

CHAPTER XVI

THE STRUCTURE AND LIQUIDITY OF THE
BANKING INSTITUTIONS

AT THE END of 1956, 27 commercial banks and 93 credit co-operative societies were operative in Israel. Two new banks were established during the year, while one of the credit co-operative societies merged with an existing bank. The expansion of the banking network through the opening of new branches continued in 1956, but against 21 new bank branches and 18 branch offices of credit co-operative societies which had been opened in 1953, 18 new branch offices were established by banks in 1956 and only four by credit co-operative societies.

TABLE XVI-1
*Banking Institutions' Branch Offices, 1954-1956**

	1954	1955	1956
<i>Banks</i>			
Head Offices	24	25	27
Branches	135	156	174
<i>Total—Bank Offices</i>	159	181	201
<i>Credit Co-operative Societies</i>			
Head Offices	92	94	93
Branches	56	74	78
<i>Total—Offices of Credit Co-operative Societies</i>	148	168	171
<i>Total—Offices of Banking Institutions</i>	307	349	372

* Revised figures.

SOURCE: Bank of Israel.

The granting of licences for the opening of two new banks in 1956¹ constituted a certain change of policy in this sphere.

In the preceding years no licences had been issued to new banks, it being

¹ In 1955 one formal licence was given to a financial institution which had actually been conducting banking transactions for 20 years.

assumed that the existing banking institutions were adequate to provide the banking services required by the economy. When the Bank of Israel was established, the power to licence banking transactions was transferred to the Governor of the Bank. After examining the situation, the Bank concluded that under present circumstances there was no more reason to withhold licences for the establishment of new banks, provided they will be capable to contribute to the development of the economy by concentrating financial resources in a non-inflationary manner—particularly if the capital invested in such banks derives from transfers from abroad.

Two objectives could be discerned in the banking institutions' policy of opening new branches: the first was to open small offices in urban and suburban residential areas, where a more intimate link than in the larger branches can be forged between the institution and its client. The second was to open branches in immigrant settlements, the inhabitants of which had not previously been accustomed to avail themselves of banking services.

The progressive concentration of business in the hands of a few large banks is a striking phenomenon of the Israel banking system. About one-third of the total volume of bank deposits is in the country's biggest bank, which is also responsible for about one-third of the total volume of credit granted by the banking institutions. This bank, together with two other large banking institutions, accounted for 53 per cent of all bank deposits maintained at the end of 1955. By the end of 1956, the share of these three banks had risen to 56 per cent. These three institutions had, moreover, granted 60 per cent of the credit outstanding at the end of 1955 and 1956. The remaining 24 banks accounted for 23 per cent of the deposits and 18 per cent of the outstanding credit at the end of 1956, while the 93 credit co-operatives held 21 per cent of the deposits and granted 22 per cent of the total outstanding credit. Details are given in table XVI-2.

It should be noted that the large banks account for a greater proportion of credit than of deposits—and particularly of demand deposits, while the contrary is true in the case of the smaller banks. This phenomenon was more marked at the end of 1955 than at the end of 1956, presumably because the flow of deposits by the public during 1956 was directed more to the big banks, while the volume of their advances did not expand at a faster rate than that of the other banking institutions. There was a conspicuous movement of time deposits from the smaller to the larger banks, since the latter introduced saving schemes bearing comparatively high rates of interest. Moreover, it is not unlikely that some of the smaller banks may have channelled time deposits to their subsidiary companies.

In consequence of these trends, the share of the big banks in the total cash resources of the banking institutions and their balances at the Bank of Israel increased from 56 to 59 per cent.

TABLE XVI-2

*The Share of Various Banking Institutions in Total Credit and in Deposits,
End 1955 and End 1956
(in per cent)*

	<i>The three large banks</i>	<i>Other banks</i>	<i>Credit co-operatives</i>	<i>All banking institutions</i>
Cash and Deposits at the Bank of Israel				
1955	56	29	15	100
1956	59	29	12	100
Total Credit Granted to the Public				
1955	60	16	24	100
1956	60	18	22	100
Total Deposits of the Public				
1955	53	26	21	100
1956	56	23	21	100
Demand Deposits				
1955	54	25	21	100
1956	55	24	21	100
Time Deposits				
1955	49	27	24	100
1956	59	18	23	100

SOURCE: Calculations of the Bank of Israel.

1. THE STRUCTURE OF THE ASSETS AND LIABILITIES OF THE BANKING INSTITUTIONS

The total amount of assets and liabilities of the banking institutions grew in 1956 by nearly IL.140 million, i.e. by 16.4 per cent. The structure of their assets and liabilities at the end of 1955 and the end of 1956 is shown in table XVI-3.

The most important change on the assets side consisted of an increase in the relative proportion of cash and balances kept by the banking institutions at the Bank of Israel, while deposits with other banking institutions declined—although the share of both these items in total assets remained unchanged. This shift has been in progress continuously ever since the establishment of the Bank of Israel. Part of the decrease in deposits kept at other banking institutions was due to the modification of the clearing arrangements between the banking institutions (see Chapter XXII below), and was also reflected in the “Mutually Offsetting Accounts” of deposits kept at other banking institutions. Due to the credit restrictions, which do not allow the banks to utilize all their additional liquid assets for credit expansion, ordinary advances represented a smaller proportion of the banking institutions’ total assets. On the other hand, the share of loans granted

TABLE XVI-3

The Structure of Assets and Liabilities of the Banking Institutions, 1955 and 1956

<i>Assets</i>	<i>In IL. millions</i>		<i>In per cent</i>		<i>Liabilities</i>	<i>In IL. millions</i>		<i>In per cent</i>	
	<i>end of 1955</i>	<i>end of 1956</i>	<i>end of 1955</i>	<i>end of 1956</i>		<i>end of 1955</i>	<i>end of 1956</i>	<i>end of 1955</i>	<i>end of 1956</i>
Cash and Balances of Banking					Own Capital	32.0	37.0	5.3	5.1
Institutions at the Bank of Israel	95.6	136.7	15.7	19.1	Demand Deposits	266.6	314.4	43.7	43.8
Net Balances at Other Banking					Time Deposits ^b	90.7	100.3	14.9	14.0
Institutions	69.7	62.0	11.5	8.7	Government Deposits ^c	156.4	200.6	25.7	28.0
Ordinary Loans to the Public	240.1	264.1	39.4	36.8	Loans	47.6	45.9	7.8	6.4
Loans to the Public from Govern- ment Deposits	142.9	180.9	23.4	25.2	Other Accounts (net)	16.1	19.1	2.6	2.7
Loans to the Government (gross)	19.7	13.8	3.2	1.9					
Securities	33.7	48.9	5.5	6.8					
Immovable Assets	7.7	10.9	1.3	1.5					
<i>Total</i>	609.4	717.3	100.0	100.0	<i>Total</i>	609.4	717.3	100.0	100.0
<i>Mutually Offsetting Items</i>					<i>Mutually Offsetting Items</i>				
Balances kept at Other Banking					Balances kept for Other Banking				
Institutions	47.6	40.1	20.3	15.1	Institutions	47.6	40.1	20.3	15.1
Liabilities of Clients	157.9	182.5	67.2	68.8	Guarantees for Clients' accounts	157.9	182.5	67.2	68.8
Other Accounts	29.4	42.6	12.5	16.1	Other Accounts	29.4	42.6	12.5	16.1
	844.3	982.5	100.0	100.0	<i>Grand Total</i>	844.3	982.5	100.0	100.0

^a All assets and liabilities are in both Israel and foreign currency.

^b Includes Guarantee Deposits and Deposits Earmarked for Loans.

^c Includes Deposits Earmarked for Loans.

from Government deposits increased somewhat, and Government deposits accounted for a correspondingly larger proportion of the banks' liabilities.

As regards other items, mention should be made of the larger investment by banking institutions in securities; the proportion of securities within their total assets consequently increased somewhat in 1956. The chief reasons for this rise were the credit restrictions, the issue of linked securities, and the requirement by the Treasury and the Bank of Israel to invest in such securities 60 per cent of the saving scheme funds. Though the securities portfolio of the banking institutions represented, even in 1956, a negligible proportion of their total assets, it should be pointed out that some banks control subsidiary companies (which are in fact investment companies) and their investments in securities are frequently made through these companies. These investments do not appear in the statistics of the banking institutions.

The liabilities side showed only minor changes. The share of time deposits within total liabilities decreased. As stated above, Government deposits expanded as a consequence of the relative increase in the volume of the Development Budget loans granted through the banking institutions and thus constituted a higher percentage of the banks' total assets.

2. THE LIQUIDITY OF BANKING INSTITUTIONS

The definition of liquid assets remained unchanged in 1956, and comprised the following assets:

- (a) Currency.
- (b) Gold and silver coin or bullion.
- (c) Balances in the Bank of Israel.
- (d) Balances in other Israel banking institutions, except for balances deposited by banks in credit co-operative societies.
- (e) Balances deposited in banks abroad.
- (f) Treasury bills.
- (g) Certificates of 3% Government Loan to Financial Institutions.

The most liquid of these assets are cash and balances in local currency at the Bank of Israel, apart from balances which the banks are required to deposit at the Bank of Israel in connection with letters of credit or saving schemes, in so far as credit against the latter has not been expanded to the permissible limit. Cash and balances in local currency at the Bank of Israel are therefore described hereunder as primary liquid assets.

(a) *The Sum Total of Liquid Assets*

The liquid assets of the banking institutions expanded in 1956 from IL.233 million to IL.246 million, as shown in table XVI-4. Developments during the year may be divided into five periods: the volume of liquid assets declined by IL.19 million during the first quarter, expanded by IL.12 million in April and

May, and after having remained unchanged in June and July, declined again—by IL.37 million in August, September and October and increased by the considerable amount of IL.57 million during the last two months of the year.

TABLE XVI-4
Liquid Assets and Liquidity Ratio, 1956
(in IL. millions)

<i>Type of Assets or Deposits</i>	<i>December 1955</i>	<i>March 1956</i>	<i>May 1956</i>	<i>July 1956</i>	<i>October 1956</i>	<i>December 1956</i>
Cash	11.8	12.3	11.4	12.4	13.4	11.7
Balances in Israel Currency at the Bank of Israel ^a	81.7	70.0	98.3	95.5	66.5	106.5
<i>Total—Primary Liquid Assets</i>	93.0	82.3	109.7	107.9	79.9	118.2
3% Government Loan	19.4	21.1	21.2	21.2	21.3	21.4
Balances in Other Domestic Banking Institutions	67.0	59.2	51.8	49.2	42.3	56.7
<i>Total—Liquid Assets in Israel Currency</i>	179.4	162.6	182.7	178.3	143.5	196.3
Balances in Foreign Currency at the Bank of Israel ^b	3.1	4.0	3.5	3.4	4.2	5.9
Balances in Banks Abroad ^c	50.6	47.5	40.5	44.6	41.7	44.0
<i>Total—All Liquid Assets</i>	233.1	214.1	226.7	226.3	189.4	246.2
Deposits subject to Liquidity Requirements	374.4	366.5	372.4	378.9	355.0	396.3
Formal Liquidity Ratio, in <i>per cent</i>	62.3	58.4	60.9	59.7	53.4	62.1
Local Currency Deposits subject to Liquidity Requirements	300.4	300.1	321.9	319.7	304.9	332.3
Primary Liquidity Ratio, in <i>per cent</i>	31.0	27.4	34.1	33.8	26.8	35.6

^a Excluding deposits in connection with letters of credit and saving schemes.

^b Excluding a special deposit earmarked for loans to the Treasury.

^c Excluding balances in connection with letters of credit.

SOURCE: Bank of Israel.

(b) *Surplus Liquidity*

The obligatory liquidity ratios in respect of various types of deposits, as prescribed in the regulations issued by the Bank of Israel at the end of 1954, remained in force during 1956, as follows:

TABLE
Changes in the Composition of Liquid
(in IL.)

	<i>January- March</i>	<i>April and May</i>
A. PRIMARY LIQUID ASSETS		
1. <i>Factors Increasing the Volume of Liquid Assets</i>		
Conversion of Foreign Currency ^a	+15.9	- 0.3
Credit to Government from the Bank of Israel	-11.7	+16.3
Credit to Public from the Bank of Israel	+ 0.9	+ 1.7
Government Deposits and Deposits for Periods of less than 18 months in Banking Institutions	- 2.7	+ 0.4
Other Deposits and Debitory Accounts of the Banking Institutions	+ 3.6	+ 1.9
<i>Total</i>	+ 6.0	+20.0
<i>Less:</i>		
2. <i>Factors Decreasing the Volume of Liquid Assets</i>		
Credit Granted by Banking Institutions	+ 2.9	+ 1.4
Investments of Banking Institutions and Other Creditory Accounts	+ 1.2	- 3.6
Amount of Cash in Circulation	+11.2	- 6.0
Balances in the Bank of Israel Not Constituting Liquid Assets ^b	+ 2.0	—
<i>Total</i>	+17.3	- 8.2
1. - 2.	-11.3	+28.2
Errors and Omissions	+ 0.6	- 0.8
<i>Total—Primary Liquid Assets</i>	-10.7	+27.4
B. OTHER LIQUID ASSETS IN ISRAEL CURRENCY		
Balances in Other Banking Institutions ^c	- 7.8	- 7.4
3% Government Loan Bonds ^d	+ 1.7	+ 0.1
<i>Total</i>	- 6.1	- 7.3
C. LIQUID ASSETS IN FOREIGN CURRENCY		
Foreign Currency Deposits in Banking Institutions	- 7.5	- 5.3
Foreign Currency Acquired by the Banking Institutions, less Foreign Currency Sold by Them	+ 4.9	- 2.0
<i>Less:</i> Assets in Foreign Currency Not Constituting Liquid Assets	+ 0.4	- 0.2
<i>Total</i>	- 2.2	- 7.5
<i>Total—All Liquid Assets</i>	-19.0	+12.6

^a If banking institutions purchase more foreign currency than they sell, they reduce their liquid assets in Israel currency, while a surplus of purchases over sales of foreign currency by the Bank of Israel increases the volume of such liquid assets.

^b Including amounts deposited in connection with saving schemes and letters of credit.

^c A decline in the balance kept at other banking institutions reduces the total of liquid assets.

as a result of increased bank advances to the Government and the re-depositing of cash by the public in the banking institutions.

In June and July the volume of liquid assets remained relatively stable, since the influence of higher credit to the Government was offset by the negative conversion of foreign currency. These two factors continued to operate in August, September and October, but they were supplemented during this period by the expansion of credit of the banking institutions, while in October large-scale cash withdrawals were made by the public. Altogether, the liquid assets of the banking institutions diminished during these three months by about IL.37 million.

During the last two months of 1956, the volume of liquid assets began to expand rapidly, as a result of the expansion of credit to the Government, the re-depositing of cash previously withdrawn by the public, the reduction of outstanding bank advances, the conversion of foreign currency, and the larger balances kept by banking institutions in other banking institutions. Altogether, liquid assets increased by IL.56.8 million during November and December 1956.

(d) *The Composition of Liquid Assets*

Considerable changes in the composition of liquid assets took place during the year. Especially conspicuous was the continual tendency to increase the proportion of balances maintained at the Bank of Israel, and thus of primary liquid assets.

The total amount of till money held by the banking institutions is subject to only minor variations, since the banks always endeavour to hold the minimum amount required for their current operations. The amount of 3% Government Loan bonds likewise remained virtually unaltered. Balances kept at other banking institutions declined continuously until October, due to the general decrease in the liquidity surplus and the conversion of balances at other banking institutions into time deposits at the Bank of Israel. This trend became stronger during and after May, in consequence of the higher interest rate paid on time deposits by the Bank of Israel. The volume of foreign currency balances maintained by the banking institutions at the Bank of Israel expanded somewhat, because of the increase in the foreign currency balances of Israel residents, which were deposited in banks and transferred by them to the Bank of Israel. On the other hand, the balances kept in banking institutions abroad contracted,—a development apparently linked with the decline of the state's total assets in foreign exchange.

Developments in the various types of balances maintained by the banking institution in the Bank of Israel are shown in table XVI-7.

TABLE XVI-5
*Deposits Subject to Liquidity Requirements, Liquid Assets and
 Surplus Liquidity, 1956*
 (in IL. millions)

	<i>December 1955</i>	<i>March 1956</i>	<i>May 1956</i>	<i>July 1956</i>	<i>October 1956</i>	<i>December 1956</i>
Deposits Subject to Liquidity Requirements	374.4	366.5	372.4	378.9	355.0	396.3
Obligatory Liquid Assets	259.0	251.5	268.8	272.1	248.3	280.6
less: Exemptions from Liquidity Requirements	49.6	45.4	49.8	49.8	54.4	56.6
Obligatory Liquid Assets after Deduction of Exemptions from Liquidity Requirements	209.4	206.1	219.0	222.3	193.9	224.0
Actual Liquid Assets of the Banking Institutions	233.1	214.1	226.7	226.3	189.4	246.2
Surplus (+) or Deficit (—) of Liquid Assets	+23.7	+8.0	+7.7	+4.0	- 4.5	+22.2

SOURCE: Bank of Israel.

In order to assess the influence of factors causing fluctuations in the volume of liquid assets, it has been assumed that the proportion of cash held by the public was constant at 41.6 per cent of the total money supply, i.e. the average for 1955. In so far as there has been a change in this ratio, it is considered as an autonomous factor which itself exerted an influence upon the variations in the sum total of liquid assets.

The breakdown of the factors affecting the volume of liquid assets held by the banking institutions during 1956 is given in table XVI-6. This table shows that liquid assets declined during the first quarter of 1956, because of the contraction of credit to the Government which occurred during this period, and due to withdrawals of cash by the public in connection with the holiday season. There was also a considerable decrease in the balances kept by banking institutions in other banking institutions.² The conversion of foreign currency balances increased the amount of liquid assets. The overall change, as a result of all factors, was a decline of IL.19 million in the total amount of liquid assets in the first quarter of the year.

During April and May, liquid assets increased by more than IL.12 million,

² The conversion of balances kept in other banking institutions into other kinds of liquid assets reduces the total amount of liquid assets held by the banking institutions, since the quantity of cash in the institution where the balances were originally maintained is diminished.

	<i>Per cent</i>
1. On Balances of banks in Israel	100
2. On balances of credit co-operative societies deposited	
a. in banks	60
b. in other credit co-operative societies,	100
3. On balances of banks kept abroad (including head offices, branches and correspondents)	100
4. On demand deposits and time deposits for periods not exceeding 18 months	
a. on the amount of such deposits on 31.3.1951	50
b. on the amount of such deposits as accrued between 31.3.1951 and 31.3.1952 (or 31.3.1953, as preferred by the banking institution)	75
c. on the amount of such deposits as accrued after 31.3.1952 (or 31.3.1953, as preferred by the banking institution)	90

All the funds deposited in banking institutions constitute additional liquid assets. To the extent that such new deposits are subject to liquidity requirements lower than 100 per cent, surplus liquid assets accrue to the banking institutions. Obviously, the lower the prescribed liquidity ratio, the larger the surplus of liquidity created.

Obligatory liquidity ratios on the marginal deposits of banking institutions being very high, the Bank of Israel sometimes grants exemptions from the liquidity requirements. These exemptions are granted to banking institutions which have not fully utilized their permissible volume of credit and, which are prevented by the shortage of liquid assets from granting loans considered of high priority by the Bank of Israel. The amount of such loans is deducted by the banking institutions from the sum total of liquid assets they are required to maintain.

The total amount of the banking institutions' obligatory liquid assets, the amount of liquid assets actually held by them, and the exemptions from the liquidity requirements are detailed in table XVI-5.

(c) *Factors Causing Variations in the Volume of Liquid Assets*

Every transaction increasing the deposits in banking institutions which is caused by the activity of an agency other than a banking institution brings about an expansion of their liquid assets. Such transactions include the granting of credit by the Bank of Israel, the conversion of foreign currency balances, and the depositing of money by the public. However, when the growth of deposits is the result of an extension of credit or of investments—i.e. to operations originating in the banking institutions themselves—the creation of additional deposits is preceded by withdrawals of cash from the institutions concerned. Hence, such transactions, though expanding the total amount of deposits, reduce the volume of liquid assets at the disposal of banking institutions.

VI-6

Assets Held by Banking Institutions, 1956

(in millions)

June and July	August- October	and December November	Total	Total change in factor	Effect on the money supply
-12.5	-14.8	+ 9.0	- 2.7	+ 6.3	+ 6.3
+12.2	+16.5	+10.7	+44.0	+75.0	+75.0
+ 1.0	—	+ 2.4	+ 6.0	+10.1	+10.1
- 1.8	- 1.6	+ 1.4	- 4.3	-10.5	+10.5
+ 5.8	+ 4.3	+ 2.9	+18.5	+44.2	-44.2
+ 4.7	+ 4.4	+26.4	+61.5		
+ 4.1	+ 7.1	- 6.1	+ 9.4	+22.7	+22.7
+ 3.2	+ 3.0	+ 3.2	+ 7.0	+17.0	+17.0
- 1.5	+20.5	- 9.1	+15.1	—	—
+ 0.4	+ 1.2	+ 0.5	+ 4.1	+ 4.1	—
+ 6.2	+31.8	-11.5	+35.6		
- 1.5	-27.4	+37.9	+25.9	—	—
- 0.3	- 0.6	+ 0.4	- 0.7	—	+ 0.2
- 1.8	-28.0	+38.3	+25.2		
- 2.6	- 6.9	+14.4	-10.3	-10.3	—
—	+ 0.1	+ 0.1	+ 2.0	+ 2.0	—
- 2.6	- 6.8	+14.5	- 8.3		
+ 9.2	- 5.6	+ 9.2	—	—	—
- 2.1	+ 3.5	+ 2.7	+ 1.6	+ 0.6	—
+ 3.1	—	+ 2.5	+ 5.4	+ 5.4	—
+ 4.0	- 2.1	+ 4.0	- 3.8		
- 0.4	-36.9	+56.8	+13.1	—	+97.6

^a These securities are included in the investments of banking institutions as a factor reducing the total of liquid assets in the same way as other investments. Since, however, they are themselves defined as liquid assets, they *ipso facto* also increase the total of liquid assets.

SOURCE: Calculations of the Bank of Israel.

TABLE XVI-7
Balances of Banking Institutions in the Bank of Israel, 1956
(in IL. millions)

	<i>December 1955</i>	<i>March 1956</i>	<i>May 1956</i>	<i>July 1956</i>	<i>October 1956</i>	<i>December 1956</i>
Obligatory Minimum Balances	43.1	43.3	45.6	47.1	48.1	46.4
Excess Balances in Demand Deposits	34.4	26.6	45.8	41.8	15.6	59.6
Time Deposits	6.2	4.1	11.2	11.3	9.1	7.3
<i>Total Liquid Balances in Israel Currency kept at the Bank of Israel</i>	83.7	74.0	102.6	100.2	72.8	113.3
Amount Deposited in respect of Letters of Credit	2.0	3.5	3.5	3.6	4.5	4.8
Amounts Deposited in connection with Saving Schemes	—	0.5	0.2	1.1	1.8	2.0
<i>Total Balances in Israel Currency at the Bank of Israel</i>	85.7	78.0	106.3	104.9	79.1	120.1

SOURCE: Bank of Israel.

(e) *Liquidity Ratios*

The formal liquidity ratio is the ratio between the sum total of assets, as defined in the liquidity regulations, and the volume of deposits subject to liquidity requirements. The ratio of primary liquidity is the ratio between primary liquid assets (i.e. cash and liquid balances in Israel currency at the Bank of Israel) and the sum total of local currency deposits against which liquid assets must be held. The latter ratio provides an indication of the immediate solvency of the banking institutions.

Table XVI-4 shows that the ratios of formal and primary liquidity fluctuated during the year, in line with the total volume of formal and real liquid assets. The real liquidity ratio rose more than the formal liquidity ratio, since the proportion of balances at the Bank of Israel within the sum total of liquid assets increased. Indeed, at the end of 1956 the formal liquidity ratio returned to its end 1955 level—i.e. about 62 per cent, whereas the primary liquidity ratio rose from 31 per cent at the end of 1955 to 35.6 per cent at the end of 1956.