

CHAPTER XIV

THE MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. MAJOR MONETARY DEVELOPMENTS

DEVELOPMENTS in the monetary system during 1962 were profoundly affected by the alteration of the exchange rate on February 9. Monetary expansion assumed unprecedented proportions: between the end of 1961 and the end of 1962 the public's financial assets increased by IL 642 million, or approximately 40 per cent, the money supply by IL 287.5 million, or 29.7 per cent, and less liquid deposits by IL 354.7 million, or 54.6 per cent. This expansion primarily reflected the fact that the devaluation was implemented during a period when foreign currency reserves continued to be accumulated at a rapid pace and the public held a large balance of foreign currency deposits. Moreover, the monetary expansion was accompanied by a decline in the propensity of the public to hold money, which accentuated the pressures on the demand side.

The big increase in net foreign currency assets held by the banking system—arising both from the accumulation of new assets and from the adjustment of their IL value following devaluation—was the main cause of the monetary expansion of 1962. Another was the growth of bank credit to the public. On the other hand, the Government's liabilities to the banking system declined, this having a contractive monetary effect.

As regards the direct sources of monetary expansion, the year 1962 may be divided into two periods. During the first five months—when the rate of increase was particularly high—the predominant factor was the rapid accumulation of foreign currency assets. Bank credit to the public was not expanded during this period, while the Government's net liabilities to the banking system declined sharply. However, during the last seven months of the year, the accumulation of foreign currency assets proceeded much more slowly, and the increase of bank credit to the public became the most important source of monetary expansion. The Government's net debt to the banking system showed a moderate rise during this period.

Devaluation intensified the effect of foreign currency conversion on the growth of the money supply in three ways: by increasing the rate at which foreign currency was accumulated, by increasing the value of foreign currency in terms of Israel pounds, and by increasing the rate of conversion of both current transfers and existing deposits. The steep rise in the banking system's foreign

currency assets—most of which were accumulated by the Bank of Israel—represented the continuation of a trend that began already in 1958. Its acceleration in 1962 was mainly due to the devaluation. The net increase in the banking system's foreign currency assets during the year reviewed came to \$ 128 million, bringing the total up to \$ 420 million, as compared with only \$ 47 million at the end of 1957. In 1961, when the rate of accumulation was also rapid, the net increment amounted to only \$75 million. However, owing to the alteration of the exchange rate, the accumulation of foreign currency had a relatively greater effect on the money supply in 1962 than in 1961, exceeding the difference in the magnitude of the accumulation. The immediate monetary effect of raising the exchange rate from IL 1.80 to IL 3 per dollar was to increase the IL value of foreign currency assets and liabilities by 67 per cent. The revaluation of the deposits of personal restitution recipients (Pazak and Tamam) upon devaluation augmented their volume by almost IL 200 million.¹ This was not immediately reflected by an expansion of the money supply, but it considerably enlarged the volume of financial assets held by the public, which can actually be converted into means of payment at any time. Moreover, the devaluation was followed by an accelerated rate of conversion, both out of existing foreign currency deposits and out of current transfers from abroad,² for the expectation of devaluation had previously been one of the motives for postponing conversion.

Altogether, the net value of the banking system's foreign currency assets grew by IL 733 million, of which IL 377 million represents the addition resulting from the revaluation of these assets on devaluation day. The increase due to the accumulation of new assets was thus IL 356 million. Not all of this amount was actually converted into local currency, part of it being deposited by foreign currency recipients in Pazak and Tamam accounts. The outstanding balance of these accounts rose by \$ 46 million during the year reviewed. Owing to this excess of new deposits over withdrawals from existing deposits, a considerable part of the net increase in foreign currency assets was not reflected in the expansion of the money supply.

The second factor in the monetary expansion of 1962 was, as already stated, bank credit granted to the public. According to the banking system's balance sheets, the increase in this item amounted to IL 231 million. But this figure includes the increment due to the revaluation of the outstanding balance of foreign currency credits on devaluation day (IL 61 million) and to the revaluation of the balance of linked credit outstanding at the end of the year (IL 34 million). Disregarding revaluation increments, the actual expansion of credit reached IL 136 million, or 17 per cent. Of this amount, IL 44 million

¹ Before devaluation, recipients of personal restitution payments could convert their deposits at a rate 20 per cent higher than IL 1.80/\$ 1, since they were granted a premium in the form of debentures, but the liability of banking institutions to the depositors was recorded at the official exchange rate.

² See section 4(a) below.

Table XIV-1

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1958-62

(From end of year to end of year)	IL million						Per cent					
	1958	1959	1960	1961	1962 ^a	1962 ^b	1958	1959	1960	1961	1962 ^a	1962 ^b
Sources												
Accumulation of foreign currency assets ^c	65.7	90.6	153.3	134.4	355.9	733.1	78.0	60.4	63.7	34.1	67.4	138.8
Expansion of credit to the public ^d	63.7	97.1	131.9	153.0	136.4	231.7	18.7	24.0	26.3	24.1	17.3	29.4
Expansion of credit to the Government	39.6	5.1	-4.1	-48.0	-60.9 ^e	-295.4	12.5	1.4	-1.1	-13.4	-19.7	-95.4
Other factors, net	-3.6	-10.9	4.7	2.1	-15.8	-27.2	†	†	†	†	†	†
Total	165.4	181.9	285.8	241.5	415.6	642.2	22.2	20.0	26.2	17.5	25.7	39.7
Components												
Money supply	83.7	66.0	154.3	88.9	287.5	287.5	14.5	10.0	21.3	10.1	29.7	29.7
Less-liquid deposits	81.7	115.9	131.5	152.6	128.1	354.7	48.8	46.4	35.9	30.7	19.7	54.6
Total	165.4	181.9	285.8	241.5	415.6	642.2	22.2	20.0	26.2	17.5	25.7	39.7

^a Excluding increments due to devaluation and linkage.

^b Including increments due to devaluation and linkage.

^c Including foreign loans.

^d Excluding foreign loans.

^e Including credits totalling IL 7 million granted by banking institutions to institutions of higher learning through the Government. In banking statistics, this amount is recorded as credit to the Government.

^f The balance of this item is small, sometimes even negative; hence the rates of change—which often reach several hundred per cent as a result of small fluctuations—are of no significance.

represents credit granted from deposits of the public earmarked for loans,¹ which does not involve an increase in the money supply. The expansion of ordinary credit from the resources of the banking system thus totalled IL 92 million, or 15 per cent, as compared with IL 100 million, or more than 19 per cent, in 1961. During the months January–May 1962, credit to the public from the resources of the banking system grew by only IL 8 million,² but from June to December the increase totalled IL 84 million.

Transactions between the Government and the banking system had a contracting monetary effect in 1962, as they partly offset the expansion due to other factors.³ But this effect was concentrated entirely during the first half of the year, whereas in the second half the Government's debt to the banking system showed a moderate rise. Between the end of 1961 and the end of 1962, the Government's net liabilities to the banking system decreased by IL 295 million. This decline was largely due to the transfer to the Government of the increment stemming from the revaluation of the net foreign currency assets held with the Bank of Israel (IL 162 million), as well as to the revaluation of the excess of the Government's foreign currency deposits over its foreign currency liabilities to the banking system (IL 65 million). These revaluation increments, totalling together IL 227 million, were not utilized to increase Government expenditure (which would have been tantamount to deficit financing) but were frozen. Against these revaluation increments, payments totalling IL 35 million were made by the Treasury to importers on account of exchange rate guarantees; in the Treasury's accounts this sum is deducted from the revaluation increments. By creating a current surplus of revenue over expenditure, the Government was able to reduce its net liabilities to the banking system by an additional IL 68 million.⁴

The amount of financial assets held by the public, which, as defined in this chapter, include both the money supply and the public's less liquid deposits with banking institutions, increased between the end of 1961 and the end of 1962 by IL 642 million. Less liquid deposits expanded by IL 355 million, including IL 227 million in revaluation and linkage differentials. Thus the public preferred to keep a considerable portion of its additional financial assets in a

¹ Mainly from the deposits of financial institutions and provident funds.

² The increase totalled IL 15 million in January and IL 8 million during the first week of February. But between devaluation day and the end of May there was a contraction of IL 14 million.

³ A review of the Government's "balance of payments", including its transactions with the various local economic sectors and the rest of the world, will be found in Chapter VII. A description of the money flows of the public sector as a whole will be found in Chapter XV.

⁴ According to Table XIV-1, the decline amounted to some IL 61 million. However, this figure includes IL 7 million in credit granted by banking institutions to institutions of higher learning through the Government; this sum appears in banking statistics as credit to the Government.

less liquid form, with the result that the effect of the expansionary factors was only partly reflected in the increase of the money supply. Nevertheless, there is no doubt that such a considerable increment of assets, the liquidity of which is relatively great, in itself influences the level of domestic demand and constitutes a potential source of further monetary growth. The increase occurred mainly in foreign currency deposits, institutional deposits earmarked for loans, and deposits in approved saving schemes. On the other hand, local currency time deposits contracted.

The rapid monetary expansion was accompanied by an acceleration in the velocity of circulation of the money supply—a development which further increased the pressure of demand on the economy's resources. The average velocity of demand deposits in banks was 11 per cent greater in 1962 than in 1961. The circulation velocity of the total money supply in relation to national income or the total resources available to the economy rose by 2 to 7 per cent. The higher velocity of circulation of money—in other words, the decline in the propensity of the public to hold money—was due to the rapid growth of less liquid financial assets, the mounting expectations of price increases in the wake of devaluation, and to the spread of the practice of trading in promissory notes through banking institutions, which to some extent activated dormant monetary balances.¹

The large increase in the economy's liquidity following devaluation, in a period of full employment and strong demand pressures on real resources, inevitably had adverse repercussions on the price level and the balance of payments. If monetary and fiscal policy does not succeed in arresting the rapid increase in liquidity, it will be but a short time before the positive contribution of devaluation to the improvement of Israel's competitiveness in foreign markets is dissipated.

Devaluation was carried out in a period when foreign currency was rapidly accumulating and the public had at its disposal a large balance of foreign currency deposits—circumstances which severely handicapped the monetary authorities. Yet, were it not for the countermeasures adopted by the Government and the Bank of Israel, foreign currency accumulation and conversion on so great a scale would undoubtedly have led to a much faster increase in the money supply than actually occurred.

The Bank of Israel took several steps intended to limit the expansion of bank credit, while encouraging saving and discouraging foreign currency conversion. However, it should be remembered that under very strong inflationary pressures, such as prevailed in 1962, monetary measures *per se* are of limited efficacy. The Bank of Israel therefore undertook an extensive campaign to explain the issues involved, emphasizing the need for additional measures. The steps instituted by the Government included the creation of a budgetary surplus, the

¹ See section 4(c) below.

Table XIV-2

AVERAGE ANNUAL INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1958-62

(From end of year to end of year)	IL million						Per cent					
	1958	1959	1960	1961	1962 ^a	1962 ^b	1958	1959	1960	1961	1962 ^a	1962 ^b
Sources												
Accumulation of foreign currency assets ^c	5.6	93.3	117.0	146.5	286.2	632.0	4.6	74.0	53.3	43.5	59.3	130.9
Expansion of credit to the public ^d	57.2	82.2	115.5	176.2	109.3	168.3	18.7	22.6	25.9	31.4	14.8	22.8
Expansion of credit to the Government	60.6	0.5	2.2	-29.4	-90.3	-299.4	20.7	0.1	0.6	-8.3	-27.7	-91.8
Other factors, net	0.3	7.9	-7.3	-2.1	-3.4	-14.8	e	e	e	e	e	e
Total	123.7	183.9	227.4	291.2	301.8	486.1	17.2	21.8	22.1	23.2	19.5	31.4
Components												
Money supply	85.3	80.8	99.6	147.7	163.9	163.9	15.2	12.5	13.7	17.9	16.8	16.8
Less-liquid deposits	38.4	103.1	127.8	143.5	137.9	322.2	24.0	52.0	42.4	33.4	24.1	56.3
Total	123.7	183.9	227.4	291.2	301.8	486.1	17.2	21.8	22.1	23.2	19.5	31.4

^a Excluding increments due to devaluation and linkage.

^b Including increments due to devaluation and linkage.

^c Including foreign loans.

^d Excluding foreign loans.

^e The average balance of this item is small, sometimes negative; hence the rates of change—which often reach several hundred per cent as a result of small fluctuations—are of no significance.

absorption and freezing of monies received outside the budgetary framework from the advance redemption of mortgage loans, compulsory saving, greater efforts to raise funds through the issue of long- and short-term debentures, measures to reduce the flow of capital imports, etc. However, these steps have not been on the requisite scale. In particular, too little has been done to reduce capital imports, the prime cause of the increase in the economy's liquidity. The acceptance of short-term foreign credits was not absolutely forbidden, and various institutions and importers increased their outstanding foreign liabilities.

It now appears that the measures adopted were inadequate, being unable to prevent excessive monetary expansion. The injection of additional purchasing power to such an extent as in 1962 demanded more stringent measures than those actually implemented by the Government and the central bank in the field of both fiscal and monetary policy.

The steps taken in the monetary sphere were chiefly aimed at restricting credit by raising the liquidity ratios. Most of the monies accruing from the conversion of foreign currency by the public were deposited in banking institutions, thus increasing their liquid assets. In 1962 the ordinary liquid assets of these institutions grew by IL 121 million, approximately IL 100 million of it during the months February–May. This is an unprecedented rate of expansion over so short a period. The additional liquid assets could have served as a basis for a big expansion of credit, had the banking institutions not been compelled to utilize them to cover the deficits in their liquidity requirements.

Liquidity ratios were raised several times during 1961. The banking institutions had to gradually cover the resultant deficiencies in liquid assets by diverting a certain percentage of their additional deposits for this purpose. On the eve of devaluation there was still a big "recognized deficiency", and this prevented banking institutions from expanding credit in the first few months following devaluation, when their liquid assets began to grow rapidly. Against all new deposits, banking institutions were required to hold liquid assets at the rate of 64 per cent (i.e. in accordance with the normal liquidity provisions), since during the first half of 1962 the Bank of Israel did not increase the amount of credit granted within the framework of the 22 per cent of controlled credit exempted from the liquidity regulations; the remaining 36 per cent had to be utilized for covering the "recognized deficiency".¹ The marginal liquidity ratio during these months thus reached 100 per cent, and this was the reason why the accumulation of new liquid assets to the amount of IL 100 million did not lead to any expansion of credit whatever, but was entirely reflected in the rise of the

¹ As long as the deficiency created by the raising of the liquidity ratio in October 1961 was not covered, the banking institutions had to channel 18 per cent of their new deposits to covering this deficit and a further 18 per cent to covering the previous "recognized deficiency", created when the liquidity ratio was raised in March and June of 1961. In most banking institutions both of these deficiencies still existed during the first half of 1962, and this made it impossible for them to expand credit.

effective liquidity ratio from 32 per cent at the end of January to 40 per cent at the end of May. At the end of December 1962, the effective liquidity ratio was 39.4 per cent, as against 34.9 per cent at the end of December 1961.

In addition to raising the liquidity ratio, the Bank of Israel reduced the volume of rediscounts, particularly during the first half of 1962, when the growth of the banking institutions' liquid assets was most rapid. When the Bank of Israel reduces its credit, not only is the money supply directly decreased, but the banking institutions find themselves with fewer liquid assets, and this limits their ability to grant new loans.

The Bank of Israel likewise refrained, as stated, from granting the full amount of exemptions within the framework of the 22 per cent of controlled credit. This was tantamount to raising the effective liquidity ratio still further. Thus this instrument, which was introduced chiefly for the qualitative control of credit, in 1962 served as a means of quantitative control.

To discourage the conversion of personal restitution transfers, the rate of interest on Pazak and Tamam accounts was raised. Interest on deposits for periods of 12 months or more was increased from 6 per cent to 7 per cent per annum. To prevent a mass withdrawal of deposits in approved unlinked saving schemes after devaluation, a special non-recurrent grant was promised to those who kept their deposits for another year.¹ It was also agreed with the banking institutions to introduce saving schemes linked to the consumer price index, or unlinked but carrying much higher rates of interest than those paid under similar schemes before the devaluation. And indeed, the slight decline in saving scheme deposits which began in the middle of 1961 was arrested, and in the second half of 1962 such deposits were even considerably increased.

This survey of the monetary expansion—its sources and its components—is based on the consolidated balance sheet of the banking system. This balance sheet is in Israel pounds, and the valuation of foreign currency assets and liabilities has been made at the official exchange rate. The changes that occurred in these items reflect, *inter alia*, the alteration of the exchange rate on February 9. It is therefore difficult to compare various monetary series from the pre-devaluation and post-devaluation periods. An attempt to evaluate the influence of the various factors on the money supply on the basis of changes in the credit items, which include accounts expressed in terms of foreign currencies and foreign currency deposits, is liable to prove misleading. For the increase due to revaluation at the new exchange rate did not directly affect the quantity of the money supply. On the other hand, this growth must not be disregarded, since it influenced the behavior of many economic units and individuals in the country. The demand of persons owning foreign currency deposits is undoubtedly influenced by the increase in the value of these deposits. Similarly, the behavior

¹ See section 3(4) below.

of persons owing linked debts is affected by an increase in the IL value of the balance outstanding, even if in terms of foreign exchange it remains unchanged.

For the reader's convenience, changes in linked and foreign currency balances which occurred on devaluation day are also shown separately, as are the amounts remaining after these changes have been deducted.

2. THE MONEY SUPPLY

The increase in the money supply between the end of December 1961 and the end of December 1962 totalled IL 287.5 million, or 29.7 per cent. In 1961 the growth was only 10.1 per cent. Demand deposits expanded by IL 222.2 million, while the amount of cash held by the public rose by IL 63.3 million. In consequence, the proportion of cash within the money supply declined from 35.5 to 32.6 per cent.

But when we examine the average annual volume of the money supply, a very different picture emerges: the increase in 1962 is then only 16.8 per cent, as compared with 17.9 per cent in 1961 (see Table XIV-4). The difference is due to seasonal fluctuations in the money supply, which did not follow the same pattern over both years (see Diagram XIV-1). Owing to the decline during the second half of 1961, the volume of the money supply at the end of that year was smaller than the annual average. But in 1962, the money supply expanded continuously throughout the year, and its volume at the year's end exceeded the annual average by 10 per cent. Thus, even should no further expansion take place, the average size of the money supply in 1963 will still be 10 per cent larger than in 1962.

The correct way of measuring changes in the money supply depends upon the objectives of those concerned. If the purpose is to estimate the influence of the money supply on demand during a certain period, the best yardstick is the average size of the money supply. On the other hand, when the aim is to analyze seasonal developments or the influence of monetary policy on the growth of the money supply, or to forecast the effects of a future increase in the money supply, it is better to refer to the rate of increase between two fixed points in time.

The 29.7 per cent rise in the money supply between the end of 1961 and the end of 1962 is of considerable significance, since this expansion will affect the average size of the money supply in 1963—and thus also the level of demand and prices anticipated for that year. However, the original point of comparison—the end of 1961—was relatively low owing to the contraction of the money supply during the second half of that year, and this was reflected by the rate of expansion between the beginning and the end of 1962.

The rate at which the money supply expanded during 1962 was irregular. It was fastest in the three months that followed devaluation, when foreign currency conversion reached its peak and means of payment increased by 3.6

per cent per month. Later in the year, the rate of growth slackened, and during the last quarter it averaged only 1.1 per cent per month (see Table XIV-4). During the first half of 1962, the average monthly rate of expansion was 2.7 per cent, as compared with 2.2 per cent during the first half of 1961. During the second half of 1962, the rate was 1.6 per cent, as compared with an average monthly decrease of 0.6 per cent during the second half of 1961.

The tendency for the percentage of cash within the money supply to decline, characteristic of recent years but absent during 1961, reappeared in 1962. The

Table XIV-3
ANNUAL RATES OF INCREASE IN THE MONEY SUPPLY, 1955-62
(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	%
Cash						
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
1962	409.3	65.3	19.0	382.8	41.4	12.1
Demand deposits						
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
1962	847.3	222.2	35.5	754.9	122.5	19.4
Money supply						
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
1962	1,256.6	287.5	29.7	1,137.7	163.9	16.8

Table XIV-4

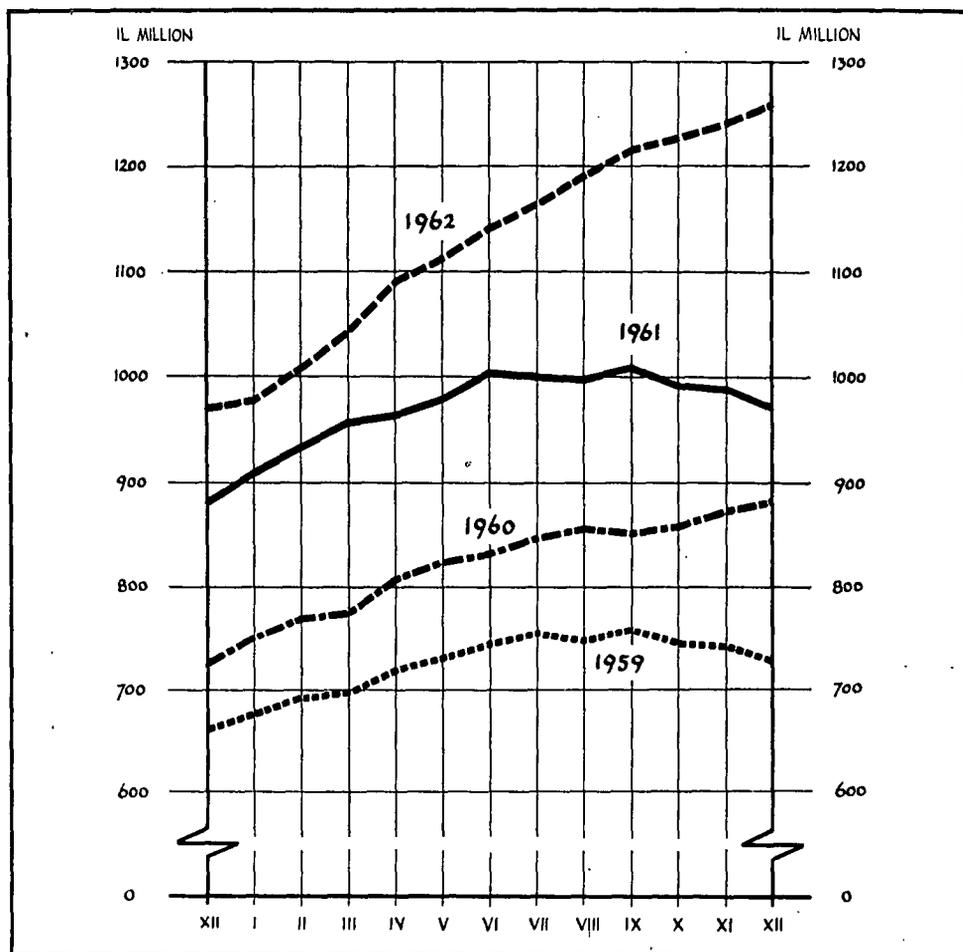
THE MONEY SUPPLY, BY MONTHS, 1961

(IL million)

(End of month)

Month	Cash			Demand deposits			Money supply		
	Total	Increase or decrease (-) from end of previous month		Total	Increase or decrease (-) from end of previous month		Total	Increase or decrease (-) from end of previous month	
		IL million	%		IL million	%		IL million	%
December 1961	344.0	-9.9	-2.8	625.1	-9.1	-1.4	969.1	-19.0	-1.9
1962 January	344.6	0.6	0.2	631.9	6.8	1.1	976.5	7.4	0.8
February	350.1	5.5	1.6	655.6	23.7	3.8	1,005.7	29.2	3.0
March	355.9	5.8	1.7	685.4	29.8	4.5	1,041.3	35.6	3.5
April	367.1	11.2	3.0	721.4	36.0	5.0	1,088.5	47.2	4.3
May	368.4	1.3	0.4	741.8	20.4	2.8	1,110.2	21.7	2.0
June	377.3	8.9	2.4	762.6	20.8	2.8	1,139.9	29.7	2.8
July	385.4	8.1	2.1	777.5	14.9	2.0	1,162.9	23.0	2.0
August	392.9	7.5	1.9	797.3	19.8	2.5	1,190.2	27.3	2.3
September	416.2	23.3	5.9	798.7	-1.4	0.2	1,214.9	24.7	2.1
October	410.8	-5.4	-1.3	813.9	15.2	1.9	1,224.7	9.8	0.8
November	415.3	4.5	1.1	825.8	11.9	1.5	1,241.1	16.4	1.3
December	409.3	-6.0	-1.4	847.3	21.5	2.6	1,256.6	15.5	1.2

Diagram XIV-1
THE MONEY SUPPLY, BY MONTHS, 1959-62



proportion of cash, which averaged 35 per cent in 1960 and 1961, dropped to an average of 33.7 per cent in 1962, and was only 32.6 per cent at the end of the year reviewed. Between the end of December 1961 and the end of December 1962, the amount of cash in circulation increased by IL 65.3 million, or 19 per cent, whereas demand deposits expanded by IL 222.2 million, or 35.5 per cent. The effect of the net cash withdrawals by the general public as a factor limiting the amount of liquid assets held by banking institutions was thus smaller than in 1961 (see Table XIV-16).

The rapid growth of the money supply during 1962 was accompanied by an increase in the velocity of circulation of money (see Table XIV-6). This indicates that the public was inclined to reduce the ratio between its monetary balances and the volume of its transactions. From the aspect of the influence of spending upon the economy's total demand, the above development reflects a cer-

Table XIV-5

**CASH AS A PERCENTAGE OF TOTAL
MONEY SUPPLY, 1954-62**

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
1962	33.7
End of month	
1962 January	35.3
February	34.8
March	34.2
April	33.7
May	33.2
June	33.1
July	33.1
August	33.0
September	34.3
October	33.5
November	33.5
December	32.6

tain intensification of pressures originating from monetary expansion. It may be assumed that one of the main factors increasing the velocity of circulation was the expectation of rapid price increases after devaluation, which led to a "flight" from money.

The average velocity of demand deposits rose by 11 per cent, from 16.2 per cent in 1961 to 17.9 per cent in 1962. The rise was particularly steep during the first three months after devaluation, when the volume of purchases and transactions in financial and other assets swelled appreciably. During these three months, the velocity of demand deposits was 15 per cent greater than in the corresponding months of 1961.

The higher velocity of demand deposits in 1962 was connected with the greater proportion of deposits drawable by check. The latter constituted 61.5 per cent of all demand deposits in 1962, as compared with 58.2 per cent in 1961. Deposits drawable by check invariably have a considerably higher velocity than other demand deposits. It may be that this development, which ran counter to the trend characterizing 1961 and previous years, was partly due to the

growth of the trade in promissory notes through banking institutions.¹ To the extent that financial resources diverted to such transactions include a high proportion of demand deposits not drawable by check, the change in the structure of deposits may partly be ascribed to the growing practice of trading in promissory notes.

Such trade does not normally create new means of payment, but it may have an influence upon the velocity of circulation. When the effect is to activate dormant monetary balances of potential lenders, instead of merely substituting one use of money for another, the velocity of circulation of the money supply is increased.

The average circulation velocity of the money supply in relation to the national income (i.e. transactions in final goods and services produced locally) rose by 1.8 per cent in 1962. In relation to the economy's total resources (i.e. to transactions in all final goods and services available for use in the economy, both locally produced and imported), the rise was 7.6 per cent. Both indicators do not include transactions in financial assets and real estate. It may be that this factor makes them incomplete as compared with the indicator of the velocity

Table XIV-6
INDICATORS OF VELOCITY OF CIRCULATION OF
MONEY SUPPLY, 1955-62

Year	Average annual velocity of circulation of money supply in relation to:		Average annual velocity of demand deposits ^c
	National income ^a	Total available resources ^b	
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	6.23	16.4
1961	4.18	6.30	16.2
1962	4.25	6.78	17.9

^a Nominal national income divided by the average annual money supply.

^b Gross national product, at current prices, plus import surplus, divided by the average annual money supply.

^c Total debits in local currency demand deposits of banks divided by the average annual volume of these deposits. Deposits of credit cooperative societies have been excluded.

¹ See section 4 (c) below. The significance of this phenomenon was described in the Annual Report of the Bank of Israel for 1961, pp. 283 and 300.

of demand deposits, which includes transactions in financial assets. This might account for the different rates of increase in velocity—a difference apparently due to the relatively larger volume of transactions in financial assets and real estate as compared with transactions in final products from current output.

3. OTHER FINANCIAL ASSETS HELD BY THE PUBLIC¹

In 1962 there was a big increase in the public's less liquid deposits with banking institutions. The volume of these deposits expanded by IL 355 million, or nearly 55 per cent, between the end of 1961 and the end of 1962. Most of the increase occurred in foreign currency deposits or deposits linked to the exchange rate of foreign currencies, where the influence of the devaluation was especially marked. After deducting the increments deriving from the revaluation of foreign currency on the day of the devaluation—which totalled IL 199 million—as well as the increments deriving from the revaluation of linked deposits at the end of the year—which totalled IL 28 million—there still remains an increase of IL 128 million, or approximately 20 per cent. This compares with an increase of IL 153 million, or 31 per cent, in 1961.

The greatest expansion occurred in the Tamam and Pazak deposits of recipients of German personal restitution payments. The outstanding balance of these two types of accounts rose during the year by IL 274 million, reaching IL 477 million. Of this increment, IL 140 million was the result of revaluation on devaluation day, and IL 134 million (or \$ 46 million²) represented the excess of new deposits over withdrawals from existing deposits. The increase during 1961 totalled \$ 43 million, though the volume of restitution payments was approximately 20 per cent smaller than in 1962—\$ 110 million as against \$ 135 million. The lower rate of conversion in 1961 was undoubtedly connected with the expectations of devaluation. Pazak and Tamam balances must be deposited by the banking institutions with the Bank of Israel, and therefore cannot serve as a source for the expansion of credit.

Other types of deposits which expanded appreciably include deposits earmarked for loans (by IL 70 million³) and deposits within the framework of approved saving schemes (by IL 19 million). On the other hand, there was a

¹ Deposits of foreign residents (Patach), which in banking statistics are included in the deposits of the public, are not dealt with in this section. Patach deposits are defined here as liabilities to foreign residents, and as such are deducted from the total of the banking system's foreign currency assets when computing the net balance of such assets. The volume of Patach deposits expanded by \$ 18 million during 1962, reaching \$ 99.1 million (i.e. IL 297.4 million) at the end of the year.

² The increase in January has been converted at IL 1.80=\$ 1; the increase during the remaining 11 months of the year—at IL 3.00=\$ 1.

³ Including a revaluation increment of IL 27 million at the end of December 1962.

Table XIV-7

DEPOSITS OF THE PUBLIC OTHER THAN MEANS OF PAYMENT IN BANKING INSTITUTIONS, 1958-62
(IL million)

Period	Deposits in Israel currency						Deposits in foreign currency ^a	Grand total
	Saving schemes	Time deposits	Deposits earmarked for loans and provident fund deposits earmarked for approved investments	Deposits against liabilities	Deposits linked to the exchange rate (Pazak)	Total less-liquid deposits in Israel currency		
1958	52.8	75.4	52.1	11.1	14.9	206.3	43.7	250.0
1959	59.7	78.8	87.9	9.9	34.3	270.6	95.3	365.9
1960	71.4	98.2	128.5	7.8	52.4	358.3	139.1	497.4
1961	85.4	85.9	184.1	10.3	95.1	460.8	189.2	650.0
1962	104.3	67.6 ^b	254.7 ^c	16.7	250.1 ^d	693.4	311.3 ^e	1,004.7
1962 January	84.9	81.9	185.7	11.1	98.6	462.2	199.1	661.3
February	84.6	78.4	188.7	11.6	168.7 ^d	532.0	339.8 ^e	871.8
March	84.7	76.5	194.7	12.1	175.6	543.6	333.4	877.0
April	85.1	74.4	201.7	13.4	184.4	559.0	330.1	889.1
May	85.8	73.4	202.7	13.9	192.7	568.5	323.9	892.4
June	86.6	72.8	206.2	12.8	200.6	579.0	319.2	898.2
July	87.7	72.9	206.3	12.4	208.1	587.4	317.8	905.2
August	88.6	71.1	209.2	14.9	217.8	601.6	309.5	911.1
September	91.3	69.6	210.5	15.5	223.6	610.5	315.4	925.9
October	93.9	68.6	212.7	16.0	231.6	622.8	319.5	942.3
November	100.2	67.6	218.2	16.2	239.7	641.9	318.1	960.0
December	104.3	67.6 ^b	254.7 ^c	16.7	250.1	693.4	311.3	1,004.7

^a Excluding deposits of foreign residents (Patach).

^b An increase of IL 1.1 million was due to linkage increments computed in December.

^c An increase of IL 26.8 million was due to linkage increments computed in December.

^d An increase of IL 65.8 million was due to the revaluation of these deposits on devaluation day (February 9).

^e An increase of IL 132.7 million was due to the revaluation of these deposits on devaluation day.

substantial contraction of time deposits in Israel currency (IL 18 million) and deposits against foreign currency liabilities (IL 41 million¹), and this increased the money supply. The growth of deposits earmarked for loans represents that part of the credit expansion which did not involve an increase in the money supply.

(1) *Pazak deposits*: The increase of IL 155 million in the balance of Pazak accounts was due to several factors: the raising of the exchange rate, the larger volume of restitution payments from West Germany, the raising of the interest rate on deposits for periods of 12 months or more from 6 per cent to 7 per cent per annum, and the reduction of the percentage of restitution receipts authorized to be held in Tamam accounts from 33 per cent to 25 per cent after devaluation. At the same time, however, there were factors stimulating conversion after devaluation. Of the total increment, IL 66 million represents the revaluation of the balance of Pazak deposits on the day of the devaluation, and IL 89 million—the net addition of new deposits. At the end of December 1962, the outstanding balance of Pazak deposits totalled IL 250 million.

(2) *Tamam deposits*: The increase during the year totalled IL 119 million, of which IL 74 million was the result of revaluation on devaluation day and IL 45 million constituted the net addition of new deposits. Thus the net increase in Tamam deposits, excluding revaluation, was equivalent to approximately 50 per cent of the net increase in Pazak deposits. The reduction of the percentage of transfer monies permitted to be deposited in Tamam accounts from 33 per cent to 25 per cent, the limiting of the uses to which foreign currency from Tamam deposits can be put,² the larger allocation of foreign currency for travel abroad, and the general relaxation of foreign currency controls, all these reduced the advantages of Tamam over Pazak deposits. This explains the big difference in the relative rates of expansion of the two types of deposits as compared with previous years, when Tamam accounts grew very much faster than Pazak accounts.

On the eve of devaluation, the outstanding balance of Tamam deposits was larger than that of Pazak deposits, but later the ratio changed (see Tables XIV-7 and XIV-8). At the end of December 1962, the balance of Tamam deposits totalled IL 227 million.

(3) *Deposits earmarked for loans*: These are in the main deposits of various financial institutions and provident funds earmarked for loans to specific clients or for purposes specified in advance. To the extent that such deposits are utilized for approved purposes, they are not subject to the ordinary liquidity require-

¹ According to the data in Table XIV-8, this decrease amounted to only IL 11 million, because they include the increment due to the revaluation of the balance outstanding on devaluation day.

² After devaluation, these deposits could be drawn upon in foreign currency only for the purchase of foreign securities, for foreign travel, and for the payment of legal costs connected with personal restitution claims.

ments.¹ In general, they are deposited for a period of several years, and partly linked to the exchange rate or the consumer price index.² Credit from such deposits is in almost all cases medium-term and is partly linked. The increase in this item totalled IL 70.6 million, of which IL 43.8 million represented new deposits, and IL 26.8 million, revaluation differentials.

The special deposits of provident funds earmarked for approved investments continued to contract. The decline began in November 1960, when the special arrangement governing these deposits (under which they were considered an "approved investment") was terminated. Some of these monies were transferred to "special deposits of approved institutions earmarked for loans"—an item which increased by IL 58 million.³ There was also an increase of IL 15 million in deposits of provident funds earmarked for loans to their members.

(4) *Deposits in approved saving schemes*: Between their inauguration in 1956 and the middle of 1961, these deposits expanded almost continuously. From the middle of 1961 to the middle of 1962, their balance remained virtually unchanged; but during the last six months of 1962, they expanded again—by IL 18 million. The balance outstanding at the end of 1962 exceeded IL 104 million.

The reason for the stagnation between the middle of 1961 and the middle of 1962 may be ascribed to the fact that all these deposits were unlinked, and when expectations of devaluation and price increases grew stronger, withdrawals from them increased. An even larger volume of withdrawals after devaluation was prevented by the guarantee of a special grant to all persons holding on to their deposits for another year. This grant is on a rising scale, increasing in accordance with the life of the deposit.⁴ In this manner, the banking institutions acceded to the demand to permit depositors in saving schemes to share in the linkage profits which the institutions had reaped by investing part of the saving scheme funds in linked securities.

In the middle of 1962, saving schemes linked to the consumer price index were introduced side by side with the existing unlinked schemes, and the frame-

¹ As regards deposits not yet utilized for the granting of credit for approved purposes, the liquidity ratio required of the banking institutions is 90 per cent.

² After devaluation, the link to the exchange rate was discontinued in respect of new deposits.

³ These are in the main deposits of financial institutions of Hevrat Ovdim (the Histadrut holding company), whose debentures are recognized as an "approved investment" for provident funds. These financial institutions deposit part of the amounts raised by their debenture issues, earmarked them primarily for the granting of loans to Histadrut enterprises (see Bank of Israel Annual Report for 1961, p. 287). Of the IL 58 million increment, IL 14 million came from linkage differentials following the revaluation carried out in December 1962.

⁴ On deposits held for five years prior to the end of January 1962, the grant amounts to 20 per cent of the balance at the end of January 1963; on deposits held for four years—15 per cent; on deposits held for three years—10 per cent; and on deposits held for less than three years—5 per cent.

work was widened by the inclusion of additional banking institutions. Following these developments, the volume of saving scheme deposits increased considerably.

The terms offered by the various banking institutions are not identical. The rate of interest on linked schemes usually approximates 4 per cent. This interest is itself unlinked, and it is exempt from income tax if the deposit has been held for at least three years. Deposits kept for five years or more become fully linked. If the deposit is held for over four years, 70 per cent of the principal becomes linked, and if held for over three years—50 per cent. Deposits for shorter periods do not benefit from the linking clauses. Banking institutions are required to invest 85 per cent of the saving scheme monies in linked debentures specially approved for this purpose. They may utilize the remaining 15 per cent at their discretion.

Interest on deposits in the unlinked schemes is on a rising scale, increasing according to the life of the deposits: it ranges from 4–5 per cent per annum for periods of less than three years to 6 per cent plus a non-recurrent 4 per cent grant if the deposit is held for over three years. Deposits held for over four years receive a non-recurrent grant of 10 per cent, and pay 6 per cent interest per annum. The utilization of monies deposited in unlinked saving schemes remains the same as before devaluation: 60 per cent must be invested in approved securities, up to 25 per cent can be used for credit controlled by the Government and the Bank of Israel, and the remaining 15 per cent may be freely utilized by the banking institutions concerned.

(5) *Time deposits*: The decline that began in the middle of 1961 continued in 1962. During the second half of 1961, the balance of time deposits decreased by nearly IL 20 million, and during 1962 by over IL 18 million. These deposits are unlinked, and as in the case of approved saving schemes, the decline was due to the growing expectations of devaluation and a rise in prices. The extension of the liquidity regulations to cover time deposits for periods exceeding 18 months, which came into force in March 1961, presumably was also partly responsible for the decline, as was the growing practice of trading in promissory notes through banks, due to which monies from time deposits were increasingly utilized for the purchase of promissory notes offering a higher yield.

(6) *Deposits against liabilities in foreign currency*: These deposits are mainly intended as cover for documentary credits opened in connection with import transactions. They contracted during the year by IL 11 million, but after deducting the increment due to revaluation on devaluation day, the decrease reaches IL 41 million. In terms of U.S. dollars, the balance declined from \$ 25 million at the end of 1961 to \$ 11 million at the end of 1962.

This decline was chiefly due to the devaluation, since after February 9 neither importers nor banking institutions were interested in purchasing foreign currency before carrying out an import transaction as a hedge against a possible devaluation. Though it remained obligatory to deposit a certain percentage of the value of the imports concerned when letters of credit were opened, the methods of

financing imports underwent a change—a shift from letters of credit to the payment of cash against documents. This method of import financing frees the importer from the need to deposit money before his transaction is actually implemented, while the foreign exporter is protected by guarantees from a third party. These developments enabled the banking institutions to sell some of the frozen foreign currency balances they had previously been inclined to hold, thus increasing their liquid assets and their ability to extend credit.

(7) *Other foreign currency deposits*: This item includes, *inter alia*, miscellaneous accounts of importers and exporters. It increased from IL 28 million at the end of 1961 to IL 35 million at the end of 1962. However, after deducting the increment due to revaluation on devaluation day, there was actually a decrease of IL 14 million. In terms of U.S. dollars, the balance declined from

Table XIV-8

FOREIGN CURRENCY DEPOSITS OF THE PUBLIC IN BANKING INSTITUTIONS, 1958-62^a

(IL million)

(End of period)

Period	Tamam deposits	Deposits against liabilities	Orders and drafts due for payment	Other deposits	Total
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
1962 ^b	226.6	34.3	15.4	35.0	311.3
1962 January	111.5	46.1	10.0	31.5	199.1
February	188.6	74.3	22.0	54.9	339.8
March	191.2	65.6	23.2	53.4	333.4
April	194.7	56.4	22.0	57.0	330.1
May	197.8	55.8	20.8	48.6	323.9
June	200.8	52.2	18.6	47.6	319.2
July	202.8	51.7	20.5	42.8	317.8
August	205.1	45.0	19.6	39.8	309.5
September	209.7	41.6	17.8	46.3	315.4
October	215.4	44.7	18.8	40.6	319.5
November	221.0	41.4	17.5	38.2	318.1
December	226.6	34.3	15.4	35.0	311.3

^a Excluding deposits of foreign residents (Patach), which are defined as liabilities to foreign countries, and as such are deducted from the total when the banking system's net foreign currency assets are computed.

^b The revaluation increment following devaluation totalled IL 132.7 million, divided as follows: Tamam deposits—IL 74.3 million; deposits against liabilities—IL 30.7 million; orders and drafts due for payment—IL 6.7 million; other deposits—IL 21 million.

\$ 16 million at the end of 1961 to \$ 12 million at the end of 1962. This decline, apparently due to the devaluation, also exerted an influence upon the expansion of the money supply.

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

The increase in the financial assets of the public, including the increment due to revaluation on devaluation day, totalled IL 642 million (or 40 per cent) during the year under review. The two sources of increase were, as already stated, the accumulation of foreign currency assets by the banking system and the expansion of bank credit to the public. On the other hand, the decline in the Government's debt to the banking system was a factor limiting monetary expansion. Though the revaluation of the balances outstanding on the day of the devaluation did not immediately affect the money supply, it increased the value of the financial assets owned by the public. In contrast, the revaluation increment derived from the excess of foreign currency assets over foreign currency liabilities in the Bank of Israel (and in net Government deposits) reduced the Government's debt to the banking system.

Monetary expansion was faster during the first half of 1962, largely owing to the revaluation of balances on devaluation day. But the accumulation of foreign currency, which was the main cause of monetary expansion during the year, was likewise concentrated chiefly in the first six months, when approximately three-quarters of the total annual foreign currency increment accrued. Accordingly, the money supply also expanded more rapidly during the first half of the year.

From the aspect of the direct causes of monetary expansion, the year 1962 may be divided into two periods. During the first five months, the accumulation of foreign currency was the decisive factor in stimulating monetary expansion, while the decline in the Government's debt to the banking system exerted a restraining influence, and bank credit to the public was only slightly expanded. During the last seven months of the year, on the other hand, the accumulation of foreign currency proceeded much more slowly, while the expansion of bank credit to the public became the main source of monetary growth. The decline in the Government's debt to the banking system was halted, and there was even a moderate rise.

(a) *Accumulation of foreign currency balances¹*

The rapid accumulation of foreign currency balances by the banking system which characterized the years 1958-61 gathered further momentum in 1962.

¹ The data on foreign currency balances cited in this Report have been revised to include loans granted by the Bank of Israel to foreign states and foreign banks, as well as foreign loans by local banking institutions. In previous Reports, these items—which were relatively small—were included under bank credit to the public.

Table
CONSOLIDATED BALANCE SHEET

(IL)

(End of period)

	1958	1959	1960	1961	1962 ^a	1962 January
Assets and liabilities						
Credit to the public ^b						
From the Bank of Israel	27.6	31.7	52.0	56.4	71.9	63.0
From banking institutions	377.5	470.5	582.1	730.7	946.9	741.0
Total	405.1	502.2	634.1	787.1	1,018.8	804.0
Investment of banking institutions						
In non-governmental securities	21.4	31.2	44.2	49.6	29.3	49.8
In subsidiary companies	5.8	6.4	9.2	24.7	60.8	24.6
Total	27.2	37.6	53.4	74.3	90.1	74.4
Credit to the Government						
From the Bank of Israel	289.1	317.7	316.8	275.6	-31.1	226.2
From banking institutions ^c	67.7	44.2	41.0	34.2	45.5	38.3
Total	356.8	361.9	357.8	309.8	14.4	264.4
Net foreign currency balances ^d						
With the Bank of Israel	162.0	199.4	342.1	477.4	1,247.2	514.4
With banking institutions	-12.1	41.1	51.7	50.8	14.1	56.8
Total	149.9	240.5	393.8	528.2	1,261.3	571.2
Balances in transit	7.8	0.8	4.2	2.2	9.7	3.8
Less: Non-liquid deposits						
In Israel currency	206.3	270.6	358.3	460.8	693.4	462.2
In foreign currency	43.7	95.3	139.1	189.2	311.3	199.1
Total	250.0	365.9	497.4	650.0	1,004.7	661.3
Equity capital and other accounts (net)	26.9	51.2	65.7	82.5	133.0	80.0
Money supply ^e	659.9	725.9	880.2	969.1	1,256.6	976.5

^a Including devaluation and linkage differentials.

^b Excluding foreign loans.

^c Including Government securities.

XIV-9

OF THE BANKING SYSTEM, 1958-62

million)

1962										
Feb- ruary	March	April	May	June	July	August	Sep- tember	October	No- vember	De- cember
91.0	81.0	66.2	65.9	54.1	46.3	60.2	58.9	68.3	71.8	71.9
775.8	784.4	798.2	803.4	829.8	850.8	855.0	885.0	891.5	908.8	946.9
866.8	865.3	864.4	869.3	883.9	897.1	915.2	943.9	959.8	980.6	1,018.8
50.3	50.5	49.8	50.3	51.9	55.9	53.5	55.3	55.6	59.8	60.8
24.7	23.9	24.1	24.2	24.3	25.3	27.0	27.1	27.7	28.0	29.3
75.0	74.4	73.9	74.5	76.2	81.2	80.5	82.4	83.3	87.8	90.1
-4.7	-21.0	-41.1	-63.0	-45.9	-52.3	-49.8	-47.0	-41.5	-52.3	-31.1
40.4	44.9	46.0	45.3	44.5	38.9	47.0	44.9	46.0	60.9	45.5
35.7	23.9	4.9	-17.6	-1.4	-13.4	-2.8	-2.1	4.6	8.7	14.4
890.3	967.0	1,059.1	1,110.5	1,130.4	1,152.3	1,163.9	1,174.9	1,193.3	1,213.9	1,247.2
86.5	71.4	55.4	49.0	41.2	45.3	42.0	39.1	35.2	25.5	14.1
976.8	1,038.4	1,114.5	1,159.5	1,171.6	1,197.6	1,205.9	1,214.0	1,228.5	1,239.4	1,261.3
7.6	9.1	10.8	9.9	10.6	11.3	5.6	9.6	6.0	11.9	9.7
532.0	543.6	559.0	568.5	579.0	587.4	601.6	610.5	622.8	641.9	693.4
339.8	333.4	330.1	323.9	319.2	317.8	309.5	315.4	319.5	318.1	311.3
871.8	877.0	889.1	892.4	898.2	905.2	911.1	925.9	942.3	960.0	1,004.7
84.4	92.8	90.9	93.0	102.8	105.7	103.1	107.0	115.2	127.4	133.0
1,005.7	1,041.3	1,088.5	1,110.2	1,139.9	1,162.9	1,190.2	1,214.9	1,224.7	1,241.1	1,256.6

^a Including foreign loans.^e Including demand deposits with the Israel Bank of Agriculture, which are included in the money supply statistics.

Despite the increase in the import surplus, foreign currency reserves rose by \$ 128 million during the year reviewed, as compared with an increase of \$ 75 million in 1961, and totalled \$ 420 million. The striking increase in capital imports—especially private restitution payments from Germany, transfers by foreign investors, and foreign loans—made it possible to cover the \$ 416 million import surplus while considerably enlarging the State's foreign currency reserves.

In view of the considerable impact which this large capital influx had on the economy's liquidity, there was reason to expect stronger restraining measures than those actually adopted in an attempt to arrest the monetary expansion. In particular, the prevailing conditions called for a reduction of short-term foreign liabilities. The Government did, in fact, reduce its own direct short-term foreign liabilities, but various institutions, companies, and importers continued to receive short-term credit from abroad with Government approval, and instead of contracting, such liabilities actually grew. After the devaluation, when the fear of an impending alteration of the exchange rate disappeared (this was previously a restraining factor), the pressure to obtain short-term foreign credit, which is relatively cheap, mounted.

The steep rise in capital imports during 1962 was largely due to the devaluation, which increased the local currency return received on foreign currency transfers. Apparently this was partly the result of the transfer of monies deliberately held back abroad in anticipation of devaluation. However, the effect of the devaluation in the monetary sphere was not confined to the stimulation of foreign currency transfers: the higher exchange rate was also reflected in the greater weight of current transfers and the existing foreign currency balances in terms of local currency. The net foreign currency balances of the banking system rose by IL 733 million between the end of 1961 and the end of 1962. Net foreign currency balances held by the Bank of Israel increased to a still greater extent, since the banking institutions reduced their net foreign currency assets during 1962.¹ This reduction was another consequence of the devaluation, for one of the motives previously encouraging the banks to hold foreign currency—which is not considered a liquid asset for the purpose of the liquidity regulations and normally carries a relatively low rate of interest—was eliminated. The change in the methods of financing imports following devaluation was another factor in the reduction.² The sale of foreign currency to the Bank of Israel served to increase the banking institutions' liquid assets, since the proceeds of such foreign currency sales are not required to be used for offsetting the "recognized deficiency" in liquid assets (the regulations stipulate that only liquid assets arising out of additional deposits are to be directed to this end).

A further effect of the devaluation was the higher rate of conversion of

¹ The decline totalled IL 37 million, or IL 70 million if the revaluation increment on devaluation day is deducted. In terms of U.S. dollars, it totalled \$ 23 million.

² See section 3 above.

foreign currency transfers. When expectations of devaluation mounted in 1961, there was a tendency among persons transferring foreign currency to keep a relatively high percentage of the transfers in foreign currency time deposits, in the hope of being able to convert them at a more favorable rate in the future. This motive ceased to apply after devaluation. On the other hand, expectations of price increases became stronger, and this led to a higher rate of conversion

Table XIV-10

NET FOREIGN CURRENCY ASSETS WITH THE BANKING SYSTEM,
1958-62

(IL million)

(End of period)

Period	With the Bank of Israel (net) ^a	With banking institutions			Total (1) + (4)
		Assets ^b	Foreign liabilities ^c	Net assets (2) - (3)	
1958	162.0	65.9	78.0	-12.1	149.9
1959	199.4	86.6	45.5	41.1	240.5
1960	342.1	121.6	69.9	51.7	393.8
1961	477.4	187.9	137.1	50.8	528.2
1962	1,247.2	310.6	296.5	14.1	1,261.3
1962 January	514.4	179.3	122.5	56.8	571.2
February	890.3 ^d	288.2	201.7	86.5 ^e	976.8 ^f
March	967.0	290.4	219.0	71.4	1,038.4
April	1,059.1	281.7	226.3	55.4	1,114.5
May	1,110.5	280.6	231.6	49.0	1,159.5
June	1,130.4	284.2	243.0	41.2	1,171.6
July	1,152.3	282.5	237.2	45.3	1,197.6
August	1,163.9	282.7	240.7	42.0	1,205.9
September	1,174.9	278.2	239.1	39.1	1,214.0
October	1,193.3	311.0	275.8	35.2	1,228.5
November	1,213.9	318.9	293.4	25.5	1,239.4
December	1,247.2	310.6	296.5	14.1	1,261.3

^a Including foreign loans, less foreign residents' deposits (Patach) with the Bank of Israel.

^b Including loans to foreign residents.

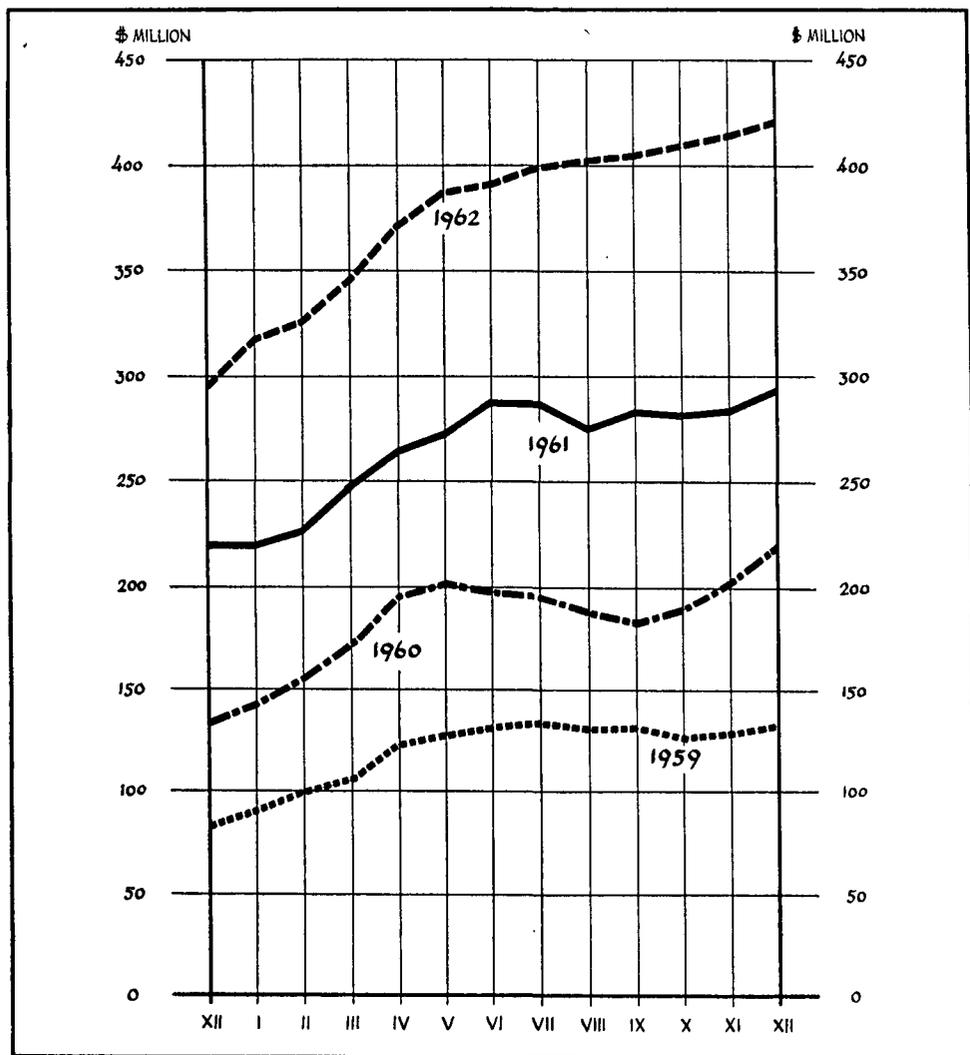
^c Including deposits of foreign residents (Patach), but excluding amounts deposited by banking institutions with the Bank of Israel.

^d An increase of IL 343.8 million was due to revaluation following the devaluation.

^e An increase of IL 33.5 million was due to revaluation following the devaluation.

^f An increase of IL 377.3 million was due to revaluation following the devaluation.

DIAGRAM XIV-2
FOREIGN CURRENCY BALANCES, BY MONTHS, 1959-62



of current foreign currency transfers.¹ Thus in 1962 a larger proportion of the net increment of foreign currency balances was reflected in the creation of means of payment than in 1961.

The seasonal pattern of foreign currency accumulation was much the same

¹ For the same reason, withdrawals from existing deposits were larger in 1962 than in 1961. A sample of personal restitution recipients showed that the rate of conversion of current receipts was 47 per cent during the second half of 1962, as against 35 per cent during the second half of 1961. The actual rate of conversion of all monies available to restitution recipients—including Tamam and Pazak balances at the beginning of the year, as well as current receipts during the year—reached 26.4 per cent in 1962, as compared with 21.5 per cent in 1961.

in 1962 as in former years (see Diagram XIV-2), but the usual decline during the summer months failed to materialize. Accumulation proceeded throughout all months of the year, but there was an especially striking increase in the early months, which is characteristic of the last few years. The growth in foreign currency balances from January to May 1962 totalled \$ 94 million, as compared with only \$ 34 million during the months June-December 1962.

(b) *Credit to the Government*

The change in the Government's debt to the banking system is not necessarily a reliable indicator of the effect of the Government's activities upon the economy, since it also conducts numerous and varied financial transactions with foreign countries. An examination of the Government's transactions with the banking system alone cannot disclose the extent to which the Government added to or reduced the excess demand in the economy. The answer can be found only through a general analysis of money flows between the Government and all the other economic sectors, including the rest of the world.¹ This chapter limits itself to surveying the Government's financial transactions with the banking system and their influence upon the money supply.

According to the consolidated balance sheet of the banking system, the Government's net liabilities to the banking system declined by IL 295 million between the end of 1961 and the end of 1962. The major part of this decline—IL 162 million—was due to the revaluation of the net foreign currency balances held by the Bank of Israel on the day of the devaluation. The devaluation increment was transferred to the Treasury in March, in accordance with the Budget (Amendment) Law of 1962.² Of this amount, IL 135 million was utilized to redeem Government liabilities to the Bank of Israel (in the main for the premature redemption of long-term loans), while the remaining IL 27 million was made available to the Government in a special account to cover payments in connection with exchange rate guarantees given to importers before devaluation.³ The Government itself possessed on devaluation day a surplus of foreign currency deposits over foreign currency liabilities to the banking system, and revaluation according to the new exchange rate increased this surplus by IL 65 million.

Besides the changes due to revaluation, there was a further decline in the Government's debt to the banking system as a result of the surplus of receipts over expenditure both within and outside the budget. Devaluation caused some special outlays, such as the payment of exchange rate differentials to the amount of IL 35 million in connection with guarantees given to importers, as well as

¹ This analysis is presented in Chapters VII and XV of this Report.

² The profits of the Bank of Israel are normally transferred to the Treasury at the end of the year.

³ By the end of 1962, these payments actually totalled some IL 35 million.

Table XIV-11

THE GOVERNMENT'S DEBT TO THE BANKING SYSTEM, 1958-62

(IL million)

(End of period)

Period	To the Bank of Israel				To banking institutions				Total debt
	Current credit (net)	Long-term credit and securities	Less: capital accounts	Total	Current credit (net)	Long-term credit and securities	Less: net deposits	Total	
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
1962	-252.7	242.6	21.0	-31.1	16.2	60.8	31.5	45.5	14.4
1962 January	-104.5	351.8	21.2	226.2	8.2	53.4	23.3	38.3	264.4
February	-186.9	367.4	185.2	-4.7 ^a	10.9 ^b	51.7	22.1	40.4	35.7
March	-240.2	243.2	24.0	-21.0	13.6	53.0	21.6	44.9	23.9
April	-257.8	243.2	26.5	-41.1	13.8	55.2	23.0	46.0	4.9
May	-276.6	243.2	29.5	-63.0	15.1	53.3	23.1	45.3	-17.6
June	-259.7	243.2	29.4	-45.9	13.2	54.2	23.0	44.4	-1.4
July	-263.3	243.2	32.1	-52.3	13.0	49.2	23.3	38.9	-13.4
August	-256.8	242.8	35.8	-49.8	11.3	56.0	20.3	47.0	-2.8
September	-254.9	242.7	34.8	-47.0	10.0	54.4	19.6	44.9	-2.1
October	-246.5	242.2	37.2	-41.5	10.6	56.2	20.8	46.0	4.6
November	-245.4	233.9	40.9	-52.3	16.8 ^c	64.9	20.7	60.9	8.7
December	-252.7	242.6	21.0	-31.1	16.2	60.8	31.5 ^d	45.5	14.4

^a Including a decrease of IL 229.0 million due to revaluation on the basis of the new exchange rate.^b Including an increase of IL 1.5 million due to revaluation on the basis of the new exchange rate.^c Including IL 7 million in credit to educational institutions granted through the Government.^d Including an increase of IL 7 million due to linkage increments.

of revaluation increments on foreign currency accounts deposited by public companies with the Accountant General before devaluation and subsequently withdrawn. The Government's expenditure on commodity and service imports likewise expanded considerably owing to the alteration of the exchange rate. On the other hand, the Government had some special receipts connected with the devaluation: the premature redemption of linked loans (especially mortgages), which was a condition for forgoing the linkage provisions, brought in large amounts. The difference between total receipts from local sources and from abroad (excepting the revaluation increment accruing to the Government from the banking system) and total payments, including net credit to other sectors, reached IL 68 million. This excess of receipts reduced the Government's net debt to the banking system. Credit to the Government from banking institutions expanded by IL 10 million, while credit to the Government from the Bank of Israel contracted by IL 78 million. Thus the Government froze IL 68 million of its "ordinary" financial resources, besides refraining from utilizing the large amounts accruing to it from the revaluation of its assets with the banking system for the expansion of its expenditure.

The net decline in bank credit to the public was almost wholly concentrated in the first five months of the year. During this period, the net Government debt to the banking system declined by IL 327 million. After deducting the decrease due to revaluation, there was still a real contraction—involving a reduction in the money supply—of some IL 100 million, and this proved sufficient to offset a considerable part of the monetary expansion caused by foreign currency conversion. On the other hand, between June and December 1962 bank credit to the Government was increased by IL 32 million. This was due to the seasonal excess of payments over receipts during these months.

The Government's transactions with the banking system during 1962 produced a creditory balance of more than IL 250 million in its current account at the Bank of Israel. This balance exceeded the Government's total long-term liabilities to the Bank of Israel (see Table XIV-11).

(c) *Bank credit to the public*

(1) *The expansion of credit:* According to the consolidated balance sheet of the banking system, the outstanding balance of bank credit to the public rose by IL 231.7 million, or 29.4 per cent, during 1962. This increase includes the IL 61.2 million¹ increment from the revaluation of the foreign currency credits outstanding on the day of the devaluation, and the increment due to the linking of credits to the consumer price index or the dollar, which reached IL 34.1

¹ Of this, IL 33.0 million in foreign currency bills discounted by the Bank of Israel, and IL 28.2 million in foreign currency credit to the public from banking institutions (excluding credit to foreign residents, which is included with the banking system's foreign currency assets).

million at the end of December 1962.¹ The real expansion of credit thus totalled only IL 136.4 million, or 17.3 per cent. This additional credit includes an amount of IL 44.1 million granted from third-party deposits earmarked for loans—in the main deposits of financial institutions and provident funds—which does not involve an expansion of the money supply.² The growth of ordinary bank credit to the public thus totalled IL 92.3 million, or 15 per cent, as compared with 19 per cent in 1961.

The expansion of ordinary bank credit consists of an increase of IL 109.8 million in credit granted by banking institutions and a contraction of IL 17.5 million in rediscounts by the Bank of Israel. The latter was chiefly due to the sale of IL 16.4 million worth of discounted bills by the Bank of Israel to banking institutions within the framework of the unutilized balance of controlled credit. A further decrease of IL 1.1 million was due to a real contraction in the amount of credit extended to the public by the Bank of Israel. The additional volume of controlled credit from banking institutions reached IL 40.6 million in 1962 but, as already stated, IL 16.4 million of this amount does not constitute a net increment but merely the purchase of bills from the Bank of Israel. New credit within the framework of exemptions from the liquidity regulations and rediscounts thus totalled IL 23.1 million, while new credit not controlled by the Bank of Israel totalled IL 69.2 million.

Table XIV-12
CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM,
1958-62
(IL million)

Period	Balance at end of year	Increase in end-year balances		Annual average	Increase in annual average	
		IL million	%		IL million	%
1958	405.1	63.7	18.7	363.6	57.2	18.7
1959	502.2	97.1	24.0	445.8	82.2	22.6
1960	634.1	131.9	26.3	561.3	115.5	25.9
1961	787.1	153.0	24.1	737.5	176.2	31.4
1962 ^a	1,018.8	231.7	29.4	905.8	168.3	22.8
1962 ^b	923.5	136.4	17.3	846.8	109.3	14.8

^a Including increments due to devaluation and linking.

^b Excluding increments due to devaluation and linking.

¹ Of this, IL 26.1 million in credits granted from deposits of the public earmarked for loans.

² The ordinary liquidity regulations do not apply to these deposits, which may be fully utilized for the granting of loans for approved purposes. Only that part of the deposits still unutilized must be covered by liquid assets to the extent of 90 per cent.

The expansion of ordinary bank credit to the public¹ was almost entirely concentrated in January and the months June to November inclusive. In January there was an expansion of IL 15 million, while between June and November the increase totalled IL 89 million. On the other hand, between February and May there was a decline of IL 7 million, and in December—a further decline of IL 5 million.

The expansion in January, which followed a marked contraction during the last quarter of 1961, was partly due to an increase in the unauthorized liquidity deficiency in violation of the liquidity regulations (see Table XIV-19). In addition, the volume of rediscounts by the Bank of Israel increased during this month by IL 7 million. On the other hand, bank credit did not expand at all—in fact, it even contracted somewhat—in the first months after devaluation (February to May), when foreign currency conversion reached its peak and the liquid assets of the banking institutions increased by approximately IL 100 million. However, the banking institutions were compelled to divert almost all their additional liquid assets to covering the “recognized deficiency” created by the raising of the liquidity ratios in 1961.² This deficiency was not subject to a fine, but the banking institutions were required to cover it gradually by diverting a certain proportion of their new deposits for this purpose. On the eve of devaluation there was still a large “recognized deficiency”, and it checked the expansion of credit despite the rapid increase in the banking institutions’ deposits and liquid assets resulting from the accelerated pace of foreign currency conversion. Moreover, the Bank of Israel did not increase the volume of controlled credit within the framework of exemptions from the liquidity regulations, and it reduced the amount of bills rediscounted. These developments led to a rise in the actual liquidity ratio from 32.3 per cent at the end of January 1962 to 40.3 per cent at the end of May—an unprecedented rate of increase over so short a period (see Table (XIV-17).

Some small banking institutions succeeded in covering their “recognized deficiencies” either completely or in part during these months, thus being free to utilize their additional liquid assets for granting credit.³ But this explains only a small percentage of the additional credit granted during the months June–November 1962. Most of the increment was due to various factors the

¹ Less the increments due to devaluation and linking, as well as credit granted from deposits of the public earmarked for loans.

² A detailed account of changes in the liquidity regulations introduced in 1961 may be found in Bank of Israel Bulletin No. 15, pp. 77–94 and in Bank of Israel Bulletin No. 16, pp. 50–52.

³ The banking institutions which liquidated the deficiency caused by the raising of the liquidity ratio in October 1961 were entitled to use 18 per cent of every new deposit received for the granting of credit, while the few banking institutions which succeeded in covering also the deficiency of June 1961 were entitled to utilize 36 per cent of their additional deposits for the expansion of credit.

influence of which could not be prevented under the liquidity regulations then in force. As the pressure for credit expansion mounted during the summer and autumn, which are normally seasons of greater demand for credit, many banking institutions failed to withstand the pressure, expanding credit beyond the limits permissible under the liquidity regulations, even though this made them liable to fines. The unauthorized deficiency in liquid assets grew from IL 4 million at the end of June to IL 22 million at the end of November.¹ Deficiencies in liquid assets have been created during these months for several years past. The existing fines² apparently are insufficient to prevent infringements of the liquidity regulations over short periods, especially when there is growing pressure for the expansion of credit. An additional cause of credit expansion during the June–November period was the seasonal increase in controlled credit within the framework of exemptions from the liquidity regulations. This increase totalled IL 27 million³ and in the main financed citriculture and other branches of agriculture. The developments described above led to a fall in the actual liquidity ratio from approximately 40 per cent at the of May to 36 per cent at the end of November. Moreover, the banking institutions had at their disposal other sources for expanding credit, such as sales of foreign currency and increases in their equity capital. In this manner, many banks acquired liquid assets which enabled them to expand credit despite the existence of a “recognized deficiency”, since according to the regulations then in force the banks were only compelled to cover the “recognized deficiency” by diverting a specified percentage of their new deposits for this purpose.⁴

In December, ordinary credit from banking institutions contracted by IL 8 million, despite the considerable increase in the amount of liquid assets at their disposal. The deficiency was thus substantially reduced, and the actual liquidity ratio rose from 35.9 per cent at the end of November to 39.4 per cent at the end of December. On the other hand, the volume of rediscounts expanded by IL 3 million, so that the contraction of ordinary bank credit during the month totalled only IL 5 million.

Besides the expansion of ordinary bank credit to the public by IL 92 million and the increase of IL 44 million in the volume of credit granted from deposits of the public earmarked for loans, there was an appreciable increase in the amount of credit granted through the intermediation of banking institutions—in the main with their guarantee. There are no data indicating the scale of such

¹ During December, the unauthorized deficiency fell below IL 8 million.

² The fine totals 10 per cent per annum, and payments of such fines are not deductible for income tax purposes.

³ Excluding purchases of bills from the Bank of Israel, which have no effect upon credit expansion.

⁴ The raising of the liquidity ratio by a further 3 per cent in January 1963 was implemented in a different manner: the banking institutions were compelled to increase their liquidity ratio by 0.5 per cent per month, regardless of whether their deposits had increased or not.

Table XIV-13

**CREDIT GRANTED TO THE PUBLIC FROM THE RESOURCES OF
THE BANKING SYSTEM, 1958-62***

(IL million)

(End of period)

Period	From the Bank of Israel	From banking institutions	Total bank credit	Against Government deposits	From Government deposits earmarked for loans	Total (3) + (4) + (5)
	(1)	(2)	(3)	(4)	(5)	(6)
1958	27.6	377.5	405.1	64.7	101.0	570.8
1959	33.6	470.5	502.2	67.4	116.2	685.8
1960	52.0	582.1	634.1	65.4	118.1	817.6
1961	56.4	730.7	787.1	53.5	177.1	1,017.7
1962	71.9	946.9	1,018.8	84.9	258.2	1,361.9
1962 January	63.0	741.0	804.0	52.6	176.9	1,033.5
February	91.0 ^b	775.8 ^c	866.8	54.6	178.3	1,099.7
March	81.0	784.4	865.3	82.2	181.7	1,129.2
April	66.2	798.2	864.4	93.2	182.3	1,139.9
May	65.9	803.4	869.3	98.3	182.6	1,150.2
June	54.1	829.8	883.9	103.0	183.7	1,170.6
July	46.3	850.8	897.1	101.8	182.8	1,181.7
August	60.2	855.0	915.2	103.0	183.6	1,201.8
September	58.9	885.0	943.8	100.0	183.5	1,227.3
October	68.3	891.5	959.8	93.9	184.0	1,237.7
November	71.8	908.8	980.6	87.4	201.8	1,269.8
December	71.9	946.9 ^d	1,018.8	84.9	258.2 ^e	1,361.9

^a Excluding foreign loans.^b Including an increase of IL 33.0 million due to the revaluation of foreign currency credits following the alteration of the exchange rate.^c Including an increase of IL 28.2 million due to the revaluation of foreign currency credits following the alteration of the exchange rate.^d Including linkage differentials totalling IL 34.3 million.^e Including linkage differentials totalling IL 14.7 million.

credit, but the much larger number of Israel currency bank guarantees, partly connected with the trading of promissory notes through banks, undoubtedly indicates a considerable increase in the volume of such transactions. This development reflects the continuation of a trend which began to gather momentum after April 1961.

Though some banking institutions have been transacting business of this kind for some years, it used to be confined mainly to promissory notes of the Jewish Agency and various other public bodies. The big banks virtually did not deal in promissory notes of private enterprises before 1961. But after

March 1961, there was a new development in this market: the payment of interest on loans granted by anonymous lenders was recognized as an expense by the income tax authorities, provided that a banking institution confirmed that 25 per cent of the interest had been deducted for income tax. This arrangement conferred a distinct advantage on persons lending through banks, since interest payments on loans granted other than through banks are recognized as an expense only after income tax has been deducted at source to the extent of 40 per cent. In consequence, a considerable proportion of the credit was transferred from the black credit market outside the banking institutions to the organized trade in promissory notes through banks.

The efficient service offered by the banking institutions in mediating between lenders and borrowers, their readiness to guarantee the payment of promissory notes, and the possibility of lending money at relatively high interest rates in a respectable manner through a banking institution, all these have given an impetus to the development of this trade in promissory notes. Another contributory factor is the considerable increase in the economy's liquidity that has taken place recently. It may be assumed, therefore, that the larger volume of credit granted in this manner represents not only a substitute for other uses of the same funds but also a net addition to the total volume of domestic credit.

The inflationary character of the development of the trade in promissory notes applies to only part of these transactions, the exact size of which cannot be determined. To the extent that the channelling of funds to this market is at the expense of similar uses, the money supply is not affected. Only when the funds derive from dormant balances or from the liquidation of time deposits can they be said to increase aggregate demand. The higher velocity of demand deposits in 1962 was apparently due in part to the larger scale of trading in promissory notes.¹

In several cases, grave legal shortcomings were found in transactions in promissory notes through banks: the promissory note concerned was unidentifiable, and the lender regarded the banking institution as his sole debtor. Such transactions were nothing more than a camouflaged way of obtaining deposits for the granting of credit in contravention of the liquidity regulations. To prevent this, the liquidity requirements were extended to include transactions in promissory notes, in all cases where it could not be proved that the function of the banking institution was confined to mediation.

The fact that the trade in promissory notes through banks competes successfully with short-term Government loans, even though the terms offered to the lenders are not always better, seems to be largely due to the higher commission collected by the banks on such transactions, and to their desire to satisfy the credit needs of their clients. Many banks actively solicit owners of liquid financial balances to purchase promissory notes through their mediation, and

¹ See section 2 above.

it seems that the true net return on such transactions as compared with the purchase of short-term Government obligations is not always understood. Short-term Government loans are liable to income tax at a maximum rate of 25 per cent, so that the net return on them is approximately 8½ per cent per annum. Transactions in promissory notes usually yield from 8 to 11 per cent per annum (after deduction of 25 per cent income tax), but the tax deducted at source is not the entire amount due, since this kind of income does not benefit from tax concessions. Consequently, the net yield is lower in the case of lenders whose marginal tax rate exceeds 25 per cent. This point does not always seem to be sufficiently explained.

2. *The destination of credit*: Part of the credit granted to the public by the banking institutions is controlled by the Bank of Israel and various Government departments, and this fact influences its destination. The qualitative control of credit is an inevitable result of the law limiting the rate of interest and of the excessive demand for credit existing at the maximum legal interest rate. The object of credit control is to ensure that essential enterprises—especially concerns producing for export—are not adversely affected by the credit restrictions. Controlled credit is granted at a lower rate of interest than ordinary bank credit, while credit for the financing of exports carries interest at a considerably lower rate.

In the latter part of 1962, a general fund for the financing of industrial exports was inaugurated. The participants are the Government (20 per cent), the Bank of Israel (20 per cent), and the banking institutions (60 per cent). Half the participation of the banking institutions is within the framework of exemptions from the liquidity regulations, while the remaining half is supplied from their free resources. The fund finances working capital required for export production, as well as actual export deliveries until payment for them has been received. Interest on loans from the fund was originally fixed at 7½ per cent per annum, but was reduced to 6 per cent at the beginning of 1963. The monies of other funds serving the same purpose will be gradually transferred to this fund, which will supersede all other export finance arrangements.

Credit controlled by the Bank of Israel includes rediscounts, credits within the framework of the 22 per cent exempted from the liquidity requirements, credits granted from 25 per cent of the monies deposited in approved unlinked saving schemes, and some of the foreign currency credits from the Israel banking system. Most of the credit under Bank of Israel control is granted within the framework of exemptions from the liquidity regulations. Credit controlled by the Bank of Israel represented 30 per cent of all bank credit granted to the public at the end of 1962—a similar rate as the year before.

Part of the foreign currency credits and loans from working capital funds administered jointly with the Government are not included among the credit under Bank of Israel control, but are allocated by various Government departments. The allocation of credits from the deposits of various institutions ear-

Table XIV-14

**CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM,
BY SOURCE AND DESTINATION, DECEMBER 31, 1962^a**

Destination	Controlled by the Bank of Israel ^b	Not controlled by the Bank of Israel	Total bank credit (1) + (2)	Credit against Govern- ment deposits	Total (3) + (4)
	(1)	(2)	(3)	(4)	(5)
IL million					
Agriculture	99.0	74.6	173.6	3.0	176.6
Industry	91.9	250.6	342.5	50.0	392.5
Construction	6.4	46.0	52.4	10.1	62.5
Commerce	18.1	85.2	103.3	10.8	114.1
Public services	25.0	13.2	38.2	0.3	38.3
Local authorities	8.1	50.3	58.4	0.1	58.5
Financial and credit institutions	1.5	25.9	27.4	0.1	27.5
National institutions	33.7	4.5	38.2	0.2	38.4
Services	4.4	39.6	44.0	3.2	47.2
Private individuals	—	103.7	103.7	3.7	107.4
Miscellaneous ^c	1.5	39.6	41.1	3.6	44.7
Total	289.6	733.2	1,022.8 ^d	85.1	1,107.9
Percentages					
Agriculture	34.2	10.2	17.0	3.5	15.9
Industry	31.7	34.2	33.5	58.7	35.4
Construction	2.2	6.3	5.1	11.9	5.6
Commerce	6.2	11.6	10.6	12.7	10.3
Public services	8.6	1.8	3.7	0.4	3.5
Local authorities	2.8	6.9	5.7	0.1	5.3
Financial and credit institutions	0.5	3.5	2.7	0.1	2.5
National institutions	11.6	0.6	3.7	0.2	3.5
Services	1.5	5.4	4.3	3.8	4.3
Private individuals	—	14.1	10.1	4.3	9.7
Miscellaneous	0.5	5.4	4.0	2.3	4.0
Total	100.0	100.0	100.0	100.0	100.0

^a Including devaluation increment of IL 61.2 million and linkage differentials of IL 34.3 million. The devaluation increment is mostly in credit to industry, public services, and the National Institutions. Most of the linkage differentials are in credit to industry and local authorities.

^b Including Bank of Israel rediscounts and controlled credit granted by the banking institutions.

^c Including credit granted to artisans.

^d This amount is IL 4 million larger than the figure cited in Table XIV-13. The difference is due to the fact that no deduction has been made here for the participation of mortgage and investment banks in consortial loans by banking institutions.

Table XIV-15

**BANK CREDIT GRANTED TO THE PUBLIC, BY SOURCE AND
DESTINATION, 1958-62^a**

(End of period)

Destination	1958	1959	1960	1961	1962 ^b
IL million					
Agriculture	114.4	129.7	143.4	157.4	176.6
Industry	130.5	163.6	214.4	264.4	392.5
Construction	28.2	36.9	42.6	52.1	62.5
Commerce	54.0	68.1	77.1	82.2	114.1
Public services	21.4	24.4	33.9	31.8	38.5
Local authorities	7.0	7.7	10.3	32.7	58.5
Financial and credit institutions	7.5	13.9	14.3	21.9	27.5
National Institutions	14.8	17.6	29.0	34.7	38.4
Services	25.9	29.4	36.2	44.7	47.2
Miscellaneous ^c	66.7	78.6	97.0	119.5	152.1
Total^d	470.4	569.9	698.4	841.4	1,107.9
Percentages					
Agriculture	24.3	22.7	20.5	18.7	15.9
Industry	27.8	28.7	30.7	31.4	35.4
Construction	6.0	6.5	6.1	6.2	5.6
Commerce	11.5	11.9	11.4	9.8	10.3
Public services	4.5	4.4	4.7	3.8	3.5
Local authorities	1.5	1.3	1.5	3.9	5.3
Financial and credit institutions	1.6	2.4	2.0	2.6	2.5
National Institutions	3.1	3.1	4.2	4.1	3.5
Services	5.5	5.2	5.2	5.3	4.3
Miscellaneous	14.2	13.8	13.8	14.2	13.7
Total	100.0	100.0	100.0	100.0	100.0

^a Including loans granted against Government deposits to persons owing income tax.^b Including devaluation increment of IL 61.2 million and linkage differentials of IL 34.3 million. Most of the devaluation increment is in credit to industry, public services, and the National Institutions. Most of the linkage differentials are in credit to industry and local authorities.^c Including credit granted to private persons.^d Figures have been revised by the deduction of loans to foreign residents, which in previous years were included in the various items of credit to the public, mainly in "Commerce" and "Miscellaneous".

marked for loans is determined by the depositors. However, as in 1961, most of the new credit to the public from banking institutions was granted without any external control.

In 1962 there was a considerable expansion of bank credit to industry. The share of this sector in the total volume of bank credit to the public has been rising for some years (see Table XIV-15), reflecting primarily its growing importance in the economy—particularly as regards exports. New bank credit to industry (exclusive of revaluation increments due to devaluation and linking) reached IL 67 million in 1962, constituting approximately half the total increase in bank credit to the public. If credit granted against Government deposits to persons and bodies owing taxes etc. is added, the share of industry rises to IL 94 million out of the IL 168 million of new credit to the public.

Bank credit to other economic sectors (again excluding revaluation and linkage increments) was expanded by approximately IL 70 million.¹ Credit to the commercial sector expanded by IL 30 million; to agriculture—by IL 20 million; to private individuals—by IL 20 million;² and to local authorities—by IL 15 million. On the other hand, credit to the National Institutions and public services contracted by more than IL 20 million.

5. THE LIQUIDITY OF BANKING INSTITUTIONS³

The liquidity of the banking institutions increased considerably during 1962. This was due to large-scale purchases of foreign currency by the Bank of Israel while further tightening the liquidity regulations. The average annual liquidity ratio rose from 33.6 per cent in 1961 to 36.7 per cent in 1962, after having declined by 3 per cent between 1960 and 1961. Between the end of 1961 and the end of 1962, the liquidity ratio rose from 34.2 to 39.4 per cent. The banking institutions' ordinary liquid assets rose by IL 121 million, or about 51 per cent, during the year reviewed. At the same time, the volume of deposits against which ordinary liquid assets must be held expanded by IL 216 million, or some 31 per cent. The banking institutions were compelled to divert most of their additional liquid assets deriving from new deposits to covering the current liquidity requirements, as well as the "recognized deficiencies" caused by the raising of the liquidity ratio in 1961. This prevented the use of new deposits for the further expansion of credit.

¹ Excluding credit granted against Government deposits to persons and bodies owing taxes, which totalled less than IL 5 million for all economic sectors other than industry.

² Of which some IL 10 million was extended to members of provident funds from deposits of these funds earmarked for loans.

³ In contrast to previous Bank of Israel Annual Reports, the reference here is to ordinary liquidity ratios in Israel currency only—i.e. to deposits which were subject to a liquidity ratio of 64 per cent in 1962, and not to the deposits subject to liquidity ratios of 90 or 100 per cent.

LIQUID ASSETS OF BANKING INSTITUTIONS,^a BY SOURCE, 1958-62

End of period	Credit from the Bank of Israel		Net foreign currency assets at the Bank of Israel	Net balances in transit between banking institutions	Total (1) + (2) + (3) + (4)	Less:				
	To the public (net) ^b	To the Government				Cash held by the public ^c	Net foreign currency balances of banking institutions at the Bank of Israel	Liquid assets in Israel currency against deposits requiring 90% or 100% liquid cover ^d	Total deductions (6) + (7) + (8)	Liquid assets in Israel currency (5) - (9)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1958	27.2	289.1	162.0	8.6	486.9	251.5	38.3	19.2	309.0	177.9
1959	31.2	317.7	199.4	0.2	548.5	260.0	80.8	19.3	360.1	188.4
1960	48.3	316.8	342.1	0.5	707.7	299.6	136.4	24.7	460.7	247.0
1961	54.5	275.6	477.4	0.4	807.9	344.2	213.4	13.3	570.9	237.0
1962	66.9	-31.1	1,247.2	1.1	1,284.1	409.4	490.4	26.5	926.3	357.8
1962 January	58.6	226.2	514.4	2.1	801.3	344.7	219.7	11.8	576.2	225.1
February	82.9	-4.7	890.3	1.1	969.6	350.1	373.4	8.0	731.5	238.1
March	73.7	-21.0	967.0	1.2	1,020.9	356.0	387.4	11.1	754.5	266.4
April	62.0	-41.1	1,059.1	2.7	1,082.7	367.2	399.2	14.9	781.3	301.4
May	62.7	-63.0	1,110.5	-0.2	1,110.0	368.5	404.7	12.5	785.7	324.3
June	75.1	-45.9	1,103.4	-0.1	1,132.5	377.4	422.7	15.3	815.4	317.1
July	42.0	-52.3	1,152.3	-0.4	1,141.6	385.5	427.4	12.4	825.3	316.3
August	55.8	-49.8	1,163.9	2.7	1,172.6	393.0	438.0	20.8	851.8	320.8
September	54.6	-47.0	1,147.9	2.5	1,185.0	416.3	445.7	20.8	882.8	302.2
October	63.6	-41.5	1,193.3	1.7	1,217.1	410.9	461.8	23.7	896.4	320.7
November	68.8	-52.3	1,213.9	1.5	1,231.9	415.4	473.4	24.3	913.1	318.8
December	66.9	-31.1	1,247.2	1.1	1,284.1	409.4	490.4	26.5	926.3	357.8

^a In contrast to former Bank of Israel Annual Reports, the data on liquid assets presented in this table include among the deductions liquid assets held against deposits requiring 90 per cent or 100 per cent liquid cover. The totals in column 10 for previous years have been adjusted accordingly.

^b After deduction of deposits of financial institutions (including investment banks) with the Bank of Israel.

^c Including cash at the Israel Bank of Agriculture.

^d Excluding demand deposits held for banking institutions, which are included net in column 4.

The revaluation of the foreign currency assets of the Bank of Israel upon devaluation was not accompanied by an increase in the liquid assets at the disposal of banking institutions, being offset by a decline in the Government's debt and an expansion of the banking institutions' foreign currency deposits with the Bank of Israel (which do not constitute liquid assets).¹ However, the devaluation increased the liquid assets of the banking institutions in three ways: by accentuating the flow of foreign currency transfers, by increasing the percentage of foreign currency converted into local currency, and by raising the rate of exchange at which the conversion was effected. Most of the conversion proceeds were deposited with banking institutions and constituted an addition to their liquid assets. The reduction of the Government's debt to the Bank of Israel and the net withdrawal of cash by the public offset part of this increment.

After contracting in January, the volume of liquid assets expanded rapidly during the months February to May—by IL 100 million. The growth of IL 107 million during these months in deposits requiring liquid cover was almost entirely due to the depositing with banking institutions of monies deriving from foreign currency conversion, since there was virtually no expansion of credit during this period. The additional liquid assets were almost wholly utilized to meet current liquidity requirements and cover the "recognized deficiency", thus being virtually sterilized. Controlled credit within the framework of exemptions from the liquidity regulations likewise was not expanded between February and May. The liquidity ratio during these four months rose from 32.3 per cent to 40.3 per cent.

The conversion of foreign currency at the Bank of Israel² proceeded much more slowly during the months June to November, and despite a slight increase in the amount of Bank of Israel credit granted to the public and to the Government, there was a decline of IL 5.5 million in the liquid assets of the banking institutions, since cash withdrawals by the public in the amount of IL 47 million exerted a strong contracting influence. Deposits requiring liquid cover rose during these months by IL 83 million, owing mainly to the expansion of credit to the public. This expansion was due both to a seasonal increase in the volume of controlled credit within the framework of exemptions from the liquidity regulations and to the creation of unauthorized liquidity deficiencies,³ and it involved an increase in the volume of deposits requiring liquid cover and

¹ Primarily Pazak and Tamam deposits of restitution recipients, which banking institutions are obliged to deposit with the Bank of Israel (see also Table XIV-18).

² Acquisition of foreign currency by the Bank of Israel (see Table XIV-18, column 3), less the increase in the banking institutions' foreign currency deposits with the Bank of Israel (column 7).

³ See section 4(c) above. At the end of November, the unauthorized deficiency liable to a 10 per cent fine totalled IL 22 million.

the withdrawal of cash by the public. Accordingly, the liquidity ratio fell from 40.3 per cent at the end of May to only 35.9 per cent at the end of November.

In December the liquidity position of the banking institutions improved considerably. On the one hand, there was an increase in foreign currency conversion and in Bank of Israel credit to the Government, and on the other,

Table XIV-17

THE LIQUIDITY OF BANKING INSTITUTIONS IN LOCAL CURRENCY,
1958-62^a

(IL million)

End of period	Liquid balances at the Bank of Israel	Cash held by banking institutions	Net balances in transit between banking institutions	Less: Liquid assets held against deposits requiring 90% or 100% liquid cover ^b	Total ordinary liquid assets (1) + (2) + (3) - (4)	Deposits requiring ordinary liquid cover	Liquidity ratio $\frac{(5)}{(6)} \times 100$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1958	175.8	12.6	8.6	19.2	177.8	453.7	38.8
1959	194.5	13.0	0.2	19.3	188.4	515.7	36.5
1960	254.9	16.3	0.5	24.7	247.0	647.9	38.0
1961	230.5	19.4	0.4	13.3	237.0	693.4	34.2
1962	361.4	21.8	1.1	26.5	357.8	909.2	39.4
1962 January	213.5	21.4	2.1	11.8	225.2	697.5	32.3
February	223.3	21.7	1.1	8.0	238.1	720.2	33.1
March	255.4	21.0	1.2	11.1	266.5	750.8	35.5
April	289.3	24.4	2.7	14.9	301.5	787.0	38.3
May	314.7	22.4	-0.2	12.5	324.3	805.0	40.3
June	310.5	22.0	-0.1	15.3	317.1	826.5	38.4
July	305.5	23.5	-0.4	12.4	316.3	843.0	37.5
August	315.9	23.0	2.7	20.8	320.8	860.1	37.3
September	295.8	24.8	2.5	20.8	302.3	860.0	35.2
October	317.6	25.2	1.7	23.7	320.8	876.5	36.6
November	318.7	22.9	1.5	24.3	318.8	887.7	35.9
December	361.4	21.8	1.1	26.5	357.8	909.2	39.4

^a The figures cited in this table differ slightly from those published by the Examiner of Banks for two reasons: first, the figures here do not include the Israel Bank of Agriculture, and secondly, the liquid balances shown here are based on the balance sheet of the Bank of Israel, whereas the Examiner's data are based on the balance sheets of the banking institutions. In contrast to previous Bank of Israel Annual Reports, the data here refer to ordinary liquid assets, deposits against which liquid cover in ordinary liquid assets is required, and actual liquidity ratios after deduction of deposits requiring 90 per cent or 100 per cent liquid cover and of the liquid assets held against such deposits. Figures for previous years have been revised accordingly.

^b Excluding demand deposits held for banking institutions. These deposits appear net in column 3.

the public reduced its cash holdings. The banking institutions restricted their credit, and sold foreign currency assets to the Bank of Israel in order to increase their liquidity toward the end of the year and to cover their unauthorized deficiencies.¹ The volume of liquid assets grew during this month by IL 39 million, and the liquidity ratio rose from 35.9 per cent to 39.4 per cent.

In 1962 banking institutions were obliged to hold liquid assets to the extent of 64 per cent of their deposits requiring ordinary liquid cover. If the entire amount exempted from the liquidity requirements within the framework of controlled credit had been allocated, the effective liquidity ratio would have fallen to 42 per cent. Since not all of the quota was exploited, the liquidity ratio should have slightly exceeded 42 per cent. However, at the end of the year the effective liquidity ratio was only 39.4 per cent, because there was still a "recognized deficiency" of IL 38 million as well as an unauthorized deficiency of IL 8 million.

6. DEVELOPMENT OF BANKING INSTITUTIONS

The rapid expansion of the banking institutions' activities was further accelerated in 1962. Their consolidated balance sheet grew by 56 per cent, this exceptionally large increase reflecting the revaluation of foreign currency assets upon the alteration of the exchange rate. After deducting the increments due to revaluation and linkage, the increase still totals 37 per cent, as compared with 28 per cent in 1961 and 24 per cent in 1960.

On the assets side, there was a marked increase in balances with the Bank of Israel, which also include Pazak and Tamam deposits revalued upon devaluation (see Table XIV-18). On the liabilities side, this increase is reflected by the item "Less liquid deposits of the public with banking institutions", which include the deposits of persons receiving restitution payments in foreign currency. Moreover, there was a considerable growth in credit to the public from the resources of the banking institutions and from Government deposits. This was partly due to the expansion of credit and partly to the revaluation of the outstanding balance of foreign currency credits and credits linked to the exchange rate or to the consumer price index. Demand deposits grew to a much greater extent than in previous years (see Table XIV-3).

Equity capital increased by 52 per cent in 1962, as compared with 36 per cent in 1961. This item includes both paid-up capital and reserve funds, and its growth is a good indicator of the local and foreign capital raised by many of the banking institutions. However, in contrast to 1961, there was a slight

¹ The unauthorized deficiency declined sharply from IL 22 million at the end of November to less than IL 8 million at the end of December.

Table XIV-18

ASSETS AND LIABILITIES OF THE BANKING INSTITUTIONS, 1961-62

(End of period)

	IL million		Percentages		Increase from 1961 to 1962	
	1961	1962 ^a	1961	1962 ^a	IL million ^a	% ^a
Assets						
Cash and balances at the Bank of Israel	496.8	932.7	27.4	33.9	435.9	87.7
Loans to the public	730.7	946.7	38.8	40.0	216.0	29.5
Loans to the Government	7.7	17.1	0.4	0.6	0.4	122.1
Loans to the public from Government deposits	230.7	343.2	12.7	12.5	112.5	48.8
Foreign currency assets	188.0	310.7	10.4	11.4	122.7	65.2
Securities	128.0	150.8	7.1	5.5	22.8	17.8
Real estate	32.3	41.1	1.8	1.5	8.8	27.2
Net balances with banking institutions	-2.9	5.1	-0.1	0.2	8.0	275.9
Total	1,811.3	2,747.4	100.0	100.0	936.1	51.7
Liabilities						
Demand deposits	642.1	846.3	34.5	30.8	222.2	35.6
Non-liquid deposits	650.1	1,004.6	35.9	36.6	354.5	34.5
Claims of other countries ^b	170.6	352.8	9.4	12.8	182.2	106.8
Government deposits	257.9	375.8	14.2	13.7	117.9	45.7
Equity capital	70.3	106.6	3.9	3.9	36.3	51.6
Other accounts (net)	38.3	61.3	2.1	2.2	23.0	60.1
Total	1,811.3	2,747.4	100.0	100.0	936.1	51.7
Contingent accounts						
Balance held by and for banking institutions	38.8	54.0			15.2	39.2
Clients' liabilities and guarantees	433.8	722.2			288.4	66.5
Other accounts	104.1	207.9			103.8	99.7
Total	576.7	984.1			407.4	70.6
Grand total	2,388.0	3,731.5			1,343.5	56.3

^a Including revaluation and linkage increments.^b Including deposits of foreign residents.

decrease in the percentage of equity capital (excluding hidden reserves) in total liabilities inclusive of contingent accounts.¹

There was also very rapid growth in the contingent accounts. This was due partly to the revaluation of the foreign currency accounts, particularly guarantees in connection with the financing of foreign trade, and in part to the increase in guarantees in connection with the trade in promissory notes.

The extension of the branch network slowed down appreciably in 1962. The number of new branches was 34, as against 98 in 1961 and 79 in 1960. Most of the new branches were already being built or contracts for their erection had already been signed when the law obligating banking institutions to receive a permit from the Governor of the Bank of Israel before opening new branches came into force on May 24, 1961. A subcommittee of the Advisory Council of the Bank of Israel, set up to discuss applications for such permits and advise the Governor in this matter, refrained from recommending the

Table XIV-19

BANKING INSTITUTIONS AND THEIR BRANCHES, 1955-62

(End of period)

	1955	1956	1957	1958	1959	1960	1961 ^a	1962
The 3 big banks								
Head offices	3	3	3	3	3	3	3	3
Branches	104	114	193	219	244	289	335	351
Total	107	117	196	222	247	292	338	354
Other banks								
Head offices	21	22	22	22	22	23	23	23
Branches	52	61	67	72	83	111	151	169
Total	73	83	89	94	105	134	174	192
Credit cooperatives								
Head offices	94	93	59	52	42	29	27	26
Branches	74	79	49	48	54	60	72	72
Total	168	172	108	100	96	89	99	98
All banking institutions								
Head offices	118	118	84	77	67	55	53	52
Branches	230	254	309	339	381	460	558	592
Total	348	372	393	416	448	515	611	644

^a Revised figures.

¹ After deduction of contingent accounts, equity capital is found to constitute approximately 3.9 per cent of total liabilities in both 1961 and 1962.

Table XIV-20

**CASH AND BALANCES WITH THE BANK OF ISRAEL,
CREDIT, AND DEPOSITS, BY TYPE OF BANKING
INSTITUTION, 1955-62**

(percentages)

(End of period)

	The 3 big banks	Other banks	Credit cooperatives	Total
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
1962	66	28	6	100
Loans to the public from 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
1962	64	28	8	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
1962	65	25	10	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
1962	71	23	6	100

opening of new branches, except for those already in various stages of establishment. A few exceptions were made for branches of banks in development areas and Arab villages.

Of the 34 new branches, 16 belong to the three big banks and 18 to other banks. Credit cooperative societies did not increase their branches. One society went out of existence in 1962, after merging with one of the banks. Thus the number of credit cooperatives fell to 26.

The trend towards greater concentration of banking activities in the hands of the "Big Three" ended in 1961, after a steady rise of several years' duration. In 1962 their weight actually declined somewhat. Their share of credit granted to the public fell from 67 to 64 per cent, and that of less liquid deposits—from 72 to 71 per cent. Their share of cash and balances at the Bank of Israel remained unchanged at 66 per cent, and only their share of local currency demand deposits rose—from 64 to 65 per cent.

On the other hand, there was an increase in the relative importance of other banks as regards most items of the consolidated balance sheet, the only exception being local currency demand deposits, where their proportion remained constant at 25 per cent. The rapid growth in the activities of some medium-sized and small banks apparently was mainly at the expense of credit cooperative societies.

The decline in the weight of credit cooperatives during 1962 continued a trend that started some years ago. This trend is partly connected with the decrease in the number of such cooperatives following mergers with banks. However, its main cause in 1962, as in some of the previous years, was the slower rate of expansion of existing cooperatives. The transfer of the business of one of the cooperatives to one of the banks in 1962 can explain only a small part of the decline in the relative volume of the cooperatives' activities during this year. In the main items of the consolidated balance sheet of the banking institutions, the share of credit cooperative societies today does not exceed 6 to 10 per cent, as compared with 20 per cent or more during the years 1955 and 1956.

7. INCOME AND EXPENDITURE OF BANKING INSTITUTIONS

The intensified activity of the banking institutions in 1962 was reflected by an increase in profits. Operating income grew by IL 55 million, or 36 per cent, after having risen by 29 per cent in 1961. There was an appreciable increase in income from interest on deposits held with the Bank of Israel, which expanded considerably during the year reviewed. The growth of these deposits was mainly connected with the revaluation of foreign currency deposits following the 67 per cent increase in the exchange rate, as well as with the big rise in local currency deposits held as liquid assets at the Bank

of Israel in accordance with the liquidity regulations. The main item of income—interest and commission on loans—rose by 18 per cent, following a rise of 22 per cent in 1961.

Operating expenses also increased appreciably, by IL 49 million or 35 per cent, after having risen by 29 per cent in 1961. The biggest increase was in interest paid on deposits, and was due primarily to the much larger value of foreign currency deposits of restitution recipients and of foreign residents as a result of the revaluation of outstanding balances on devaluation day and the addition of new deposits during the year. Expenditure on wages went up

Table XIV-21

INCOME AND EXPENDITURE OF BANKING INSTITUTIONS, 1961-62

	IL million		Per cent of total		Increase from 1961 to 1962	
	1961	1962	1961	1962	IL million	%
Operating income						
Interest and commission on loans and bills discounted	86.2	102.0	57.0	49.6	15.8	18.3
Service charges	31.9	41.0	21.1	19.9	9.1	28.5
Interest on deposits with the Bank of Israel and other banks	17.2	38.4	11.4	18.7	21.2	123.3
Other income	16.0	24.4	10.5	11.8	8.4	52.5
Total operating income	151.3	205.8	100.0	100.0	54.5	36.0
Operating expenditure						
Wages, salaries, and fringe benefits	57.0	70.7	40.7	37.4	13.7	24.0
Interest paid on deposits	53.3	80.6	38.0	42.6	27.3	51.2
Other expenditure	29.8	37.7	21.3	20.0	7.9	27.0
Total operating expenditure	140.1	189.0	100.0	100.0	48.9	34.9
Profits ^a						
Operating profit	11.2	16.8	77.8	68.6	5.6	50.0
Capital gains (net)	3.2	7.7	22.2	31.4	4.5	140.6
Total profits	14.4	24.5	100.0	100.0	10.1	70.1
Operating profit as a per cent of operating income	7.4	8.2				
Operating profit as a per cent of equity capital ^b	18.4	20.9				
Total profits as a per cent of equity capital ^b	23.7	30.5				

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

^b Excluding hidden reserves.

24 per cent, following an average rise of 11 per cent in the number of employees and an increase in wage rates. In 1961 wage payments were 25 per cent higher than in the preceding year.

As a result of these developments, operating profit advanced by IL 6 million, or 50 per cent, reaching IL 17 million, after having risen by 27 per cent in 1961. Total profits in 1962 reached IL 17 million. In addition to operating profit, the banking institutions had capital gains of IL 8 million, as compared with IL 3 million in 1961—an increase of 141 per cent. Total profits before deduction of income tax and company profits tax advanced by IL 10 million, or 70 per cent, during the year reviewed, reaching IL 24.5 million. The increase in 1961 was IL 3.5 million, or 32 per cent. Equity capital, excluding hidden reserves, expanded by an average of 32 per cent, and thus there was a higher return on equity capital during the year reviewed. The ratio of operating profit to total operating income likewise rose, from 7.4 per cent in 1961 to 8.2 per cent in 1962.