in 1956 were the increase of the banking institutions' own capital by IL.5 million and an addition of IL.2.9 million to other accounts representing liabilities of the banking institutions (net, after deduction of accounts constituting assets).

(e) *Balances in Transit*

The amount of balances in transit within the banking system exercised a particularly important influence on changes in the money supply during 1956. Balances in transit are created by delays in the crediting or debiting of one banking institution by another. The effect of the time-lag is twofold: in the first instance, the balances kept at other local banking institutions as on the books are larger than their actual amounts. Hence, when the balance sheets of all the banking institutions are totalled up, the sum of balances kept in other banking institutions exceeds the sum of balances kept for other banking institutions, though these two figures should be equal. The difference constitutes balances in transit.

The second effect is that because of this delay the books show an amount of deposits larger than really exists when the cheque in transit is drawn on a deposit, and the appearance of a smaller volume of deposits than actually exists when the cheque in transit is drawn on a debitory account.

The growth of balances in transit inflates the money supply, creates credit which is not recorded in the reports of the banking institutions, and creates a loophole for the circumvention of credit restrictions. In May 1956, the clearing arrangements were, therefore, amended—to the effect of reducing the time-lag in the crediting and debiting of bank accounts (see Chapter XXII below).

The new system of registering clearing balances in the books of the Bank of Israel reduced the amounts in transit within the banking system from IL.27.5 million at the end of April 1956 to IL.13.1 at the end of May, i.e. by more than 50 per cent. The decline of balances in transit also decreased the quantity of money, but, as already stated, this decrease was largely formal. The importance of the reduction of balances in transit is mainly that it limits the possibilities of circumventing the credit restrictions.

TABLE XV-6
Factors Causing Changes in the Money Supply, 1956^a
(in IL. millions)

	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>Total</i>
<i>Debitory Accounts of the Public</i>					
Increase in Credit from the Bank of Israel	1.6	2.8	- 0.2	6.1	10.3
Increase in Credit from the Banking Institutions	8.2	11.4	11.6	-5.6	25.6
<i>Total Credit</i>	9.8	14.2	11.4	0.5	35.9
Increase in Investments of Banking Institutions in non-governmental Securities	1.0	2.5	0.6	1.4	5.5
Increase in Investments of Banking Institutions in Immovable Assets	0.9	0.7	0.3	1.2	3.1
<i>Total</i>	11.7	17.4	12.3	3.1	44.5
<i>Creditory Accounts of the Public</i>					
Increase (-) in Time Deposits with Banking Institutions	- 3.0	- 5.7	- 0.7	- 2.8	-12.2
Increase (-) in Loans to Banking Institutions	- 0.7	- 0.3	- 1.3	- 1.9	- 4.2
Increase (-) in Own Capital of Banking Institutions	- 1.6	- 1.1	- 0.7	- 1.6	- 5.0
<i>Total (-)</i>	- 5.3	- 7.1	- 2.7	- 6.3	-21.4
<i>Net Increase in Debitory and Creditory Accounts of the Public</i>					
	6.4	10.3	9.6	- 3.2	23.1
Net Increase in Other Accounts of the Public	- 2.5	- 0.4	1.3	- 1.3	- 2.9
Increase in Balances in Transit	1.6	- 9.3	3.6	- 0.8	- 4.9
<i>Total Accounts of the Public in Israel Currency</i>	5.5	0.6	14.5	- 5.3	15.3
Increase in Net Government Debt in Israel Currency	-16.7	19.9	46.1	26.7	76.0
<i>Total Increase in Israel Currency Accounts</i>	-11.2	20.5	60.6	21.4	91.3
Conversion of Foreign Currency	40.3	- 3.3	-40.1	9.4	6.3
<i>Total, All Factors</i>	29.1	17.2	20.5	30.8	97.6
Discrepancies, etc. ^b	- 0.1	0.1	—	—	—
<i>Change in Money Supply</i>	29.0	17.3	20.5	30.8	97.6

^a Figures without a minus sign denote changes expanding the money supply; figures with a minus sign (-) denote changes decreasing the money supply.

^b Errors, omissions and the rounding of figures.

SOURCE: Calculations of the Bank of Israel.

After their extraordinary contraction during May, balances in transit continued to increase, reaching IL.18.5 million at the end of the year. Taking the year as a whole, the decline in the volume of these balances totalled IL.4.9 million, and to this extent they represented a contractionary factor with regard to the money supply.

3. THE INFLUENCE OF THE GOVERNMENT AND THE NON-GOVERNMENTAL ECONOMIC SECTOR UPON THE DEVELOPMENT OF THE MONEY SUPPLY

The foregoing factors affecting the money supply may be divided into "sectors" the activities of which directly induced the changes that occurred in them. For this purpose, a distinction can be made between the direct influence of the Government⁸ and the direct influence of non-governmental economic sectors, not only with regard to the local currency accounts with the banking system, but with regard to the effects of foreign currency conversion. This classification, which is shown in table XV-7 is, however, of only limited significance, since the dividing line between governmental and non-governmental economic activities is neither fixed nor always clearly defined. This applies in particular to import transactions, affecting foreign currency conversion.

(a) *The Government*

Government activities were not directly responsible for the expansion of the money supply in 1956. In January February and March—the last quarter of the financial year 1955/56—the Government represented a factor decreasing the money supply: its debt to the banking system was reduced, despite the negative conversion of foreign currency and Government activities restricted the increase in the money supply during these months by more than IL.18 million. Though the Government received large advances during the April–October period, it spent even greater amounts on the purchase of foreign currency from the Bank of Israel.⁹ In November and December, Government conversions of foreign currency were positive, though they totalled only IL.3 million. Moreover, the Government's debt increased by IL.19 million, and the

⁸ The reference here is exclusively to the Government itself. Government companies, national institutions and other public bodies are not, in this instance, included in the "Government Sector".

⁹ During the year, the Government converted about IL.30 million of foreign currency received as an advance on account of oil purchases from German Reparations. The foreign exchange for the financing of oil imports was subsequently purchased from the banking system by the oil companies, and not by the Government itself. The negative conversion resulting from these transactions has therefore been included in the account of the non-government sector, even though the corresponding positive conversion appears in the Government account.

TABLE XV-7

The Influence of the Government and of the Non-Government Sectors on Changes in the Money Supply, 1956
(in IL. millions)

Month (1)	The Government Sector				The Non-Governmental Sector				Discrepancies ^a (8)	Changes (9)						
	Accounts in Israel currency (2)	Foreign currency conversion (3)		Total (4)	Accounts in Israel currency (5)	Foreign currency conversion (6)		Total (7)								
January	- 8.6	4.5		- 4.1	-3.9	5.5		1.6	-0.1	-2.6						
February	0.6	- 3.6		- 3.0	5.2	5.6		10.8	—	7.8						
March	- 8.7	-16.7	- 2.4	- 1.5	-11.1	-18.2	4.2	5.5	30.7	41.8	34.9	47.3	—	-0.1	23.8	29.0
April	12.2	-10.9		1.3	3.5	1.9		5.4	-0.1	6.6						
May	13.5	- 5.5		8.0	-9.3	4.8		-4.5	0.1	3.6						
June	- 5.8	19.9	-10.0	-26.4	-15.8	- 6.5	6.4	0.6	16.4	23.1	22.8	23.7	0.1	0.1	7.1	17.3
July	25.7	-20.4		5.3	4.9	-0.9		4.0	-0.1	9.2						
August	5.1	- 9.1		- 4.0	5.8	6.6		12.4	—	8.4						
September	15.3	46.1	-19.6	-49.1	- 4.3	- 3.0	3.8	14.5	3.3	9.0	7.1	23.5	0.1	—	2.9	20.5
October	7.5	- 4.8		2.7	8.7	-6.2		2.5	-0.1	5.1						
November	8.7	1.8		10.5	-5.3	11.2		5.9	-0.1	16.3						
December	10.5	26.7	1.3	- 1.7	11.8	25.0	-8.7	-5.3	6.1	11.1	-2.6	5.8	0.2	—	9.4	30.8
<i>Total</i>	76.0	-78.7		- 2.7	15.3	85.0		100.3	—	97.6						

^a Errors, omissions and rounding of figures.
SOURCE: Calculations of the Bank of Israel

expansion of the money supply caused by these two factors during the last months of the year thus totalled about IL.22 million.

(b) *The Non-Governmental Sectors*

Column 5 of table XV-7 shows that transaction in local currency between the banking system and the non-governmental economic sectors resulted in the expansion of the money supply by IL.15.3 million. The fact that the activities of these sectors increased the quantity of money by only IL.0.6 million in the second quarter of the year was due to the decline of balances in transit by IL.14.4 million which occurred in May. The activities of the non-governmental sectors constituted a factor diminishing the money supply only in November and December, when the volume of time deposits continued to expand, while the amount of credit was reduced.

As shown in table XV-7, foreign currency conversions by the public amounted to IL.85 million in 1956. More than half of this amount was converted during the first quarter of the year, approximately 25 per cent during the second quarter, and the remainder during the last six months. If foreign currency conversions by the non-governmental sectors are added to its net local currency transactions with the banking system, it appears that the transactions between the banking system and this sector caused the money supply to expand by IL.100 million.

4. THE RELATIONSHIP BETWEEN DEPOSITS AND CASH HELD BY THE PUBLIC

The share of demand deposits in the total money supply ceased to rise during 1956, in contrast to the development which characterized the 1953-1955 period. In fact, the opposite trend began already in the second half of 1955, and continued throughout 1956. Consequently, the share of currency outside banks in the total money supply rose from an average of 41.6 per cent in 1955 to 43.3 per cent in 1956, as shown in table XV-8. Even disregarding the last quarter of the year, when the proportion of cash in the money supply was particularly high as a result of the unusual factors resulting from the Sinai campaign, and computing the ratio for January-September only, the average will amount to 42.6 per cent, which is 1 per cent higher than that of the corresponding period in 1955.

The causes of this phenomenon cannot be satisfactorily explained, but it may have been linked with the tense security situation existing since the end of 1955 and throughout 1956, which may have induced the public to prefer cash to bank deposits. Another possibility is that the trend was affected by the larger immigration from countries whose inhabitants are not accustomed to keeping their money in the form of bank deposits.

The proportion of cash in the total money supply increased somewhat at the

end of March and August. In 1956, March and August were holiday months during which the public received higher wage and salary payments and used more cash to finance its greater volume of purchases. The effect of the holidays was not conspicuous in the data for 1955, since the special increases in the amount of cash outside banks did not occur at the end of the month during that year.

TABLE XV-8
*Currency Outside Banks as a Percentage of the Total
Money Supply, 1955 and 1956*

<i>End of Month</i>	<i>1955</i>	<i>1956</i>
January	42.8	42.5
February	42.2	42.7
March	41.9	43.7
<i>First Quarter</i>	42.3	43.0
April	41.7	42.5
May	41.3	42.3
June	41.3	42.4
<i>Second Quarter</i>	41.4	42.4
July	41.0	41.9
August	40.5	42.8
September	41.3	42.5
<i>Third Quarter</i>	40.9	42.4
October	41.8	46.1
November	42.6	46.2
December	41.1	44.1
<i>Last Quarter</i>	41.8	45.5
<i>Annual Average</i>	41.6	43.3

SOURCE: Bank of Israel.

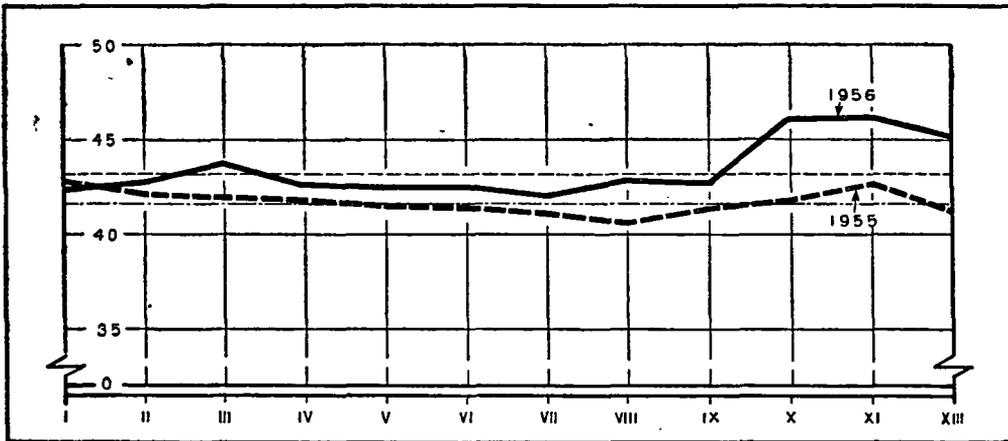
An especially big increase in the amount of cash outside banks took place at the end of October 1956, at the beginning of the Sinai campaign, when about 7.5 per cent of demand deposits were withdrawn. During the last three days of October, the amount of currency in circulation increased by some IL.20 million, or by more than 9 per cent. As regards deposits, no daily data are available, and the weekly data do not duly reflect the fluctuations. However, estimates prepared on the basis of weekly and monthly reports indicate that the increase in the amount of cash outside banks during these days was largely due to withdrawals of deposits—particularly demand deposits—rather than to an expansion of the money supply. Demand deposits decreased by IL.15 million between the end of September and the end of October 1956, and the share of cash in the

money supply accordingly increased from 42.5 per cent to more than 46 per cent.

The ratio between cash and deposits did not change during November. Though some of the deposits withdrawn during October were re-deposited in the banking institutions, this development was offset by cash payments made by the Government at that time. In December, however, the trend of October was reversed: While the amount of cash diminished by more than IL.6 million, deposits expanded by more than IL.15 million, indicating that at least part of the cash withdrawn from the banking institutions during the Sinai campaign was subsequently returned. This tendency for a re-flow of deposits was augmented by the custom of certain banking institutions to encourage the postponement, towards the end of December, of cash withdrawals by their clients. At this time, the banking institutions transfer larger amounts of cash to the Bank of Israel in connection with the conclusion of their business year and the preparation of their annual reports. The proportion of cash within the money supply thus declined from 46.2 per cent at the end of November to 44.1 per cent at the end of December.

DIAGRAM XV-2

Currency in Circulation as a Percentage of the Total Money Supply, 1955-1956



5. THE TURNOVER VELOCITY OF DEMAND DEPOSITS

The turnover velocity of demand deposits in banks¹⁰ decreased somewhat during 1956, as shown in table XV-9.

The average turnover declined slightly, from 19.2 times per annum in 1955 to 18.4 times per annum in 1956. These figures describe a general tendency prevalent throughout the year, but it must be remembered that the available data

¹⁰ No parallel data for credit co-operative societies are at present available.

provide no information as to the number of times each cheque passed from hand to hand before reaching a bank, and it is possible that this number changed in the course of the year.

As no data relating to the turnover velocity of cash, or any changes that might have occurred in it, are available, it is difficult to infer from the slight downward trend in the turnover velocity of demand deposits whether there had been any change in the turnover velocity of the money supply.

TABLE XV-9
The Turnover Velocity of Demand Deposits, 1955 and 1956

<i>Month</i>	<i>Daily average total of deposits in IL. millions</i>	<i>Total debits monthly average in IL. millions</i>	<i>Annual turnover velocity of deposits</i>	<i>Annual turn- over velocity of deposits adjusted ac- cording to the number of working days in the month^a</i>
	(1)	(2)	(2):(1)×12=(3)	
1955				
January	151.5	246.6	19.6	18.1
February	154.7	237.9	18.5	19.2
March	162.0	292.0	21.6	19.4
April	168.7	250.3	17.8	19.6
May	173.4	294.2	20.4	20.0
June	175.1	284.8	19.5	18.8
July	179.7	291.3	19.5	18.7
August	184.5	304.8	19.8	18.4
September	184.2	285.1	18.6	20.2
October	182.4	299.4	19.7	18.9
November	180.7	302.5	20.1	19.3
December	184.1	312.8	20.4	19.6
<i>Annual Average</i>	173.4	283.5	19.6	19.2
1956				
January	185.3	311.2	20.2	18.7
February	183.4	290.8	19.0	19.0
March	187.8	307.5	19.6	19.6
April	195.4	310.4	19.1	19.9
May	201.8	329.4	19.6	18.8
June	206.3	307.8	17.9	17.9
July	210.4	348.2	19.9	18.4
August	211.2	322.2	18.3	16.9
September	210.9	279.8	15.9	19.0
October	207.1	361.1	20.9	19.4
November	205.8	284.3	16.6	15.9
December	215.2	334.7	18.7	17.9
<i>Annual Average</i>	201.7	315.6	18.8	18.4

^a An average month has been assumed to include 25 working days.
SOURCE: Calculations of the Bank of Israel.