

CHAPTER XIV

THE MONEY SUPPLY, CREDIT, AND THE BANKING SYSTEM¹

1. MAJOR TRENDS IN THE DEVELOPMENT OF THE MONETARY SYSTEM

FROM THE VIEWPOINT of monetary developments, the year 1961 fell into two periods. The first half of the year was characterized by rapid monetary expansion, while in the second half the trend was slowed down to a large extent, and in the latter months there was even some contraction. These developments are reflected primarily in the figures for the money supply, on the side of the component elements of the expansion, and in the data on foreign currency balances and bank credit granted to the public, on the sources side.

During the first six months of the year the money supply rose by IL. 121 million, but in the second half it declined by IL. 32 million. The impact of the two factors causing the monetary expansion in 1961—the accumulation of foreign currency balances and the expansion of bank credit to the public—was felt mainly in the first half of the year. The net increase in foreign currency balances held by the banking system amounted to IL. 121 million during this period, whereas in the second half they were reduced by IL. 6 million, in spite of a IL. 14 million increase in December. Bank credit to the public (less credit granted from the deposits of the public earmarked for the granting of loans)² rose by IL. 95 million during the months January to June and by IL. 46 million from July to September, but contracted by IL. 22 million in the last quarter of the year.

In contrast, the Government's transactions with the banking system in 1961 had a contractive monetary effect, particularly in the first half of the year. Its indebtedness to the banking system was reduced by IL. 48 million during the year, more than IL. 46 million of this sum in the first six months alone.

The developments in the first half of 1961 were a continuation of the accelerated trend which began in 1960. After two years of deceleration, the rate of monetary growth speeded up in the first part of 1960 as the result of a larger accumulation of foreign currency balances and a substantial increase in bank

¹ Excluding the Israel Bank of Agriculture, which is included with the financial institutions surveyed in Chapter XVII.

² Consists mainly of credits granted from deposits of provident funds and various institutional deposits earmarked for loans.

TABLE XIV-1
*Increase in Financial Assets of the Public, by Sources and Components, 1955-61**

(From end of year to end of year)

	IL. million							Per cent						
	1955	1956	1957	1958	1959	1960	1961	1955	1956	1957	1958	1959	1960	1961
<i>Sources:</i>														
Accumulation of foreign currency ^b	19.8	14.9	-35.9	64.3	86.7	146.1	114.5	23.2	14.2	-29.9	76.4	58.4	62.1	30.0
Expansion of credit to the public	22.5	38.1	59.3	65.1	101.0	139.1	172.9	10.2	15.6	21.0	19.1	24.8	27.4	26.7
Expansion of credit to the Government	44.4	63.3	54.0	39.6	5.1	-4.1	-48.0	28.6	31.7	20.5	12.5	1.4	-1.1	-13.4
Other accounts (net)	-0.8	-2.4	3.7	-3.6	-10.9	4.7	2.1	c	c	c	c	c	c	c
<i>Total</i>	85.9	113.9	81.1	165.4	181.9	285.8	241.5	18.5	20.7	12.2	22.2	20.0	26.2	17.5
<i>Components:</i>														
Money supply	71.2	97.6	58.9	83.7	66.0	154.3	88.9	20.4	23.3	11.4	14.5	10.0	21.3	10.1
Less-liquid deposits ^b	14.7	16.3	22.2	81.7	115.9	131.5	152.6	12.8	12.6	15.2	48.5	46.4	35.9	30.7
<i>Total</i>	85.9	113.9	81.1	165.4	181.9	285.8	241.5	18.5	20.7	12.2	22.2	20.0	26.2	17.5

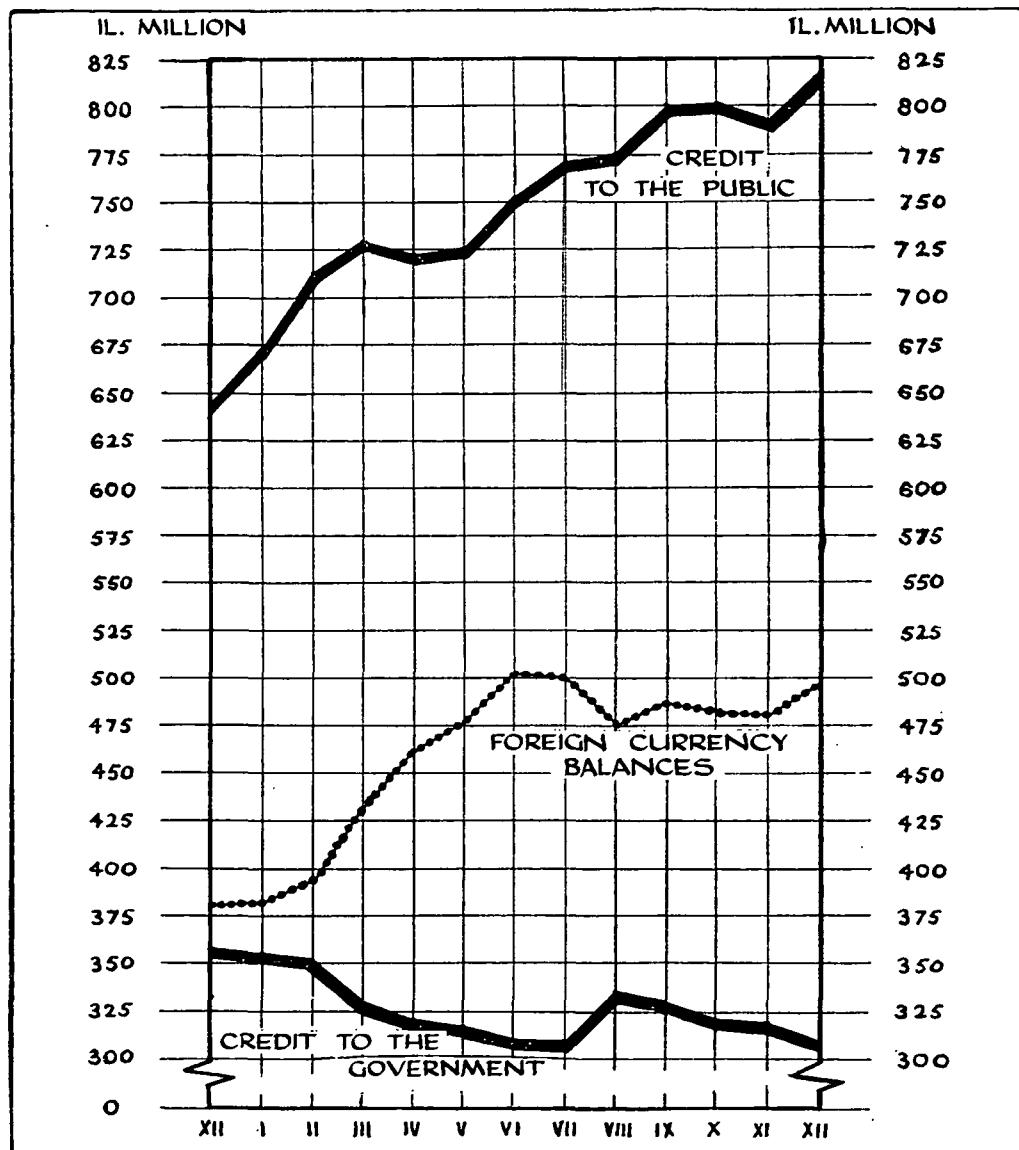
* Excluding the Israel Bank of Agriculture.

^b Adjusted figures as from 1957: Foreign currency deposits of non-residents (PATACH) have been deducted from both foreign currency balances and less-liquid deposits.

c The balance of this item is small, sometimes even negative; consequently, the rates of change, which at times reach several hundred per cent as a result of slight fluctuations, have little significance.

DIAGRAM XIV-1

*Main Sources of Increase in the Financial Assets of the Public,
by Months, 1961
(IL. million)*



credit to the public. This rapid expansion trend continued until the middle of 1961. In the period between July 1960 and June 1961, the money supply was augmented by IL 170 million and total bank credit to the public by nearly IL 200 million, or 35 per cent, which was a higher rate than in any of the preceding years. This led to a further increase in the trade deficit during the past two years and accelerated the rise in the price level which began in the second half of 1960—a development which produced a greater recognition of the need to alter the exchange rate. During the twelve months between July 1960 and June 1961, the consumer price index went up by approximately 7.5 per cent,¹ the steepest rise in the past several years. This marked expansion of credit and the general liquidity of the economy made possible a rapid increase in nominal incomes and caused demand to rise more rapidly than the growth of local production. As a result, prices climbed and the import surplus was further enlarged. The increase in local prices relative to those of various imported commodities (including customs and other indirect levies)² stimulated the expansion of imports and led to the widening of the gap in the trade balance.

In view of these circumstances, there was room for adopting restrictive monetary measures even in 1960. The Bank of Israel really possesses only one efficient instrument of monetary control, namely, regulation of the liquidity ratio which banking institutions must maintain in respect of deposits of the public. The Interest Law precludes changing the rate of interest as a means of quantitative credit control, and the smallness of the local money market limits the possibility of absorbing purchasing power through the sale of securities.³ But it became evident that the instrument available to the Bank was not always sufficiently flexible. Owing to the protracted legal procedure involved in changing the liquidity ratio, it was not until the end of March 1961 that the rate could be raised.

During the course of 1961 the liquidity regulations were tightened several times in order to check the expansion of credit. At the end of March the minimum liquidity ratio was raised 2 per cent, from 38 to 40 per cent.⁴ Furthermore, the requirement to maintain liquid assets was extended to the additional deposits made for a period of over 18 months, which formerly were exempted

¹ Excluding fruits and vegetables. The index including these two items rose by 9.5 per cent during this period.

² World prices of imported commodities showed no change whatever in 1961, whereas the level of local prices went up 8 per cent. Customs and other levies on imports were raised, but this had a negligible effect on average import prices.

³ In addition to income from domestic loans intended to finance Government expenditure.

⁴ The liquidity ratio for Israel currency deposits subject to the liquidity regulations was raised by 4 per cent, from 58 to 62 per cent, but simultaneously the rate of controlled credit exempted from the liquidity regulations was increased from 20 to 22 per cent, so that the actual increase came to only 2 per cent.

from the liquidity regulations.¹ At the end of June the possibility of maintaining "mixed liquidity" (that is, the right to include among the liquid assets the excess of foreign currency assets over foreign currency liabilities) was terminated, this being tantamount to a further increase in the liquidity ratio. At the end of October the minimum ratio was again raised by 2 per cent.²

The regulations did not stipulate that the deficiencies in liquid assets created as a result of these changes had to be immediately made up, but ordered that part of the additional deposits of the public held in banking institutions³ be diverted toward this end. Consequently, the restraining effect of these measures actually proved effective only from April to June, when deposits continued to grow. In the latter half of the year the balance of deposits declined, and hence there was no need to reduce the "recognized deficiency" in liquidity. On the other hand, the "recognized deficiency" resulting from the changes in the regulations during 1961⁴ played an important part in preventing an expansion of credit after the devaluation of the currency in February 1962, when deposits of the public and the liquid assets of the banking institutions rose considerably because of the increased conversion of foreign currency at the higher rate of exchange. For several months in the second half of 1961, there was an increase in credit, which was partly due to the exemptions from the liquidity requirements and partly to the infringement of the regulations and the consequent creation of an "unauthorized deficiency" in liquidity. However, the large fine imposed on banking institutions for incurring such a deficiency ultimately compelled them to reduce the volume of credit so as to bring down the deficiency.

As part of the effort to decrease inflationary pressure in the economy, the Bank of Israel was also active in persuading the Government and various other public bodies to refrain as far as possible from inflationary financing; and the Government's operations in 1961 did indeed have a restraining effect in the monetary sphere.

The primary factor acting to diminish the money supply in the second half

¹ The banks were granted a transitional period of four years, as from January 1962, in which to complete the quota of liquid assets required to be held in respect of the balance of the deposits as of December 31, 1960.

² For details of the liquidity regulations in 1961 and an explanatory note thereto, see Bank of Israel Bulletin, Nos. 15 and 16.

³ The regulations issued at the end of March and the end of June required the banking institutions to maintain against the additional deposits liquid assets at the rate of 40 per cent of their value and to divert 19 per cent to covering the deficit which was created. As of October 1961, the banking institutions had to maintain liquid assets at the rate of 42 per cent and divert 18 per cent to covering the deficiency created in the wake of the March and June regulations, and an additional 18 per cent to covering the new deficiency. In other words, they were permitted to loan only the remaining 22 per cent, with the approval of the Bank of Israel.

⁴ The "recognized deficiency" of all banking institutions reached nearly IL. 70 million.

of 1961 was the reduced scale of foreign currency conversion, due both to seasonal reasons and to the anticipation of devaluation. Foreign currency balances did not decline very substantially, as the inflow of personal restitution payments and other capital transfers continued; but owing to the growing expectation of devaluation, a considerable part of these receipts was not converted into means of payment but put into foreign currency deposits or time deposits linked to the exchange rate. The contraction of the money supply in the second half of 1961 and the marked slowing down of the rate of credit expansion did not check the increase in employment and national product, but they did exercise a moderating influence on the increase in the price level. In this period several factors were operative, especially on the side of production costs, which presumably should have led to a greater price rise than in the first half of the year.

The major wage increases were granted mainly in the second half of the year. Basic wage rates in most branches of the economy were raised by 6 per cent in May, retroactive from January 1961, and in July the cost-of-living allowance was increased by 5 per cent. Nevertheless, prices developed differently from what might have been expected in view of these circumstances. The consumer price index, excluding fruits and vegetables, went up by 5 per cent in the first half of the year and only 2 per cent in the second half. Other price indices also point to a slower rate of growth in the latter period. This indicates that the higher profits accumulated at the time when demand was rising, at the beginning of the year and prior thereto, enabled producers and middlemen to absorb a large part of the additional production costs without putting up prices. The monetary contraction and the difficulty of obtaining credit, which acted to reduce the overall demand in the economy, were presumably among the chief factors preventing the continued rapid increase in the level of prices during the second half of 1961. The tight liquidity position of the economy did not permit a greater stockpiling of imported commodities for speculative purposes in the last months of the year, when the anticipation of devaluation mounted, and thus it averted a further deterioration of the trade balance.

Financial assets in the hands of the public rose by IL. 242 million from the end of December 1960 until the end of December 1961. The money supply went up by IL. 89 million, or 10 per cent, while less liquid deposits expanded by IL. 153 million, or 31 per cent. But since the money supply dropped sharply at the end of the year, we get a different picture if, instead of looking at the growth which took place from the beginning of the year until the end, we examine the change in the average annual balance: Here we find that in 1961 the financial assets increased by IL. 291 million, or 23 per cent, over the 1960 figure. The average amount of the money supply rose by IL. 148 million, or 18 per cent, and the average amount of less liquid deposits by IL. 143 million, or 33 per cent. These rates of growth in the average amount of financial assets and money supply were the highest in many years.

TABLE XIV-2

Average Annual Increase in Financial Assets Held by the Public, by Sources and Components, 1956-61^a

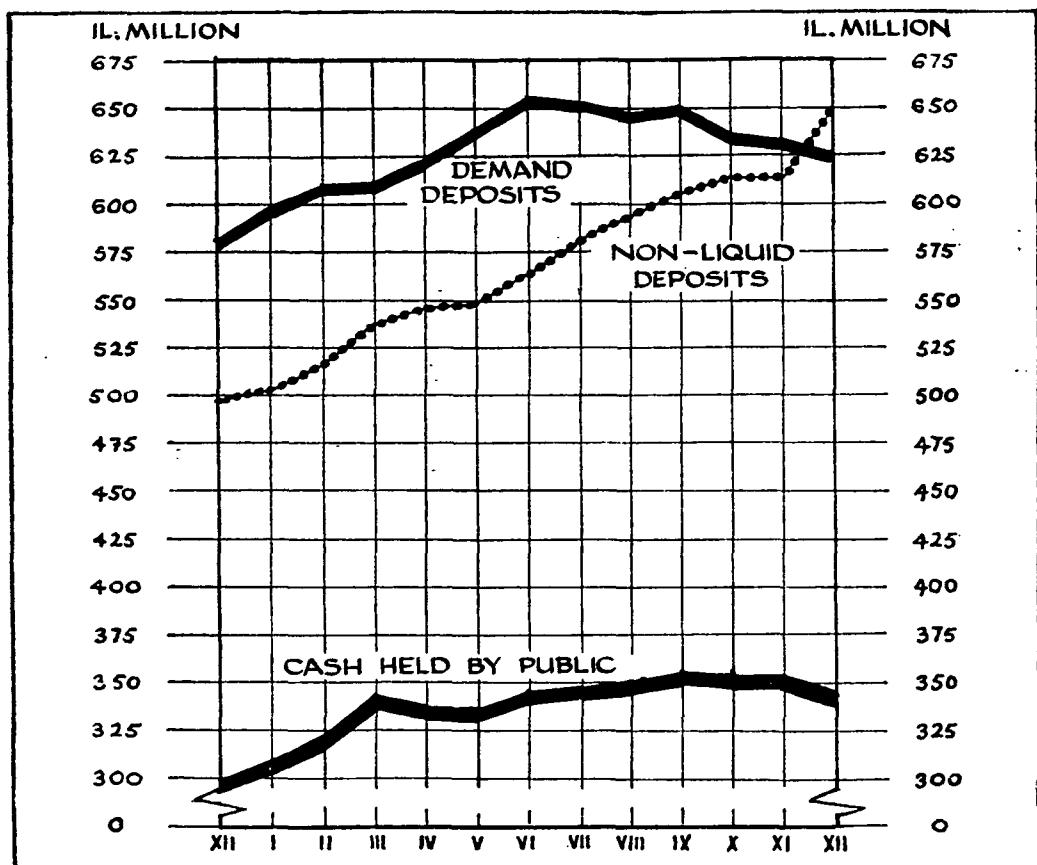
	IL. million						Per cent					
	1956	1957	1958	1959	1960	1961	1956	1957	1958	1959	1960	1961
<i>Sources</i>												
Accumulation of foreign currency ^b	19.6	-7.1	5.2	91.3	110.0	137.0	18.1	-5.6	4.3	72.6	50.7	41.9
Expansion of credit to the public	28.3	42.5	57.6	84.2	122.5	185.7	12.0	16.1	18.8	23.1	27.3	32.5
Expansion of credit to the Government	36.6	79.1	60.6	0.5	2.2	-29.4	20.7	37.1	20.7	0.1	0.6	-8.3
Other accounts (net)	-3.5	4.1	0.3	7.9	-7.3	-2.1	•	•	•	•	•	•
<i>Total</i>	81.0	118.6	123.7	183.9	227.4	291.2	15.6	19.7	17.2	21.8	22.1	23.2
<i>Components</i>												
Money supply	71.1	91.0	85.3	80.8	99.6	147.7	17.9	19.4	15.2	12.5	13.7	17.9
Less-liquid deposits ^b	9.9	27.6	38.4	103.1	127.8	143.5	8.1	20.9	24.0	52.0	42.4	33.4
<i>Total</i>	81.0	118.6	123.7	183.9	227.4	291.2	15.6	19.7	17.2	21.8	22.1	23.2

^a Excluding the Israel Bank of Agriculture.^b Excluding PATACH accounts.^c The rates of change in this item, which reach several hundred per cent as a result of slight fluctuations in the low average balance and are sometimes even negative, have little significance.

The sources of the monetary expansion were the growth of bank credit to the public and the accumulation of foreign currency balances by the banking system. From the beginning of 1961 until the end of the year, total bank credit to the public was augmented by IL.173 million,¹ or 27 per cent, while foreign currency balances went up by IL.114 million, or 30 per cent. In contrast, the Government's net indebtedness to the banking system was reduced by IL.48 million. In 1961 the Government drained off from the economy, through the budget and otherwise,² a larger amount of money than it pumped into the economy through its spending and various payments. This surplus of receipts over payments enabled

DIAGRAM XIV-2

The Financial Assets of the Public, 1961



¹ Including credit from deposits of the public earmarked for the granting of loans.

² See section 4(b) below.

the Government to reduce its debt to the banking system, thereby restraining the rate of monetary expansion.

From the viewpoint of the relative weight of the sources of monetary expansion, 1961 was similar to the previous two years. But if we compare these three years with those which preceded them, a considerable change is discernible in the relative share of both the sources of the monetary expansion and the components thereof.

Whereas from 1956 to 1958 the main cause of the monetary expansion was the larger amount of credit granted to the Government by the banking system, which directly accounted for more than half the increase in the average annual amount of financial assets, in the last three years the Government in effect stopped financing its expenditure through additional bank credit. In 1961 the average balance of the Government debt even declined.

TABLE XIV-3

*Increase in Average Balance of Financial Assets Held by the Public,
by Sources and Components, 1956-61^a*
(Percentage)

	Average 1956-58	Average 1959-61	1961
<i>Sources</i>			
Accumulation of foreign currency ^b	7.5	48.3	47.0
Expansion of credit to the public	39.1	54.5	63.8
Expansion of credit to the Government	53.6	-2.9	-10.1
Other accounts (net)	-0.2	0.1	-0.7
<i>Total</i>	100.0	100.0	100.0
<i>Components</i>			
Money supply	77.8	46.1	50.7
Less-liquid deposits ^b	22.2	53.9	49.3
<i>Total</i>	100.0	100.0	100.0

^a Excluding the Israel Bank of Agriculture.

^b Adjusted figures, after subtracting deposits of non-residents (PATACH).

On the other hand, an opposite trend characterized the influence of the accumulation of foreign currency balances. In the years 1956-58 the balances were still of limited proportions and their contribution to the monetary expansion was insignificant. In the last three years, however, the foreign currency balances at the disposal of the banking system rose substantially, constituting a major factor in the monetary growth. The average net foreign currency balances in the banking system went up by more than \$ 60 million per annum during the years

1959–61. This rate of growth was achieved despite an increase in the current deficit in the balance of payments in recent years, and it was made possible by the greater flow of capital imports, which exceeded the import surplus.

The relative share of bank credit to the public was also higher during the last three years as compared with the years 1956–58. This expansion was largely connected with the accumulation of foreign currency balances. An appreciable share of the additional balances was converted into means of payment, the greater part of which was deposited by the public in banking institutions, thereby increasing the amount of liquid assets at the disposal of the latter and enabling them to expand credit. Part of the growth in credit to the public may possibly be regarded as a substitute for the decrease in bank credit to the Government, since the Government's liabilities to various economic units increased, especially in the year 1959. But the preponderant share no doubt constituted net addition to total credit. In 1961 there was even a reduction in the amount of credit extended to the Government by suppliers, contractors, and various bodies, and consequently they did not have to resort to bank credit to finance their transactions with the Government.

The composition of the additional financial assets has also undergone a change. Whereas in the years 1956–58 the monetary expansion was reflected predominantly in an increase in the money supply, in the last three years the share of less liquid deposits rose conspicuously. This development was connected with several factors. A large part of the additional less liquid deposits originates in the deposit in special accounts of personal restitution payments received from Germany. The greater flow of restitution payments in recent years and the intensified expectation of devaluation from time to time led to a rapid increase in such deposits, whether in foreign currency accounts (TAMAM) or accounts linked to the exchange rate (PAZAK). From 1959 to 1961 the balance of such deposits rose by almost \$ 100 million. Another factor was the special arrangement with the provident funds, under which they deposited considerable sums in banking institutions out of the large increase in the annual accumulation of funds during the years 1958 to 1960. These special accounts, which are fixed-term deposits and in the main linked to the consumer price index, are regarded as "authorized investments" for purposes of the regulations governing the use of such funds.

The rapid growth of less liquid deposits in recent years is an indication that a large part of the increase in foreign currency balances and bank credit did not generate additional means of payment. Part of the increment was not converted at all into means of payment but deposited in special accounts which did not constitute means of payment. On the other hand, part of the bank credit was granted to the public from special deposits of the provident funds or other institutions which were earmarked for the granting of loans. This credit did not involve the creation of new money, as it merely represented a transfer of funds. Deposits earmarked for loans were not subject to the liquidity regulations as long as they were utilized for purposes sanctioned by the Bank of Israel and the Ministry of

Finance. The increase in regular fixed-term deposits also operated to reduce the money supply. Thus the rapid growth of less liquid deposits played no small role in recent years in offsetting the effect of the increase in foreign currency balances and bank credit over and above that in the effective purchasing power of the economy.

It should be remembered, however, that the degree of liquidity of a large part of the less liquid deposits is actually rather high; in fact, they can be converted into means of payment at any time, and hence they constitute a potential source of expansion in overall demand. The gravity of this problem was underscored after the devaluation, when foreign currency deposits and those linked to the exchange rate were converted into means of payments on an increased scale.

The expansion of the economy's foreign currency reserves, in itself a desirable development, has in recent years become the key factor in the monetary expansion and the generation of inflationary pressures in the economy. The large-scale accumulation of foreign currency balances is still going on, and the attendant results in the monetary sphere have been aggravated since the devaluation of February 1962. In such circumstances, the cardinal problem facing monetary policy-makers is the adoption of compensatory measures to counteract as far as possible the undesirable concomitant effects of the accumulation of balances and conversions from existing foreign currency deposits. In recent years the accumulation of balances has shown a decidedly seasonal pattern, with the inflationary effects thereof being felt mainly in the first half of the year. It is therefore necessary to prevent as far as possible the expansion of credit during these months. Whenever the general liquidity of the economy is augmented as a result of the conversion of foreign currency, the need to expand credit diminishes. It is imperative that monetary policy be more flexible, and toward this end a greater flexibility in introducing changes in the liquidity ratio is required, and perhaps even the development of additional instruments of monetary policy.

2. THE MONEY SUPPLY

From the end of December 1960 to the end of December 1961, the money supply expanded by IL.88.9 million, or 10.1 per cent only. This low rate was largely due to the special circumstances which prevailed at the beginning of the period under review, when the figure was particularly high, and at the end, when it was relatively low following a sharp decline in the final quarter of the year. On the other hand, if we measure the change which occurred in the average annual level of the money supply, we find that in 1961 it rose by IL.147.7 million, or 17.9 per cent. This was the highest rate of growth since 1957,¹ and it considerably exceeded the increase in the national product (at constant prices).

¹ See Table XIV-4.

TABLE XIV-4
Annual Rates of Increase of the Money Supply, 1954-61
(IL. million)

Year	Balance at end of year	Change from end of year to end of year		Average annual balance	Change from annual average to annual average	
		IL. million	%		IL. million	%
<i>Cash</i>						
1954	146.6	—	—	141.3	—	—
1955	172.5	25.9	17.7	165.6	24.3	17.2
1956	228.3	55.8	32.3	203.6	38.0	22.9
1957	230.9	2.6	1.1	230.5	26.9	13.2
1958	251.4	20.5	8.9	249.8	19.3	8.4
1959	259.9	8.5	3.4	267.3	17.5	7.0
1960	299.5	39.6	15.2	289.0	21.7	8.1
1961	344.0	44.5	14.9	341.4	52.4	18.1
<i>Demand deposits</i>						
1954	201.9	—	—	189.2	—	—
1955	247.2	45.3	22.4	231.6	42.4	22.4
1956	289.0	41.8	16.9	265.9	34.3	14.8
1957	345.3	56.3	19.5	329.9	64.0	24.1
1958	408.5	63.2	18.3	395.8	65.9	20.0
1959	466.0	57.5	14.1	459.2	63.4	16.0
1960	580.7	114.7	24.6	537.1	77.9	17.0
1961	625.1	44.4	7.6	632.4	95.3	17.7
<i>Total money supply</i>						
1954	348.5	—	—	330.5	—	—
1955	419.7	71.2	20.4	398.1	67.6	20.5
1956	517.3	97.6	23.3	469.4	71.1	17.9
1957	576.2	58.9	11.5	560.4	91.0	19.4
1958	659.9	83.7	14.5	645.7	85.3	15.2
1959	725.9	66.0	10.0	726.5	80.8	12.5
1960	880.2	154.3	21.3	826.1	99.6	13.7
1961	969.1	88.9	10.1	973.8	147.7	17.9

Because of a change in the statistical classification, the figure does not fully indicate the actual increase in the money supply. In July 1961, children's saving schemes, which formerly had been listed among the demand deposits, were recognized as "approved saving schemes", and the IL.8 million balances thereof were transferred from "demand deposits" to "approved saving schemes", thus

TABLE XIV-5

The Money Supply, by Months, in 1961

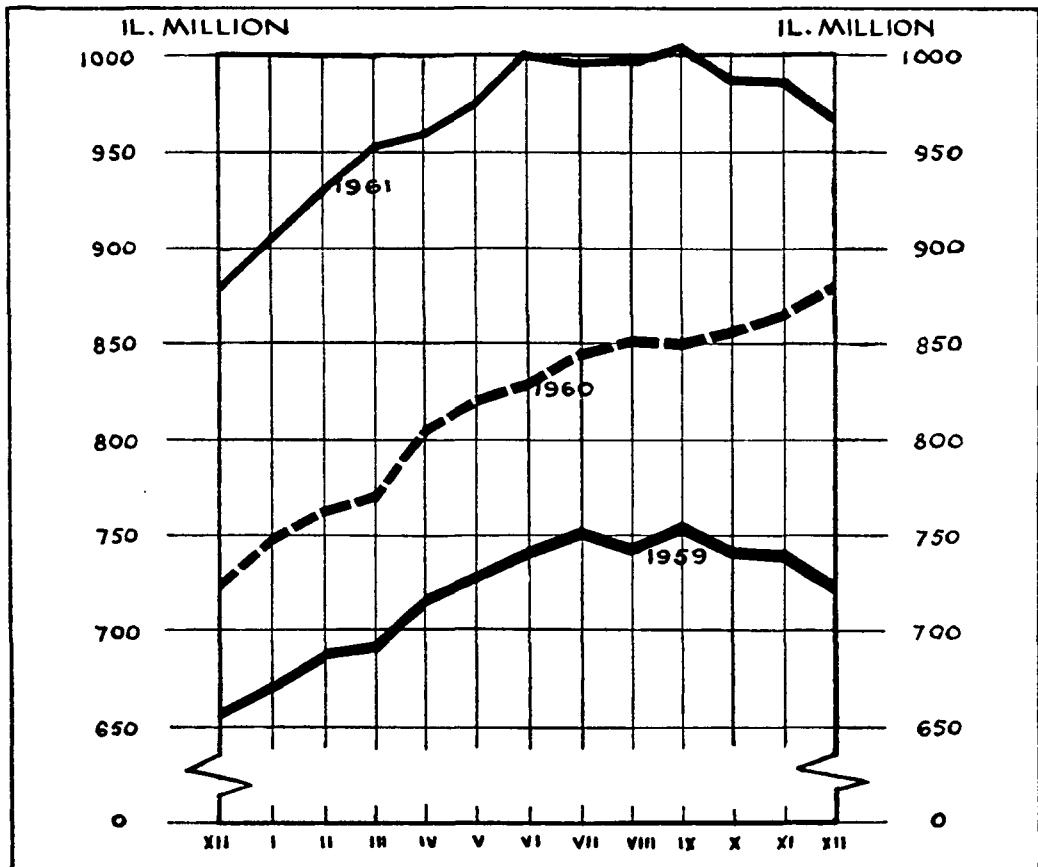
(IL. million)

(End of period)

Month	Total	Cash		Total	Demand deposits		Total	Money supply			
		Increase or decrease (-) from end of previous month			Increase or decrease (-) from end of previous month			Increase or decrease (-) from end of previous month			
		IL. million	%		IL. million	%		IL. million	%		
1960 December	299.5	-2.7	-0.9	580.7	10.7	1.9	880.2	8.0	0.9		
1961 January	308.0	8.5	2.8	599.4	18.7	3.2	907.4	27.2	3.1		
February	321.1	13.1	4.3	610.5	11.1	1.9	931.6	24.2	2.7		
March	343.6	22.5	7.0	611.1	0.6	0.1	954.7	23.1	2.5		
April	336.7	-6.9	-2.0	625.0	13.9	2.3	961.7	7.0	0.7		
May	337.2	0.5	0.1	639.1	14.1	2.3	976.3	14.6	1.5		
June	345.1	7.9	2.3	655.9	16.8	2.6	1,001.0	24.7	2.5		
July	347.2	2.1	0.6	652.5	-3.4	-0.5	999.7	-1.3	-0.1		
August	350.2	3.0	0.9	648.1	-4.4	-0.7	998.3	-1.4	-0.1		
September	356.6	6.4	1.8	651.0	2.9	0.4	1,007.6	9.3	0.9		
October	353.1	-3.5	-0.9	636.6	-14.4	-2.2	989.7	-17.9	-1.8		
November	353.9	0.8	0.2	634.2	-2.4	-0.4	988.1	-1.6	-0.2		
December	344.0	-9.9	-2.8	625.1	-9.1	-1.4	969.1	-19.0	-1.9		

causing a bookkeeping reduction of the money supply which did not reflect any real change.

DIAGRAM XIV-3
The Money Supply, by Months, 1959-61



The seasonal fluctuations in the money supply during 1961 differed from the 1960 pattern, but closely resembled that of 1959 and the preceding years.¹ The means of payment rose until the end of June, when the monthly increment reached an average of IL. 20 million, or more than 2 per cent (from January to March it came to nearly to 3 per cent). In July a decline set in and continued steadily until the end of the year, apart from September when the figure went up by IL. 9.3 million. In July, August, and November the drop was slight, about

¹ See Diagram XIV-3.

IL. 1.5 million monthly, but in October and December it totalled IL. 37 million. The aggregate decrease in the money supply from the end of June to the end of December was IL. 31.9 million, which brought the figure even a little below the average annual balance.¹

The downward trend in the percentage of cash in the total money supply, which characterized the past few years, was checked in 1961. Its share fell from 43 per cent in the years 1954–56 to 35 per cent in 1960, while in 1961 it remained unchanged. But as cash increased faster than demand deposits, its relative weight went up from 34 per cent at the end of December 1960 to 35.5 per cent at the end of December 1961. In the first half of the year, when the money supply rose rapidly, cash expanded at a higher rate than demand deposits, and in the second half, when the money supply contracted, it declined at a lower rate. In all, demand deposits rose during the year by IL. 44.4 million, or 7.6 per cent, while cash increased by IL. 44.5 million, or 14.9 per cent.

The growth of cash was particularly rapid in the first quarter of the year, and consequently its proportion of the money supply went up to 36 per cent by the end of March. As a rule, there is a heavy withdrawal of deposits in March which is connected with Passover shopping; but it is clear that the unusually large volume of withdrawals in March 1961 also reflected the influence of the ordinance providing for the deduction at source of income tax on bank deposit interest, which came into force at the end of that month. This regulation apparently aroused apprehension that a list of account-holders would be submitted to the income tax authorities, and it was this that caused the extra heavy withdrawal of deposits. The increase in cash actually occurred in the IL.50 notes, which are convenient for hoarding and conducting big transactions. After March the growth of cash was slowed down and its percentage of the total money supply declined. It is still difficult to judge whether the developments in 1961 reflected a change in the downward trend in the relation between cash and demand deposits, or whether they were merely the outcome of casual factors which temporarily checked a long-run pattern. At any rate, the additional withdrawals reduced the liquidity of the banking institutions.²

The circulation velocity of the money supply apparently underwent no significant change in 1961, as may be seen from the three indicators in Table XIV-7. A decline in the velocity of the money supply indicates a tendency on the part of the public to hold a larger percentage of financial balances in proportion to the volume of its transactions. From the viewpoint of its impact on overall demand and expenditure, such a trend represents, in some measure, a sterilization of part of the additional means of payment. The inclination of the public to hold liquid balances is determined by a whole series of institutional and economic factors, but one of the key factors is no doubt the state of expectation regarding changes

¹ See Table XIV-4.

² See section 5 below.

in the price level. The slowing down of the velocity of the money supply, which first became apparent in 1958 and continued through 1960, was certainly also connected with the growing price stability which prevailed in this period. On the other hand, the undermining of this stability and the mounting anticipation of devaluation combined to help halt the decline in the circulation velocity in 1961 or, in other words, to checking the growing tendency of the public to hold financial balances. In contrast with 1960, this factor did not exercise a restraining influence on total demand in 1961.

The ratio of national income (or total resources available to the economy) to the average amount of the money supply indicates the average number of times that each pound of the money supply is used during the year to purchase final goods and services, either locally produced or forming a part of the total resources at the disposal of the economy. The constancy of this ratio in 1961 possibly indicates that there was also no additional use of "money substitutes"

TABLE XIV-6
*Cash as a Percentage of the Money Supply,
1954-61*

Annual average		
1954		42.7
1955		41.6
1956		43.4
1957		41.1
1958		38.7
1959		36.8
1960		35.0
1961		35.0
End of month		
1961	January	33.9
	February	34.0
	March	36.0
	April	35.0
	May	34.5
	June	34.5
	July	34.7
	August	35.1
	September	35.4
	October	35.7
	November	35.8
	December	35.5

as compared with official means of payment.¹ It is hardly conceivable that in a year marked by a growing expectation of devaluation and a rise in prices, factors which had a contractive effect on the velocity of circulation were at work and offset the expansionary effect of the increased use of money substitutes on the velocity of circulation. Various indications, such as the large increase in bank guarantees, give grounds for assuming that in 1961 the practice spread of trading in promissory notes through the mediation of banking institutions. In addition to the practice already current, of trading in Jewish Agency bills or payment undertakings of the Accountant General, a number of banking institutions began to act as intermediary between borrowers and lenders outside the public sector, in exchange for a commission. In many instances the banking institutions guaranteed payment of the borrower's note. But the constancy of the circulation velocity of the money supply in 1961 presumably indicates that the funds involved in this trade generally were not dormant financial balances, but moneys which had been activated even before, either as "black market" credit or in some other form. In most cases, therefore, this trade has represented

TABLE XIV-7
Indicators of Velocity of Circulation, 1955-61

Year	Average annual velocity of money supply in relation to:		Average velocity of demand deposits
	National income ^a (1)	Total resources available to economy ^b (2)	
1955	4.35	6.76	19.6
1956	4.36	7.00	18.8
1957	4.30	6.57	18.8
1958	4.25	6.38	17.8
1959	4.27	6.39	17.7
1960	4.16	6.19	16.4
1961	4.18	6.22	16.2

^a Revised figures: GNP and national income estimates have been changed as from 1955.

⁽¹⁾ National income divided by the average annual money supply.

⁽²⁾ Gross national product (at current prices) plus import surplus, divided by average annual money supply.

⁽³⁾ Total debits in local currency demand deposits of banks divided by average annual balance of demand deposits. (Excluding the velocity of deposits of credit cooperative societies.)

¹ The reference here is to transactions in final goods. Insofar as a relative increase occurred in the use of money substitutes, which is not at all certain, it pertained to transactions in existing assets such as real estate, securities, etc., which are not included in the calculation of the ratio of circulation velocity to national income.

a mere substitute for other uses of these funds; and the banking institutions that have begun to engage in it have in effect entered an already existing market and won for themselves a share of the credit transactions which were previously carried on without their mediation.

The velocity of demand deposits, which pertains to only part of the money supply but includes transactions in existing assets, declined somewhat in the first half of the year, but rose slightly in the second half. The average annual velocity, however, underwent hardly any change as compared with 1960. Here two opposing factors were mainly at work. On the one hand, the relative share of deposits not withdrawable by check expanded, and this change in the composition of demand deposits depressed the velocity. On the other hand, the growing expectation of devaluation and rising prices worked in the opposite direction. The net result was that the average annual velocity of demand deposits remained unchanged.

3. OTHER FINANCIAL ASSETS HELD BY THE PUBLIC

In 1961 deposits less liquid than the money supply grew at a slower rate than in the previous year. From the end of December 1960 to the end of 1961, the increment came to IL.152.6 million, or 30.7 per cent, as against IL.131.5 million, or 35.9 per cent, during the corresponding period in 1960. These figures, however, give a somewhat distorted picture of the actual expansion in 1961, for they include a IL.32 million increase registered at the end of December in deposits of the public earmarked for loans, which was of a bookkeeping nature only.¹ If this sum is deducted, the absolute increment was also less than in 1960.

Most of the additional less liquid deposits had their source in the receipt of personal restitution payments from Germany. Although the inflow of such payments expanded at only a modest rate in 1961 as compared with 1960 (approximately 12 per cent), there was a conspicuous increase in the rate at which such moneys were deposited in accounts linked to the exchange rate (PAZAK), due to the anticipation of an imminent devaluation. Altogether, the deposits of restitution recipients (PAZAK and TAMAM accounts) grew by IL.78.2 million, as against IL.50.6 million in 1960. There was also a substantial increase in deposits of approved institutions which were earmarked for loans. Insofar as they are used for extending credits for approved purposes, they are not subject to the liquidity regulations. The expansion that took place in this item, apart from the bookkeeping increase at the end of December, amounted to approximately

¹ At that time several banks persuaded various institutions to assign to them the collection of loans granted by the latter. In the banks' books this was recorded on the liabilities side as "deposits earmarked for loans", and on the asset side as "credits from deposits earmarked for loans". The motivating reason for this was largely the inclination of the banks to show a big balance sheet increase at the end of the year.

IL. 28 million. There was also a gain of IL. 13 million in the balance of foreign currency deposits against liabilities, which were largely connected with the opening of documentary credits. The balance of unlinked less liquid deposits generally declined or showed a slight increase only.

(a) *The less liquid local currency deposits*

The balance of local currency deposits which do not form part of the money supply stood at IL.460.8 million at the end of 1961. The expansion during the year came to IL.102.5 million, or 28.6 per cent; but if the bookkeeping increase in "deposits earmarked for loans" at the end of December is discounted, the growth amounted to only IL.70 million, or 19.6 per cent, as compared with IL.87.7 million, or 32.4 per cent, in 1960. Over 60 per cent of this increment originated in time deposits linked to the exchange rate (PAZAK).

(1) *PAZAK accounts.* The source of such deposits is personal restitution payments from Germany and other private cash transfers. At the end of December 1961, the balance of these accounts stood at IL. 95.1 million (over \$ 53 million). In 1961 persons transferring foreign currency to Israel were permitted to deposit one-third of the amount in foreign currency accounts (TAMAM), while the balance could either be converted into means of payment at the official rate of exchange, plus a 20 per cent premium, or put into a fixed-term account linked to the exchange rate.

The rapid expansion of the PAZAK accounts in 1961 was mainly due to the growing expectation of devaluation, which was an important factor in inducing the recipients to defer the conversion of their restitution receipts. Receipts from this source went up from \$98 million in 1960 to \$110 million in 1961, while the balance of PAZAK accounts advanced by IL.42.7 million in 1961, compared with IL. 18.1 million in 1960. These figures are striking evidence of the diminished tendency in 1961 to convert restitution payments.

(2) *Deposits in approved saving schemes.*¹ These schemes, which are presently administered by eight banks and credit cooperative societies, had a total accumulation of IL.85.4 million at the end of December 1961. From the time they were introduced in 1956 until June 1961, there was virtually a continuous increase in the balances, but in the middle of 1961, a decline set in which can apparently be attributed to the fact that the deposits are not value-linked.

A comparison of the balance at the end of 1961 with that at the end of 1960 shows a gain of IL.14 million. Part of this, however, was of a bookkeeping nature only, for in July children's saving schemes aggregating IL.8 million and a smaller sum accumulated in the saving-for-secondary-education scheme administered by one of the banks, were included with the approved saving schemes. Discounting these transfers and the increment in the children's schemes, the in-

¹ A detailed survey of the approved saving schemes appeared in the Bank of Israel Bulletin, No. 16.

TABLE XIV-8
Deposits of the Public Other than Means of Payment Held in Banking Institutions, 1954-61
(IL. million)

(End of period)

Period	Saving schemes	Local currency deposits										Grand total	
		Time deposits				Total time deposits	Deposits earmarked for loans and provident fund deposits earmarked for approved investments	Against liabilities	Linked to the rate of exchange (PAZAK)	Total less-liquid deposits in local currency	Foreign currency deposits ^a		
		Up to 6 months	6 to 12 months	Over 12 months									
1954	—	11.9	5.7	27.4	45.0	25.7	11.7	—	82.4	32.7	115.1		
1955	0.7	17.5	12.7	32.5	62.7	25.3	11.9	1.2	101.8	28.0	129.8		
1956	11.4	15.7	9.3	37.8	62.8	25.8	13.4	2.3	115.7	30.4	146.1		
1957	26.5	16.7	13.7	41.2	71.6	30.3	14.8	5.6	148.8	19.5	168.3		
1958	52.8	19.7	13.3	42.4	75.4	52.1	11.1	14.9	206.3	43.7	250.0		
1959	59.7	19.2	19.4	40.2	78.8	87.9	9.9	34.3	270.6	95.3	365.9		
1960	71.4	26.5	28.2	43.5	98.2	128.5	7.8	52.4	358.3	139.1	497.4		
1961	85.4	28.4	24.0	33.5	85.9	184.1	10.3	95.1	460.8	189.2	650.0		
1961	January	71.7	27.2	29.2	44.2	100.7	129.6	7.9	54.0	363.9	138.5	502.4	
	February	72.4	26.4	30.5	46.0	102.9	135.1	8.6	56.0	375.0	141.4	516.4	
	March	73.5	27.2	31.0	45.7	103.9	139.7	8.1	61.6	386.8	150.9	537.7	
	April	76.3	30.3	31.3	43.8	105.4	140.9	8.0	63.2	393.8	153.0	546.8	
	May	77.0	31.0	31.8	43.1	105.9	140.2	8.0	66.6	397.7	151.9	549.6	
	June	78.2	31.4	30.7	43.3	105.4	142.3	8.6	70.3	404.8	157.7	562.5	
	July	84.9	34.8	25.5	42.4	102.7	142.1	9.1	75.0	413.8	167.8	581.6	
	August	84.3	30.8	28.5	40.4	99.7	140.3	9.8	79.0	413.1	179.0	592.1	
	September	84.6	32.2	29.3	38.4	99.9	141.6	11.4	81.8	419.3	186.2	605.5	
	October	85.5	32.0	29.7	38.0	99.7	143.4	11.5	87.9	428.0	185.8	613.8	
	November	84.9	30.9	26.0	36.9	93.8	145.6	11.5	91.6	427.4	186.5	613.9	
	December	85.4	28.4	24.0	33.5	85.9	184.1	10.3	95.1	460.8	189.2	650.0	

^a Excluding deposits of non-residents (PATACH).

crease in the original approved saving schemes amounted to only IL. 2 million, as against IL.11.7 million in 1960. The schemes actually continued to expand until the end of June 1961, by which time their balance had gone up IL.6 million. In the second half of the year, however, there was a IL.4 million reduction, but half of this represented the transfer of accrued interest. The undermining of the price stability and the growing belief in the imminence of devaluation prompted many depositors to exercise their right to withdraw their funds after 30 days' advance notice, and to use them for purchasing consumer goods or to invest them in such a way as to secure their value. In the latter half of the year, the volume of withdrawals expanded while that of new deposits fell off. From January to June new deposits amounted to IL. 3.5 million per month on the average, but from July to December the figure dropped to IL.2.4 million. In contrast, average monthly withdrawals increased from IL.2.5 million in the first half of the year to IL.3 million in the second half.

(3) *Time deposits.* The balance of these deposits declined by IL.12.3 million in 1961, compared with an increase of IL.19.4 million in 1960. The figure actually continued upward until the end of April 1961, but after levelling off somewhat in May and June, it began to drop. From the end of December 1960 to the end of April 1961 there was an advance of IL.7.2 million, but from the end of June until the end of December 1961 the balance declined by IL.19.5 million, IL.13.8 million of it in the last two months of the year alone.

As in the case of approved saving schemes, it seems that the contraction was due to the growing expectation of devaluation. But there were other factors as well, such as the directive issued at the end of March which extended the liquidity requirements to deposits for over 18 months. Of the total reduction of IL.12.3 million in time deposits during the year, these accounted for IL.7.5 million. In addition to deposits of private individuals, time deposits include large sums belonging to provident and other funds and to various institutions. Part of these account-holders bought up promissory notes through the mediation of the banking institutions, chiefly those of various debtors of the banks, thus enabling the latter to reduce the unauthorized deficiency in their liquidity which had reached substantial proportions.

(4) *Deposits earmarked for loans.* These are mainly deposits of various financial institutions and provident funds intended for the granting of loans to specific customers for specific purposes. The balance of this item went up by IL.55.6 million, but IL.32 million, as already indicated, was merely a bookkeeping gain recorded at the end of December.¹ The special deposits which the provident funds were permitted to make as authorized investments contracted by IL.17.6 million. This item has been shrinking steadily since the termination in November 1960 of the arrangement regarding such deposits, as a result of which only the purchase of approved securities are defined as "authorized investments".

¹ See footnote on page 284.

The special deposits are being liquidated as they pass their due dates, but in reality they are not being withdrawn from the banking institutions but indirectly transferred to another item. The provident funds are using them to purchase debentures of approved financial institutions, and the latter are putting the proceeds into "deposits of approved institutions earmarked for loans".¹

TABLE XIV-9

*Foreign Currency Deposits of the Public in Banking Institutions, 1954-61**
(IL. million)

(End of period)

Period	TAMAM deposits	Deposits against liabilities	Orders and drafts due for payment	Other deposits	Total
1954	—	7.6	0.7	24.4 ^b	32.7
1955	—	3.0	0.8	24.1 ^b	27.9
1956	1.3	2.6	2.0	23.6 ^b	30.4
1957	9.0	2.5	1.9	5.6	19.5
1958	16.3	14.9	2.0	11.5	43.7
1959	39.6	31.7	5.7	18.3	95.3
1960	72.1	31.9	7.3	27.8	139.1
1961	107.6	44.9	8.5	28.2	189.2
1961 January	74.0	33.9	8.2	22.4	138.5
February	76.5	35.3	8.4	21.2	141.4
March	81.1	34.7	10.7	24.4	150.9
April	83.6	34.1	10.4	24.9	153.0
May	86.1	32.2	9.5	24.1	151.9
June	87.9	35.7	8.7	25.4	157.7
July	90.4	42.3	10.3	24.8	167.8
August	92.3	45.5	9.8	31.4	179.0
September	94.6	46.7	12.6	32.3	186.2
October	100.4	45.9	10.0	29.5	185.8
November	104.0	45.1	9.2	28.2	186.5
December	107.6	44.9	8.5	28.2	189.2

* Less deposits of non-residents (PATACH) from 1957 onward.

^b Including PATACH accounts.

As a result of this, as well as the deposit of new moneys by various institutions, this item increased by IL.30 million. Deposits of provident funds earmarked for loans to their members rose by IL.10 million, but other categories of earmarked deposits showed only slight changes.

¹ These deposits were approved by the Bank of Israel for purposes of the provisions of Section 1(a)(7) of the liquidity regulations. Banking institutions must maintain 90 per cent liquidity only in respect of that part that is not yet utilized for the granting of loans.

(b) *Foreign currency deposits*

The balance of foreign currency deposits of the public totalled IL.189.2 million (\$ 105 million) at the end of 1961. Unlike previous reports, the present one does not include deposits of non-residents (PATACH) in this item, since for the most part they do not constitute financial assets of the public, and as foreign liabilities they were deducted from foreign currency assets at the disposal of the banking system.¹ About 57 per cent of the balance of the public's foreign currency deposits belonged to residents who had transferred foreign currency and were permitted to put a third of the sum into such accounts (TAMAM). Under the foreign currency regulations, they may use the funds for specific purposes² without special authorization. The lion's share of the remaining 43 per cent consisted of deposits against liabilities, which had been opened chiefly to serve as cover for documentary credits.

The increase in foreign currency deposits in 1961 amounted to IL.50.1 million, or 36 per cent, as against IL.43.8 million, or 46 per cent, in 1960. Deposits of residents transferring foreign currency (TAMAM) rose by IL.35.5 million, compared with IL.32.5 million in 1960. The larger growth in 1961 more or less reflected the greater inflow of personal restitution payments from Germany. Deposits against liabilities showed an increase of IL. 13 million, while all other deposits, including various accounts of importers and exporters, went up by IL.2.3 million.

4. SOURCES OF INCREASE IN THE FINANCIAL ASSETS OF THE PUBLIC

The two sources of monetary expansion in 1961, as already stated, were the expansion of bank credit to the public and the accumulation of foreign currency balances. From the end of December 1960 to the end of December 1961, credit to the public rose by IL.173 million, or 26.7 per cent, but if the bookkeeping increase of IL.32 million at the end of December 1961 is deducted, the net increment came to IL.141 million, or approximately 22 per cent. Foreign currency balances at the disposal of the banking system advanced by IL.114.5 million. These two factors would have led to an even greater increase in the financial assets of the public were it not for the restrictive influence of the IL. 48 million reduction of the Government's net indebtedness to the banking system.

The relative weight of these two sources of monetary expansion underwent considerable change during the year. In the first quarter the predominant factor

¹ The balance of the PATACH accounts reached \$80 million at the end of 1961. This sum also included deposits of temporary residents, foreign companies operating in Israel, etc.; these undoubtedly formed part of the public's financial assets, but their proportion was relatively small and they were indistinguishable from other PATACH accounts.

² Overseas travel, purchase of foreign securities and certain goods, and the sale of foreign currency to local residents for specific purposes.

was the rapid expansion of credit to the public, but in the second quarter the rate of growth slowed down considerably, and the accumulation of foreign currency balances took over first place. In the first half of the year as a whole, the impact of the increase in foreign currency balances exceeded that of the expansion of credit to the public. In contrast, in the latter half of the year foreign currency balances declined, thus exercising a restraining effect on the monetary expansion. Credit to the public continued upward at a fairly rapid rate, but contracted in the final quarter.¹ On the other hand, credit to the Government decreased steadily until the end of July, rose in August, then resumed its downward trend until the end of the year. The restrictive influence of the decline in the Government's debt was felt mainly in the first half of the year.

(a) *Accumulation of foreign currency balances²*

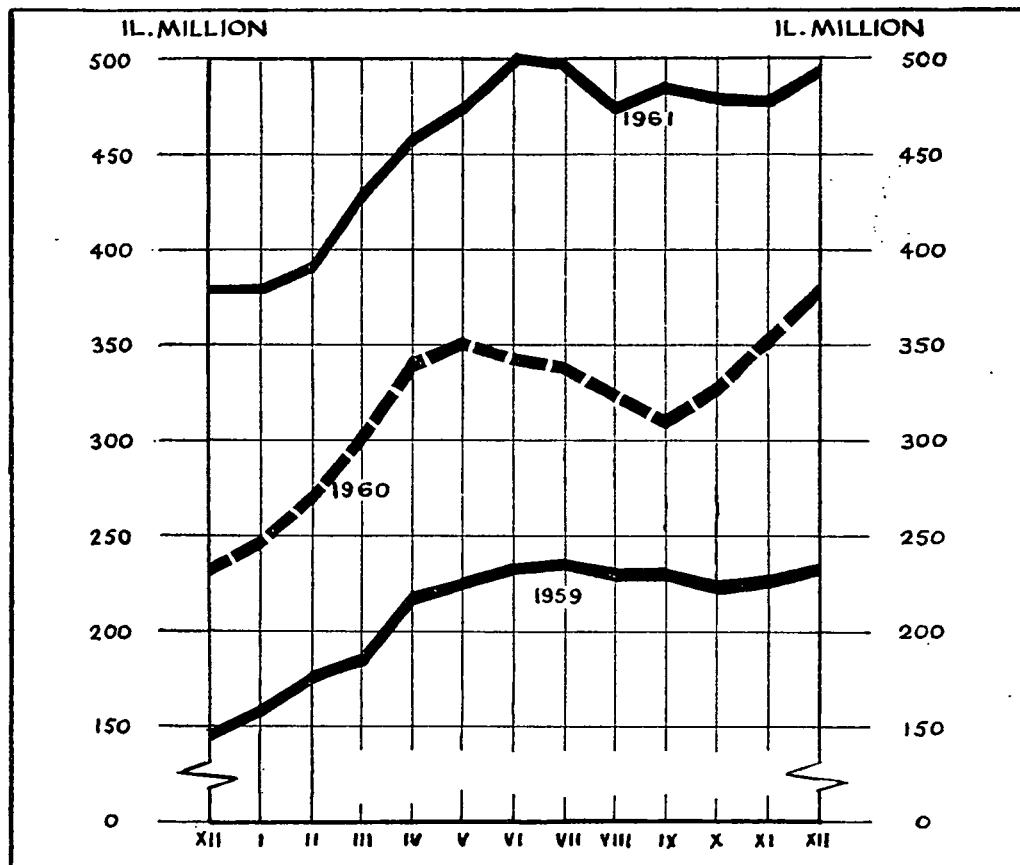
The rapid accumulation of foreign exchange reserves in the banking system continued for the fourth consecutive year. At the end of 1957 the balances had amounted to only \$ 47 million, but by the end of 1961 they reached \$ 272 million, an increase of \$ 225 million within four years, or an average of \$ 56 million annually. In the last two years they grew by more than \$ 140 million, in spite of the larger surplus of commodity and service imports. The marked increase in capital imports, especially transfers of personal restitution payments from Germany and other transfers, made it possible to finance the growing deficit between imports and exports and even to expand the economy's foreign currency balances by a substantial amount.

From the end of December 1960 to the end of December 1961, the balances advanced by IL. 114.5 million, compared with IL. 146.1 million in 1960. This factor had less impact on the growth of the money supply in 1961 than it did the year before, not only because of the smaller size of the increment, but also because of the lower rate of conversion into means of payment. In 1961 persons transferring foreign currency, particularly restitution recipients, deposited a larger percentage of their transfers in time deposits linked to the exchange rate (PAZAK); hence a smaller proportion of the additional balances was reflected in the creation of new means of payment. The lower rate of conversion in 1961 was due to the mounting expectation of devaluation and the recipients'

¹ If the bookkeeping increase at the end of December is deducted.

² The data presented here on the net balances in the banking system are adjusted figures: Deposits of non-residents (PATACH) have been subtracted from the foreign currency assets of the banking institutions and the Bank of Israel, as foreign currency liabilities (see footnote 1 on page 289. The series were revised as of August 1957, at which time this item first appeared separately in banking statistics. The balance of PATACH accounts reached IL. 144 million at the end of 1961, following an increase of some IL. 80 million during the year. In previous years the growth was much more modest (at the end of 1957 the balance stood at IL. 18 million).

DIAGRAM XIV-4

Foreign Currency Balances, by Months, 1959-61

desire to benefit from the ensuing higher exchange rate. For the same reason, withdrawals of old deposits were on a smaller scale than in 1960.

The balance of PAZAK accounts grew by IL. 42.7 million in 1961, and that of TAMAM accounts by IL. 35.5 million, making a total of IL. 78.2 million; this increase, which represented more than 68 per cent of the total increment in foreign exchange reserves, had no effect on the expansion of the money supply. In 1960 only 35 per cent of the additional balances were not converted into means of payment.

Foreign currency balances with the Bank of Israel rose by IL. 129.7 million in 1961, while those with the banking institutions declined by IL. 15.2 million. Various banking institutions sold foreign currency assets, particularly in the

TABLE

Consolidated Balance Sheet of
(IL.

(End of period)

Assets and liabilities	1954	1955	1956	1957	1958	1959	1960	1961
Credit to the public								
By the Bank of Israel	—	15.7	35.1	51.6	27.6	33.6	57.0	67.0
By banking institutions	221.5	228.3	247.0	289.8	378.9	473.9	589.6	752.5
<i>Total</i>	221.5	244.0	282.1	341.4	406.5	507.5	646.6	819.5
Investment by banking institutions								
In non-governmental securities	2.9	3.9	9.1	11.9	21.4	31.2	44.2	49.6
In subsidiary companies	4.8	4.8	5.1	5.1	5.8	6.4	9.2	24.7
<i>Total</i>	7.7	8.7	14.2	17.0	17.2	37.6	53.4	74.3
Credit to the Government								
By the Bank of Israel	133.5	171.1	236.7	271.3	289.1	317.7	316.8	275.6
By banking institutions ^b	220	28.8	26.5	45.9	67.7	44.2	41.0	34.2
<i>Total</i>	155.5	199.9	263.2	317.2	356.8	361.9	357.8	309.8
Net foreign currency balances^c								
With the Bank of Israel	53.5	83.5	92.4	82.8	162.0	197.5	337.1	466.8
With banking institutions	31.9	21.7	27.7	1.4	-13.5	37.7	44.2	29.0
<i>Total</i>	85.4	105.2	120.1	84.2	148.5	235.2	381.3	495.8
Balances in transit								
Less: non-liquid deposits	20.3	21.7	17.4	15.5	7.8	0.8	4.2	2.2
In local currency	82.4	101.8	115.7	148.8	206.3	270.6	358.3	460.8
In foreign currency ^c	32.7	28.0	30.4	19.5	43.7	95.3	139.1	189.2
<i>Total</i>	115.1	129.8	146.1	168.3	250.0	365.9	497.4	650.0
Own capital and other accounts (net)^d								
Money supply	26.8	30.0	33.6	30.8	36.9	51.2	65.7	82.5
	348.5	419.7	517.3	576.2	659.9	725.9	880.2	969.1

^a Excluding the Israel Bank of Agriculture.^b Including Government securities.^c Excluding deposits of non-residents (PATACH).

*the Banking System, 1954-61**
(million)

1961												
Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
55.7	62.0	63.7	60.3	59.5	58.3	56.5	56.9	59.8	61.1	60.7	67.0	
617.6	650.9	665.8	662.3	666.0	694.3	714.8	718.8	740.2	739.9	732.1	752.5	
673.3	712.9	729.5	722.6	725.5	752.6	771.3	775.7	800.0	801.0	792.8	819.5	
44.4	45.0	46.8	46.3	46.5	47.3	53.0	50.2	51.2	50.1	51.0	49.6	
9.0	9.0	12.9	12.9	13.1	15.7	15.9	16.6	16.9	22.7	23.1	24.7	
53.4	54.0	59.7	59.2	59.6	63.0	68.9	66.8	68.1	72.8	74.1	74.3	
312.4	306.9	281.9	274.0	267.9	265.1	261.7	291.1	288.3	280.1	286.4	275.6	
42.2	45.2	47.5	46.6	50.0	46.2	48.3	45.4	40.7	41.2	33.4	34.2	
354.6	352.1	329.4	320.6	317.9	311.3	310.0	336.5	329.0	321.3	319.8	309.8	
344.2	354.9	393.6	427.5	443.9	466.5	460.6	428.5	431.6	437.3	444.0	466.8	
37.5	38.2	38.5	33.4	31.6	35.6	39.3	47.5	56.1	44.9	37.4	29.0	
381.7	393.1	432.1	460.9	475.5	502.1	499.9	476.0	487.7	482.2	481.4	495.8	
4.9	2.2	6.1	2.3	6.7	-0.8	-0.9	-0.4	-1.0	0.9	5.2	2.2	
363.9	375.0	386.8	393.8	397.7	404.8	413.8	413.1	419.3	428.0	427.4	460.8	
138.5	141.4	150.9	153.0	151.9	157.7	167.8	179.0	186.2	185.8	186.5	189.2	
502.4	516.4	537.7	546.8	549.6	562.5	581.6	592.1	605.5	613.8	613.9	650.0	
58.0	66.3	64.4	57.1	59.3	64.7	67.9	64.2	70.7	74.6	71.3	82.5	
907.4	931.6	954.7	961.7	976.3	1001.0	999.7	998.3	1007.6	989.7	988.1	969.1	

* Including demand deposits in the Israel Bank of Agriculture, which are included in the statistics on the money supply.

TABLE XIV-11

Net Foreign Currency Balances with the Banking System, 1954-61*
(IL. million)

(End of period)

Period	With the Bank of Israel ^a	With banking institutions			Total (1)+(4)
		Assets	Foreign liabilities ^b	Net assets (2)-(3)	
(1)	(2)	(3)	(4)	(5)	
1954	53.5	72.6	40.7	31.9	85.4
1955	83.5	54.8	33.1	21.7	105.2
1956	92.4	48.5	20.8	27.7	120.1
1957	82.8	54.6	53.2	1.4	84.2
1958	162.0	64.5	78.0	-13.5	148.5
1959	197.5	83.2	45.5	37.7	235.2
1960	337.1	114.1	69.9	44.2	381.9
1961	466.8	166.1	137.1	29.0	495.8
1961 January	344.2	110.9	73.4	37.5	381.7
February	354.9	112.2	74.0	38.2	393.1
March	393.6	120.7	82.2	38.5	432.1
April	427.5	120.6	87.2	33.4	460.9
May	443.9	120.3	88.7	31.6	475.5
June	466.5	133.8	98.2	35.6	502.1
July	460.6	138.7	99.4	39.3	499.9
August	428.5	153.9	106.4	47.5	476.0
September	431.6	156.5	100.4	56.1	487.7
October	437.3	151.2	106.3	44.9	482.2
November	444.0	143.0	105.6	37.4	481.4
December	466.8	166.1	137.1	29.0	495.8

^a Less deposits of non-residents (PATACH) in the Bank of Israel.^b As from 1957, the banking institutions' foreign liabilities include deposits of non-residents (PATACH), apart from the sums deposited in the Bank of Israel.

final quarter of the year, in order to make up large deficiencies in their liquidity, which were subject to a fine.¹

The usual seasonal fluctuations in this item were apparent in 1961 as well (see Diagram XIV-4). A substantial surplus of receipts over payments in foreign currency marked the first half and end of the year—from January to June reserves rose by IL. 120.8 million and in December by IL. 14.4 million—but from July to November the figure dropped by IL. 20.7 million.

¹ See section 5.

(b) *Credit to the Government*

The Government's indebtedness to the banking system was reduced by IL. 48 million from the end of 1960 to the end of 1961. Its debt to the Bank of Israel decreased by IL. 41.3 million, and that to the banking institutions by IL. 6.7 million. The average annual balance of the debt was also lower in 1961—by IL. 29.4 million. In itself, this reduction does not indicate a surplus of regular receipts over regular payments, but merely an improvement in the cash position of the Accountant General.¹ There was still a small deficit in the Government budget in 1961, but certain extra-budgetary receipts—sums temporarily placed at the Government's disposal by public companies, various institutions, etc.—enabled it to cover the deficit and even to deposit considerable sums with the Bank of Israel. However, there is no doubt that in the last three years the budgetary deficit was reduced as compared with previous periods, thus decreasing the Government's dependence on bank credit for financing its expenditure. The reduction of the debt in 1961 was not due to the contraction of advances or the repayment of Treasury bills by the Government (these even grew by IL. 5 million), but stemmed from an increase in the Government's credit balances with the banking system. Its deposits in the Bank of Israel, particularly those in foreign currency, rose by IL. 47 million, and its net deposits in the banking institutions by IL. 6 million.

The composition of the Government's debt also underwent a change in 1961. Its current debt to the Bank of Israel declined by IL. 71.4 million, and at the end of the year the Government had a credit balance of IL. 56 million in its current account, compared with a debit balance of IL. 15.4 million at the end of 1960. The decrease in the current debt was due to the transfer of IL.32.6 million in March from this item to "Defense Loan 1960" and "contribution to international institutions loan", which come under the category of long-term credit.² The Government's deposits with the Bank of Israel increased, as already mentioned, by IL. 47 million, and if the IL. 32.6 million transfer is subtracted, the actual increase in current advances amounted to IL. 8 million.

The Government's long-term indebtedness to the Bank of Israel showed scarcely any change, except for the IL. 32.6 million transfer in March and the repayment in September of IL. 2 million on account of the Security Advance. Its debt to the banking system decreased by IL. 6.7 million, nearly all of it due to an increase in the unutilized balance of the Government's deposits earmarked for loans.

The balance of the Government's total liabilities to the banking system dropped steadily from January until July, by IL. 47.6 million; in August it rose by

¹ The cash position of the Accountant General is reflected in the changes occurring in the balance of the Government's current account in the banking system.

² See col. (1) and (2) in Table XIV-12.

TABLE XIV-12

Government Indebtedness to the Banking System, 1954-61^a
(IL. million)

(End of period)

Period	To the Bank of Israel				To banking institutions ^a				Total Government liabilities
	Current credit (net) ^b	Long-term credit and securities	Less: capital accounts ^c	Total	Current credit (net) ^b	Long-term credit and securities	Less: net deposits	Total	
1954	10.4	122.6	-0.5	133.5	9.5	24.9	12.4	22.0	155.5
1955	32.5	138.5	-0.1	171.1	17.1	22.6	10.9	28.8	199.9
1956	89.3	155.7	8.3	236.7	12.5	32.4	18.4	26.5	263.2
1957	68.6	217.8	15.1	271.3	28.5	32.7	15.3	45.9	317.2
1958	94.2	214.8	19.9	289.1	45.8	42.5	20.6	67.7	356.8
1959	18.4	319.7	20.4	317.7	13.3	49.1	18.2	44.2	361.9
1960	15.4	321.7	20.3	316.8	4.1	57.2	20.3	41.0	357.8
1961	-56.0	351.8	20.3	275.5	7.0	53.8	26.5	34.3	309.8
1961 January	11.1	321.7	20.4	312.4	3.7	57.3	18.8	42.2	354.5
February	7.3	321.7	22.1	306.9	3.5	59.5	17.8	45.2	352.1
March	-45.3	354.3	27.1	281.9	4.3	60.7	17.5	47.5	329.4
April	-51.7	354.3	28.6	274.0	3.1	61.9	18.4	46.6	320.6
May	-55.8	354.3	30.6	267.9	3.2	65.4	18.6	50.0	317.9
June	-58.1	354.2	30.9	265.1	3.0	65.8	22.5	46.2	311.3
July	-60.7	354.0	31.6	261.7	4.5	66.1	22.3	48.3	310.0
August	-29.9	354.0	33.1	291.1	4.8	62.4	21.8	45.4	336.5
September	-28.7	351.9	34.9	288.3	4.8	60.3	24.4	40.7	329.0
October	-36.6	351.9	35.1	280.1	5.8	59.8	24.4	41.2	321.3
November	-28.4	351.8	37.1	286.4	0.8	55.8	23.3	33.4	319.8
December	-56.0	351.8	20.3	275.5	7.0	53.8	26.5	34.3	309.8

^a Excluding the Israel Bank of Agriculture.^b Current liabilities less Government deposits.^c Including other accounts (net).

IL. 26.5 million,¹ but from September until December, it again declined, by IL. 26.7 million.

(c) *Bank credit to the public*

(1) *The expansion of credit:* In 1961 bank credit to the public expanded greatly. Between the end of 1960 and the end of 1961, the figure rose by IL. 172.9 million, or 26.7 per cent, while the average annual balance went up by IL. 185.7 million, or 32.5 per cent.

¹ This increase was due to the withdrawal of a IL. 14 million foreign currency deposit in order to repay a foreign debt, and to a IL.12 million increase in current advances connected with local expenditures.

However, not all of this additional credit involved the creation of new money, since a substantial part of it originated in special deposits of the public earmarked for the granting of loans. Credit from this source grew by IL. 53 million in 1961; of this amount, IL. 39 million was registered in December alone, including the IL. 32 million bookkeeping increase—i.e. the transfer to the banking institutions of existing debts owed to various financial institutions, the latter being credited with special deposits for the sums involved. The growth of ordinary bank credit to the public, which resulted in the expansion of the money supply, therefore amounted to IL. 120 million, as against IL. 100 million in 1960 and IL. 76 million in 1959.

In 1961 the public increased its pressure for further credit—largely in the wake of the growing expectation of devaluation and the rise in prices. The banking institutions had excess liquid reserves at the end of 1960, and these enabled them to expand credit at an accelerated rate in the early months of 1961. The anticipation of devaluation and the increase in prices prompted

TABLE XIV-13
Credit to the Public from the Banking System, 1955-61
(IL. million)

Balance at end of year	Increase from end of year to end of year		Average annual balance	Increase from annual average to annual average	
	IL. million	%		IL. million	%
1955	244.0	—	235.6	—	—
1956	282.1	38.1	15.6	263.9	28.3
1957	341.4	59.3	21.0	306.4	42.5
1958	406.5	65.1	19.1	364.0	57.6
1959	507.5	101.0	24.8	448.2	84.2
1960	646.6	139.1	27.4	570.7	122.5
1961	819.5	172.9	26.7	756.4	185.7

borrowers to make greater use of their right to overdraw their accounts, and credit originating in such overdrafts grew particularly fast. In consequence, most of the banking institutions incurred a deficit in their liquid assets, and the average liquidity ratio fell below the 1960 level. Thus it was possible for a considerable expansion of ordinary credit to take place without an increase in the liquid assets of the banking institutions.¹ There was also a substantial growth of credit originating from deposits excluded from the liquidity requirements.

¹ See section 5.

TABLE XIV-14

*Credit Granted to the Public through the Banking System, 1954-61**
(IL. million)

(End of period)

Period	From the resources of the Bank of Israel	From the resources of the banking institutions	Total bank credit	Against Government deposits	From Gov- ernment deposits earmarked for loans	Total (3) +(4) +(5)
	(1)	(2)	(3)	(4)	(5)	(6)
1954	—	221.5	221.5	22.5	41.5	285.5
1955	15.7	228.3	244.0	35.2	62.2	341.4
1956	35.1	247.0	282.1	46.7	73.2	402.0
1957	51.6	289.8	341.4	59.2	83.0	483.6
1958	27.6	378.9	406.5	64.7	101.0	572.2
1959	33.6	473.9	507.5	67.4	116.2	691.1
1960	57.0	589.6	646.6	65.4	118.1	830.1
1961	67.0	752.5	819.5	53.5	177.1	1,050.1
1961 January	55.7	617.6	673.3	57.5	118.6	849.4
February	62.0	650.9	712.9	65.7	120.0	898.6
March	63.7	665.8	729.5	76.8	122.2	928.5
April	60.3	662.3	722.6	71.4	122.2	916.2
May	59.5	666.0	725.5	68.5	123.8	917.8
June	58.3	694.3	752.6	66.3	124.8	943.7
July	56.5	714.8	771.3	62.2	125.8	959.3
August	56.9	718.8	775.7	60.1	125.5	961.3
September	59.8	740.2	800.0	57.6	127.0	984.6
October	61.1	739.9	801.0	54.4	126.6	982.0
November	60.7	732.1	792.8	52.7	128.1	973.6
December	67.0	752.5	819.5	53.5	177.1	1,050.1

* Excluding the Israel Bank of Agriculture.

In order to check the rapid expansion of credit, the liquidity regulations, as already indicated, were tightened several times during the year. At the end of March and October the minimum ratio was raised two per cent each time, while at the end of June the right to include the excess of foreign currency assets over foreign currency liabilities in the liquid assets was abrogated—this being tantamount to an increase in the liquidity ratio, although only in respect of those institutions which maintained "mixed liquidity."¹ The banks were not obligated to immediately make up the deficiencies in liquidity created by these statutory changes, but to utilize for this purpose part of the additional deposits alone. Since deposits subject to the liquidity regulations continued to expand

¹ Details of the changes in the liquidity regulations and explanatory notes appeared in the Bank of Israel Bulletin, Nos. 15 and 16.

until the end of June only, declining in the second half of the year, the restraining influence of the new directives was felt only during the months April to June, whereas in the second half of the year the "recognized deficiency" was not reduced at all. However, the existence of a large "recognized deficiency" on the eve of devaluation in February 1962 prevented an expansion of credit in the immediate post-devaluation period, when the banks experienced a big growth in deposits and liquid assets as a result of the stepped-up conversion of foreign currency.

The seasonal fluctuations in the volume of bank credit to the public differed in 1961 from those which characterized previous years. Whereas formerly there was a slow rise in the first months of the year followed by a rapid one in the second half, 1961 showed an opposite development. In the first three months ordinary credit grew by IL. 75 million, which represented nearly two-thirds of the total increment; apart from that which originated in deposits of the public earmarked for loans; in April and May there was a slight decline; the upward trend resumed from June until September; and in the final months there was again a contraction. The expansion of credit and the withdrawal of cash, even after the surplus of liquid assets that existed at the beginning of the year had vanished, created a large "unauthorized deficiency" in banking institutions, which reached a peak of nearly IL. 35 million in September and entailed the payment of fines. In the last three months of the year, the banking institutions reduced the volume of ordinary local currency credit to the public by approximately IL. 40 million¹ in order to cut down their "unauthorized deficiency", and by the end of the year the deficit declined steeply, to less than IL. 12 million.

During 1961 ordinary bank credit grew by IL. 120 million,² IL. 95 million of it in the first half of the year, and only IL. 25 million in the second half.

Of this increment, IL. 110 million was extended by banking institutions, and IL. 10 million came from the rediscounting of bills by the Bank of Israel. Rediscounts in local currency decreased by IL. 1.6 million, while those in foreign currency rose by IL. 11.6 million. The additional ordinary bank credit consisted of IL. 28 million in foreign currency and IL. 82 million in local currency. Nearly 75 per cent of the increase in ordinary local currency credit occurred in the item "current debitary accounts and overdrafts", and the balance in loans for fixed periods.

In addition to ordinary bank credit and that from deposits of the public earmarked for loans, a IL. 59 million increase took place in credits extended from Government deposits made within the framework of the Development Budget, which were handled by the banking institutions. The increase actually

¹ The repayment of loans did not actually come to this amount; the banking institutions sold borrowers' notes to various depositors, thus reducing the balance of time and demand deposits.

² Not counting the IL. 53 million increase in credit granted out of deposits of the public earmarked for loans.

amounted to only IL. 10 million in the first 11 months of the year, but in December the figure went up IL. 49 million. The development in that month did not represent the deposit of additional funds by the Government, but the transfer of debt collections to the banking institutions. This enabled some of the banks to report a large growth in credits and deposits in their balance sheet for the end of the year. Credit granted against Government deposits for the purpose of meeting tax obligations, to importers through the Reparations Corporation etc. declined by IL. 12 million.

In 1961 credit granted through the mediation of the banking institutions expanded greatly, as already mentioned. Various banks have been trading in notes for several years—initially those of the Jewish Agency and various other public institutions, besides payment undertakings of the Accountant General, and recently in commercial notes as well. Various banking institutions encourage account-holders to loan money to their clients, either with or without the banks' guarantee. Part of the notes thus acquired by owners of liquid financial balances were originally held by the banking institutions themselves, but were sold by the latter in order to reduce their "unauthorized" liquidity deficiency. In such cases the transaction did not result in any expansion of credit, but represented the substitution of credit by the public for bank credit. Another type of note acquired by the public through the agency of the banks was newly created commercial notes; but apparently this form of credit also largely constituted a substitute for other uses by lenders rather than the activation of dormant financial balances, as is evidenced by the fact that no increase took place in the circulation velocity of the money supply.¹ No data are available on the volume of credit made available through such trade in notes, but the increase which occurred in 1961 in the item "bank guarantees", which came to IL. 97 million or 69 per cent, was no doubt partly linked with the spread of this practice.² As for the volume of trade carried on without a bank guarantee, not even an indirect indicator is available. In any event, it must be stressed that, unlike bank credit, the credit made available through such trade in notes does not involve the expansion of the money supply, but merely represents a transfer of purchasing power. The enlargement of credit through these channels is likely to have an inflationary effect only insofar as it leads to an acceleration of the circulation velocity of the money supply—a development which apparently did not happen in 1961.²

(2) *The destination of credit:* The destination of credit depends largely on whether it is granted by the banking institutions at their own discretion or is controlled by the Bank of Israel and the Government. Credit controlled by the

¹ See Table XIV-7.

² The increase in guarantees in 1961 also included the normal growth which had no connection with the trade in notes. In 1960, when this practice had not yet become widespread, the increment amounted to IL. 45 million, or 47 per cent.

Bank of Israel consists of rediscounts, credit granted out of the 22 per cent that is exempt from the liquidity regulations, that from the 25 per cent of the funds available from deposits within the framework of approved saving schemes, and certain foreign currency credits. The last two are granted with the joint approval of the Bank of Israel and the Ministry of Finance. Before the ceiling on the volume of credits was lifted at the end of March 1961, credit exempted therefrom was also directed by the Bank of Israel. With the abolition of volume restrictions, the percentage of deposits exempted from the liquidity regulations was increased from 20 to 22 per cent of total liquid assets. Most of the credit channelled by the Bank of Israel is granted within this framework.

Of the IL. 174 million additional bank credit extended to the public in 1961, IL. 31 million, or 18 per cent, was directed by the Bank of Israel.¹ Allowing for the IL. 32 million increase deriving from deposits earmarked for loans which was recorded at the end of December and was of a bookkeeping nature only, the relative share of credit controlled by the Bank of Israel rose to around 22 per cent. Of the extra credit granted to the public by the banking institutions alone, not counting rediscounts, 16 per cent was channelled by the Bank of Israel, as compared with 25 per cent in 1960. The bulk of the credit was therefore uncontrolled bank credit. Not all of such credit, however, was given solely at the discretion of the banking institutions; part was allocated by the Government or various institutions, such as that portion of foreign currency credit that was not controlled by the Bank of Israel, credit from working capital funds administered jointly with the Government and which was granted with the latter's approval, or that part from deposits earmarked for loans whose destination was determined by the depositors. Nevertheless, most of the additional bank credit to the public in 1961 was granted without any external control.

Credit controlled by the Bank of Israel is allocated on the basis of fixed national priorities, with the stress being laid on the contribution to the advancement of economic independence. It is granted partly on the basis of overall branch arrangements and partly by way of individual approvals. The control of credit is an inevitable outcome of the law limiting the level of interest and of the existence of an excessive demand for credit at the legal interest rate; its purpose is to make part of the additional bank credit available to enterprises that are essential to the development and strengthening of the economy. Interest charged for controlled credit is lower than that for ordinary bank credit, and in the case of credit for financing export, it is much lower still.

The increase in rediscounts by the Bank of Israel amounted to IL. 10 million in 1961. Of this sum, IL. 9.5 million was accounted for by industry and commerce (intended mainly to finance industrial export and encourage trade with the new African states). An additional IL. 5.2 million worth of bills were re-

¹ See Table XIV-17.

TABLE XIV-15

*Credit Granted by the Banking System, by Source and Destination,
December 31, 1961^a*

	Bank credit					Credit against Govern- ment deposits (4)+(5)	Total (4)+(5)
	Controlled by the Bank of Israel		Uncon- trolled by the Bank of Israel	Total bank credit (1)+(2) (1)+(2)+(3)			
	From the Bank of Israel	From banking institutions	(3)	(4)			
	(1)	(2)	(3)	(4)	(5)	(6)	
<i>IL. million</i>							
Agriculture	5.3	81.8	66.6	153.7	3.7	157.4	
Industry	14.7	43.8	183.1	241.6	23.3	264.9	
Building	0.2	7.6	38.3	46.1	7.4	53.5	
Commerce	10.8	5.8	69.6	86.2	6.6	92.8	
Public services	18.8	4.4	7.7	30.9	0.9	31.8	
Local authorities	—	5.0	27.4	32.4	0.3	32.7	
Credit and financial institutions	—	2.3	23.3	25.6	0.1	25.7	
National Institutions	16.8	14.9	6.1	37.8	0.4	38.2	
Services	0.4	7.1	33.4	40.9	3.8	44.7	
Private individuals	—	—	82.4	82.4	4.0	86.4	
Miscellaneous ^b	—	0.7	41.7	42.4	3.3	45.7	
<i>Total</i>	67.0	173.4	579.6	820.0 ^c	53.8	873.8	
<i>Percentages</i>							
Agriculture	7.9	47.2	11.5	18.7	6.9	18.0	
Industry	21.9	25.3	31.6	29.5	43.3	30.3	
Building	0.3	4.4	6.6	5.6	13.7	6.2	
Commerce	16.1	3.3	12.0	10.5	12.3	10.6	
Public services	28.1	2.5	1.3	3.8	1.7	3.6	
Local authorities	—	2.9	4.7	4.0	0.6	3.7	
Credit and financial institutions	—	1.3	4.0	3.1	0.2	2.9	
National Institutions	25.1	8.6	1.1	4.6	0.7	4.4	
Services	0.6	4.1	5.8	4.9	7.1	5.1	
Private individuals	—	—	14.2	10.1	7.4	10.0	
Miscellaneous ^b	—	0.4	7.2	5.2	6.1	5.2	
<i>Total</i>	100.0	100.0	100.0	100.0	100.0	100.0	

^a Excluding credit granted by the Israel Bank of Agriculture.

^b Including credit granted to artisans.

^c This amount is IL 0.5 million larger than the balance of bank credit for 1961 appearing in Table XIV-13. This is due to the fact that the participation in consortial loans by banks and credit cooperatives is not included here with credit granted to credit and financial institutions, in order to avoid overlapping.

discounted for the National Institutions, while rediscounts for agriculture decreased by IL. 3.3 million. Most of the extra credit which this sector received derived from deposits exempted from the liquidity regulations and from the uncontrolled reserves of the banking institutions.

TABLE XIV-16
*Bank Credit, by Destination, 1954-61**

(End of period)

<i>Destination</i>	1954	1955	1956	1957	1958	1959	1960	1961
<i>IL. million</i>								
Agriculture	53.9	65.4	84.2	101.4	114.4	129.7	143.4	157.4
Industry	57.3	77.2	92.8	107.9	130.5	163.6	214.6	264.9
Building	31.8	19.8	21.4	27.4	28.2	36.9	43.1	53.5
Commerce	37.0	37.5	36.7	44.0	54.0	70.0	82.1	92.8
Public services	8.2	4.4	13.3	27.3	21.4	24.4	33.9	31.8
Local authorities	4.4	3.3	4.5	6.0	7.0	7.7	10.3	32.7
Credit and financial institutions	6.9	5.6	10.5	9.3	7.5	13.9	15.8	25.7
National Institutions	3.5	3.0	3.1	11.0	14.8	17.6	30.2	38.2
Services	10.4	13.7	16.1	17.1	25.9	29.4	36.2	44.7
Miscellaneous ^b	30.0	44.9	44.9	52.9	68.1	82.0	101.3	132.1
<i>Total</i>	243.4	274.8	327.5	404.3	471.8	575.2	710.9	873.8
<i>Percentages</i>								
Agriculture	22.2	23.8	25.7	25.1	24.3	22.6	20.2	18.0
Industry	23.5	28.1	28.3	26.7	27.7	28.4	30.2	30.3
Building	13.1	7.2	6.5	6.8	6.0	6.4	6.1	6.2
Commerce	15.2	13.7	11.2	10.9	11.4	12.2	11.5	10.6
Public services	3.4	1.6	4.1	6.7	4.5	4.2	4.8	3.6
Local authorities	1.8	1.2	1.4	1.5	1.5	1.3	1.4	3.7
Credit and financial institutions	2.8	2.0	3.2	2.3	1.6	2.4	2.2	2.9
National Institutions	1.4	1.1	1.0	2.7	3.1	3.1	4.2	4.4
Services	4.3	5.0	4.9	4.2	5.5	5.1	5.1	5.1
Miscellaneous ^b	12.3	16.3	13.7	13.1	14.4	14.3	14.3	15.2
<i>Total</i>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

* Excluding credit granted by the Israel Bank of Agriculture; including loans granted against Government deposits to persons and bodies owing taxes.

^b Including credit granted to private individuals.

The increase in credit extended to the public by banking institutions under the control of the Bank of Israel amounted to IL. 21.3 million, of which nearly 60 per cent went to agriculture and industry. There was also a relatively large expansion in the volume of credit granted to the building sector and local authorities. Uncontrolled bank credit to the public rose by IL. 143 million in 1961, but of this sum, IL. 32 million represented a bookkeeping increase only — the transfer at the end of December of existing debts to the credit of various banks. This increment was divided between industry and local authorities, both of which showed a large growth. Net of this sum, the increase in industrial

TABLE XIV-17

*Changes in Volume of Credit Granted to Public by and through the Banking Institutions,^a between the End of 1960 and the End of 1961
(IL. million)*

Destination of credit	From the banking institutions			Total bank credit (1)+(2) (1)+(3)	Credit against Government deposits	From Government deposits earmarked for loans (4)+(5) (4)+(6)	Total (7)
	From the Bank of Israel	Controlled by the Bank of Israel	Uncontrolled by the Bank of Israel				
(1)	(2)	(3)	(4)	(5)	(6)	(7)	
Agriculture	-3.3	7.4	11.6	15.7	-1.7	0.7	14.7
Industry	3.1	4.6	50.6	58.3	-8.0	-13.4	36.9
Building	—	5.6	3.8	9.4	1.0	1.1	11.5
Commerce	6.4	-2.9	9.6	13.1	-2.4	-1.3	9.4
Public services	-1.6	-1.6	1.0	-2.2	0.1	5.5	3.4
Local authorities	—	3.9	18.2	22.1	0.3	33.5	55.9
Credit and financial institutions	—	2.0	7.8	9.8	0.1	-0.1	9.8
National Institutions	5.2	-0.1	2.6	7.7	0.3	7.4	15.4
Services	0.4	2.0	6.2	8.6	-0.1	23.2	31.8
Miscellaneous ^b	-0.2	0.4	31.8	32.0	-1.2	2.3	33.1
<i>Total increase</i>	10.0	21.3	143.2	174.5 ^c	-11.6	59.0	221.9

^a Excluding the Israel Bank of Agriculture.

^b Including credit granted to private individuals.

^c This amount is IL. 1.6 million larger than the increase shown in Table XIV-13, as it is net of participation in consortial loans by other banking institutions.

Liquid Assets Held by Banking Institutions, 1955-61^a

(IL. million)

(End of period)

Period	Credit by the Bank of Israel		Net foreign exchange balances at the Bank of Israel	Net balances in transit between banking institutions	Total (1)+(2) (3) (4)	Less:		Liquid assets (5)-(8)	
	To the public (net) ^b	To the Government				Cash held by the public ^c	Deposits of banking institutions with the Bank of Israel not regarded as liquid balances		
	(1)	(2)				(6)	(7)		
1955	15.3	171.1	83.5	24.0	293.9	172.6	5.0	177.6	116.3
1956	34.5	236.7	92.4	16.2	379.8	228.4	17.8	246.2	133.6
1957	50.6	271.3	82.8	16.7	421.4	231.0	32.8	263.8	157.6
1958	27.2	289.1	162.0	8.9	487.2	251.5	49.3	300.8	186.4
1959	33.1	317.7	197.5	1.7	550.0	260.0	92.5	352.5	197.5
1960	49.0	316.8	337.1	1.2	704.1	299.6	140.3	439.9	264.2
1961	65.1	275.6	466.8	1.6	809.1	344.2	218.6	562.8	246.3
1961 January	47.5	312.4	344.2	1.5	705.6	308.1	145.3	453.4	252.2
February	55.1	306.9	354.9	2.5	719.4	321.2	150.6	471.8	247.6
March	54.1	281.9	393.6	0.8	730.4	343.7	161.1	504.8	225.6
April	52.8	274.0	427.5	1.1	755.4	336.8	165.6	502.4	253.0
May	52.7	267.8	443.9	0.2	764.6	337.3	173.5	510.8	253.8
June	53.1	265.1	466.5	0.7	785.4	345.2	180.3	525.5	259.9
July	52.9	261.7	460.6	1.7	776.9	347.3	184.0	531.3	245.6
August	52.7	291.1	428.5	2.8	775.1	350.3	190.1	540.4	234.7
September	56.6	288.3	431.6	2.9	779.4	356.7	197.4	554.1	225.3
October	58.0	280.1	437.3	2.9	778.3	353.2	207.3	560.5	217.8
November	57.9	286.4	444.0	5.6	793.9	354.0	209.9	563.9	230.0
December	65.1	275.6	446.8	1.6	809.1	344.2	218.6	562.8	246.3

^a Excluding the Israel Bank of Agriculture.^b This item is net of the deposits of financial institutions (including investment banks) with the Bank of Israel.^c Including cash held by the Israel Bank of Agriculture.

credit amounted to approximately IL. 37 million.¹ Agriculture and industry together accounted for 41 per cent of the total increment in uncontrolled credit, while 43 per cent went to private individuals, commerce, and various services. There was an especially large increase in credit to private individuals —IL. 22.4 million, or 37 per cent, which considerably exceeded the rate of growth in the overall volume of bank credit to the public. Part of the credit to private individuals was intended to finance consumption spending.

5. THE LIQUIDITY OF BANKING INSTITUTIONS

The year under review witnessed a marked deterioration in the liquidity position of the banking institutions, the average local currency liquidity ratio declining from 38.7 per cent in 1960 to only 33.8 per cent in 1961. At the end of December 1960, the ratio stood at 40.4 per cent, but it fell to 34.9 per cent at the end of December 1961. This was due to the combination of an IL. 18 million decline in the liquid balances of the banking institutions and a IL. 52 million increase in deposits subject to the liquidity regulations. By contrast, in 1960 there was a large growth of IL. 67 million in the total amount of liquid assets.

Two factors operated to reduce the liquid balances in 1961: the IL. 41 million decline in the Government's debt to the Bank of Israel and the net withdrawal of IL. 44 million in cash by the public. The main factor acting to increase the amount of liquid assets was the net acquisition of IL. 129 million in foreign currency by the Bank of Israel. This sum, however, included IL. 78 million in personal restitution payments that were not converted into local currency but deposited in PAZAK and TAMAM accounts. The banking institutions are obligated to deposit these sums in the Bank of Israel, and consequently they do not fall in the category of liquid assets. The conversion of foreign currency therefore led to an expansion of only IL. 51 million in the liquid balances of the banking institutions. The growth of Bank of Israel credit to the public led to an additional increase of IL. 16 million.² The total effect of the expansionary factors therefore amounted to IL. 67 million, while that of the contractive factors came to IL. 85 million; the net result was a decrease of IL. 18 million in the liquid balances.

¹ This increment was also reflected in the decrease that occurred in industrial credit extended from Government deposits within the framework of the Development Budget (Table XIV-17, col. 6). At the end of December, these long-term liabilities were transferred to financial institutions, which credited the Government with a non-liquid deposit that could more or less be drawn upon in accordance with the maturity dates of the loans. These loans were subsequently re-transferred to banks and included in industrial bank credit originating in deposits of approved financial institutions earmarked for the granting of loans.

² After deducting the deposits of financial institutions and the National Institutions held in the Bank of Israel.

TABLE XIV-19

*The Liquidity of the Banking Institutions in Local Currency, 1955-61**

(IL. million)

(End of period)

Period	Liquid balances with the Bank of Israel			Cash held by banking institu- tions	Net balances in transit between institu- tions	Total liquid assets (3) + (4) + (5)	Deposits subject to liquid- ity regu- lations (6)	Effective liquidity ratio (6) X 100 (7)
	Obligatory deposits (1)	Excess deposits (2)	Total (1) + (2)					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1955	43.1	38.2	81.3	11.0	24.0	116.3	296.2	39.3
1956	46.8	59.1	105.9	11.5	16.2	133.6	328.7	40.6
1957	57.6	71.5	129.1	11.8	16.7	157.6	392.1	40.2
1958	71.2	93.7	164.9	12.6	8.9	186.4	469.0	39.7
1959	81.3	101.4	182.7	13.0	1.7	197.4	531.0	37.2
1960	94.0	152.7	246.7	16.3	1.2	264.2	653.8	40.4
1961	108.2	117.1	225.3	19.4	1.6	246.3	706.0	34.9
1961 January	95.7	136.7	232.4	18.2	1.5	252.1	672.5	37.5
February	98.1	128.9	227.0	18.1	2.5	247.6	684.9	36.2
March	100.9	104.0	204.9	19.9	0.8	225.6	689.9	32.7
April	102.7	129.9	232.6	19.3	1.1	253.0	710.7	35.6
May	103.5	130.7	234.2	19.4	0.2	253.8	724.2	35.0
June	106.6	133.9	240.5	18.7	0.7	259.9	743.4	35.0
July	108.6	114.0	222.6	21.3	1.7	245.6	738.4	33.3
August	111.5	99.8	211.3	20.6	2.8	234.7	731.6	32.0
September	110.8	89.3	200.1	22.3	2.9	225.3	734.6	30.6
October	109.7	84.2	193.9	21.1	2.9	217.9	721.4	30.1
November	110.2	94.4	204.6	19.8	5.6	230.0	712.8	32.3
December	108.2	117.1	225.3	19.4	1.6	246.3	706.0	34.9

* Excluding the Israel Bank of Agriculture.

Deposits subject to the liquidity regulations continued to grow steadily until the end of June, but in the second half of the year they declined. The balance of liquid assets, on the other hand, showed sharp fluctuations, as did the actual liquidity ratio.

At the beginning of the year, the banking institutions, as already mentioned, held a large surplus of liquid balances, but the liquidity ratio dropped steeply to only 32.7 per cent by the end of March. The main causes of the decrease were the rapid expansion of credit to the public—which on the one hand increased the amount of deposits subject to liquidity, and on the other, was reflected in the greater withdrawal of cash and the reduction of the Government's indebtedness to the Bank of Israel.

In April the actual liquidity ratio rose substantially and remained on a

relatively high level until the end of June. This was due primarily to the large increase in foreign currency conversions; in addition, in April and May the expansion of bank credit was checked and the public reduced its cash holdings.

In July the steep decline resumed, and by the end of October the actual liquidity ratio reached its lowest level in many years—a mere 30 per cent. The chief reason for the worsening of the liquidity position in these months was the conspicuous seasonal reduction of foreign exchange reserves in the Bank of Israel. This period also saw the renewed expansion of credit to the public, which was accompanied by a withdrawal of cash from the banking institutions. The liquidity deficiency of the banking institutions, which was subject to a 10 per cent fine, reached unprecedented proportions.¹

In the last two months of the year the banking institutions made a determined effort to reduce the deficit. Ordinary local currency credit to the public was curtailed and various institutions sold foreign currency assets to the Bank of Israel. In December the seasonal accumulation of foreign exchange reserves resumed, and there was an increase in the conversion of such reserves into means of payment. There was also an increase in foreign currency rediscounts by the Bank of Israel, and the public cut down the amount of cash in its possession. These developments produced a gain of more than IL 28 million in the liquid balances of the banking institutions, and the actual liquidity ratio climbed from 30.1 per cent at the end of October to 34.9 per cent at the end of December. During these two months the banking institutions managed to reduce their liquidity deficiency by a considerable margin.²

6. DEVELOPMENT OF BANKING INSTITUTIONS

The rapid trend of expansion in the activities of the banking institutions continued in 1961. The consolidated balance sheet of the banking institutions showed a gain of 28 per cent as against 24 per cent in 1960 and 20 per cent in 1959. The large increase in assets was also reflected in a steep rise in operating income. A number of the major items increased faster than the general rate of growth. Own capital went up by 36 per cent, and the less liquid deposits, including those of non-residents (PATACH), by 41 per cent. On the asset side, there was a 46 per cent increase in foreign currency balances.

A particularly large expansion took place in contingent liabilities, which advanced by nearly 37 per cent. This partly reflected the increase in guarantees accompanying the spread of the trade in notes. Net of contingent liabilities,

¹ The "unauthorized deficiency", on which a fine is imposed, went up from IL 10-IL 12 million in May and June to more than IL 34 million in September. Such fines may not be treated as an expense in calculating income subject to income tax.

² The "unauthorized deficiency" declined from IL 34 million at the end of September to less than IL 12 million at the end of December.

TABLE XIV-20

Assets and Liabilities of the Banking Institutions, 1960-61^a.

(End of period)

	IL. million		Percentages		Increase or decrease (-) from 1960 to 1961	
	1960	1961	1960	1961	IL. million	%
<i>Assets</i>						
Cash and balances with						
the Bank of Israel	413.5	496.8	28.7	27.4	83.3	20.1
Loans to the public	589.6	752.5	40.8	41.5	162.9	27.6
Loans to the Government	4.4	7.7	0.3	0.4	3.3	75.0
Loans to the public from						
Government deposits	183.5	230.7	12.7	12.7	47.2	25.7
Foreign assets	114.1	166.2	7.9	9.2	52.1	45.7
Securities	110.6	128.0	7.7	7.1	17.4	15.7
Real estate	27.0	32.3	1.9	1.8	5.3	19.6
Net balances with banking						
institutions ^b	-0.6	-2.9	—	-0.1	-2.3	-383.3
<i>Total</i>	1,442.1	1,811.3	100.0	100.0	369.2	25.6
<i>Liabilities</i>						
Demand deposits	579.4	624.1	40.2	34.5	44.7	7.7
Non-liquid deposits	562.3	794.6	39.0	43.9	232.3	41.3
Foreign exchange commitments	14.5	26.1	1.0	1.4	11.6	80.0
Governments deposits	204.2	257.9	14.1	14.2	53.7	26.3
Own capital	51.8	70.3	3.6	3.9	18.5	35.7
Other accounts (net)	29.9	38.3	2.1	2.1	8.4	28.0
<i>Total</i>	1,442.1	1,811.3	100.0	100.0	369.2	25.6
<i>Contingent liabilities and guarantees</i>						
Balances held by and for						
banking institutions	29.6	38.8			9.2	31.1
Clients' liabilities and						
guarantees	316.4	433.8			117.4	37.1
Other accounts	76.3	104.1			27.8	36.4
<i>Total</i>	422.3	576.7			154.4	36.6
<i>Grand total</i>	1,864.4	2,388.0			523.6	28.1

^a Excluding the Israel Bank of Agriculture.^b Including investment and mortgage banks.

the increase in the balance sheet came to 25.6 per cent, compared with 25.4 per cent in 1960.

The number of branch offices rose by 94 during the year, as against an increase of 79 in 1960 and 42 in 1959. The law requiring a permit from the Governor of the Bank of Israel for opening a new branch went into force on May 24, 1961. From the beginning of the year until that date, 57 new branches started operation, and by the end of the year there were opened another 37, which had been in process of establishment before the law went into effect.

TABLE XIV-21

Banking Institutions and their Branches, 1955-61

(End of period)

	1955	1956	1957	1958	1959	1960	1961
The 3 big banks							
Head offices	3	3	3	3	3	3	3
Branches	104	114	193	219	244	289*	333
<i>Total</i>	107	117	196	222	247	292	336
Other banks							
Head offices*	21	22	22	22	22	23	23
Branches	52	61	67	72	83	111*	149
<i>Total</i>	73	83	89	94	105	154	172
Credit cooperative societies							
Head offices	94	93	59	52	42	29	27
Branches	74	79	49	48	54	60*	72
<i>Total</i>	168	172	108	100	96	89	99
All banking institutions							
Head offices	118	118	84	77	67	55	53
Branches	230	254	309	339	381	460*	554
<i>Total</i>	348	372	393	416	448	515	607

* Revised figures.

The three largest banks enlarged their branch network by 44, the other banks by 38, and the credit cooperative societies by 12. As a result, the relative share of the "Big Three" in the opening of new branches declined substantially—from 57 per cent in 1960 to 47 per cent in 1961; in fact, they opened fewer new branches than in 1960. Two small credit cooperative societies, which had no branches, went out of existence during the year after merging with two different banks.

TABLE XIV-22

*Cash and Balances with the Bank of Israel, Credit, and Deposits,
by Type of Banking Institution, 1955-61**

(Percentages)

(End of period)

	<i>The 3 big banks</i>	<i>Other banks</i>	<i>Credit cooperatives</i>	<i>Total</i>
Cash and balances with the Bank of Israel				
1955	56	27	17	100
1956	65	22	13	100
1957	67	24	9	100
1958	66	25	9	100
1959	66	26	8	100
1960	67	25	8	100
1961	66	27	7	100
Loans to the public from the resources of the banking institutions				
1955	54	23	23	100
1956	54	22	24	100
1957	64	19	17	100
1958	63	21	16	100
1959	66	20	14	100
1960	67	21	12	100
1961	67	22	11	100
Local currency demand deposits				
1955	54	25	21	100
1956	55	24	21	100
1957	61	24	15	100
1958	62	24	14	100
1959	64	23	13	100
1960	66	23	11	100
1961	64	25	11	100
Other deposits				
1955	54	24	22	100
1956	64	14	22	100
1957	68	19	13	100
1958	68	21	11	100
1959	69	22	9	100
1960	70	21	9	100
1961	72	21	7	100

* Excluding the Israel Bank of Agriculture.

The trend toward the centralization of banking activities which marked the past few years was halted in 1961, and the relative weight of the "Big Three" in several of the consolidated balance sheet items even dropped somewhat. Their share of cash and balances with the Bank of Israel decreased from 67 to 66 per cent, and of Israel currency demand deposits from 66 to 64 per cent. Their proportion of loans to the public remained unchanged at 67 per cent, and only in the less liquid deposits did they show an increase, from 70 to 72 per cent. In contrast, the other banks expanded their operations at a slightly faster rate, thereby increasing to some extent their share in most of the principal consolidated balance sheet items.

TABLE XIV-23
*Income and Expenditure of Banking Institutions, 1960-61**

	IL. million		Percentages		Increase from 1960 to 1961	
	1960	1961	1960	1961	IL. million	%
<i>Operating income</i>						
Interest and commission on loans and bills discounted	70.7	86.2	60.3	57.0	15.5	21.9
Commission for services rendered	23.6	31.9	20.1	21.1	8.3	35.2
Other income	23.0	33.2	19.6	21.9	10.2	44.3
<i>Total</i>	117.3	151.3	100.0	100.0	34.0	29.0
<i>Operating expenses</i>						
Wages, salaries, and social benefits	45.6	57.0	42.0	40.7	11.4	25.0
Interest on deposits	40.2	53.3	37.1	38.0	13.1	32.6
Other expenses	22.7	29.8	20.9	21.3	7.1	31.3
<i>Total</i>	108.5	140.1	100.0	100.0	31.6	29.1
<i>Net profit on operations</i>	8.8	11.2	70.9	60.2	2.4	27.3
<i>Net capital gains</i>	2.1	3.2	16.9	17.2	1.1	52.4
<i>Total profit^b</i>	10.9	14.4	87.8	77.4	3.5	32.1
Premium on bank shares sold during the year	1.5	4.2	12.2	22.6	2.7	180.0
<i>Total profit and premium income</i>	12.4	18.6	100.0	100.0	6.2	50.0

* Excluding the Israel Bank of Agriculture.

^b Before deduction of income tax and company profits tax.

The weight of the credit cooperative societies continued to decline in 1961, and in most of the items their share now stands at 7-11 per cent, compared with 20 per cent or more in 1955 and 1956. The number of societies dropped from 94 in 1955 to a mere 27 in 1961. Most of those which wound up their activities merged with banks, and a large part of their business was thus transferred to the latter. But even the existing societies reported a comparatively slower expansion of business. In 1961 their relative share diminished, even disregarding the merger of the two small societies.

7. INCOME AND EXPENDITURE OF BANKING INSTITUTIONS

The increased activity of the banking institutions in 1961 was reflected in a sharp rise in their income. Operating income rose by IL. 34 million, or 29 per cent, as compared with 25 per cent in 1960. Substantial gains were registered in "commission for services rendered" and in various other items such as "interest on deposits with the Bank of Israel", "income from foreign currency transactions", etc. The main item—"interest and commission on loans"—rose by 22 per cent, compared with 18 per cent in 1960.

Operating expenses rose steeply, by IL. 32 million or 29 per cent. The increase in operating income therefore amounted to IL. 2.4 million, or 27 per cent. The banks accounted for the entire sum—IL. 10.3 million in 1961 as against IL. 7.9 million in 1960—while the figure for the credit cooperative societies remained unchanged at IL. 0.9 million.

The banking institutions also had capital gains of IL. 3 million, as against IL. 2 million in 1960. Thus the total profit, before income tax and company profits tax, grew in 1961 by IL. 3.5 million, or 32 per cent.