

## CHAPTER XV

# THE MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

### 1. MAJOR MONETARY DEVELOPMENTS

THE RAPID INCREASE in the money supply, which began with the devaluation of February 1962, continued in 1963. During the two years 1962 and 1963 there was an expansion of IL 640 million, or 66 per cent—a rate unprecedented since the accelerated growth during the first years of the State. Between the end of 1962 and the end of 1963, the money supply went up by IL 352.7 million, or 28.1 per cent, while the average level was 30.9 per cent higher in 1963 than in 1962. Between the end of 1961 and the end of 1962, the increase amounted to IL 287.5 million, or 29.7 per cent. During the five-year period 1957–61 the average annual rise was only 13.5 per cent.<sup>1</sup>

On the other hand, less liquid deposits rose to only a moderate extent in 1963—by IL 122 million, or 12 per cent, which was a much lower rate than in any of the last several years (see Tables XV-1 and XV-2). This comparatively slow expansion was largely due to the contraction of Tamam deposits and other foreign currency deposits against liabilities.<sup>2</sup> However, other types of near-money expanded very rapidly during 1963. This applies especially to the Government Short-Term Loan and to bills purchased through the intermediation of banking institutions.<sup>3</sup> The outstanding balance of the Short-Term Loan rose by IL 114 million during the year, reaching IL 214 million at the end of December. The balance of bills traded through banks increased by IL 170 million, to IL 430 million. The rapid expansion of liquid assets of these types is a relatively new development, which has been particularly striking during the last two years.<sup>4</sup> Such assets have a relatively high yield as compared with bank deposits, and have undoubtedly served as a substitute for fixed-term deposits, especially those in local currency, which have been contracting for the past three years.

<sup>1</sup> During these five years the average increase in the average annual balance of the money supply was 15.7 per cent.

<sup>2</sup> See section 3 below.

<sup>3</sup> Bonds of the Short-Term Loan issue are for periods of six to 18 months, while the bills are for shorter periods.

<sup>4</sup> The Short-Term Loan was first issued in July 1960, but most of the sales took place in 1962 and 1963; the bill market expanded rapidly after April 1961 (see the Bank of Israel Annual Report for 1962, pp. 332 ff.).

## INCREASE IN FINANCIAL ASSETS OF THE

(From end of year to end of year)

	IL million				
	1958	1959	1960	1961	1962 <sup>a</sup>
<b>Sources</b>					
Accumulation of foreign currency assets	65.7	90.6	153.3	134.4	355.9
Expansion of credit to the public	63.7	97.1	131.9	153.0	136.4
Expansion of credit to the Government	39.6	5.1	-4.1	-48.0	-60.9
Other factors, net	-3.6	-10.9	4.7	2.1	-15.8
<b>Total</b>	<b>165.4</b>	<b>181.9</b>	<b>285.8</b>	<b>241.5</b>	<b>415.6</b>
<b>Components</b>					
Money supply	83.7	66.0	154.3	88.9	287.5
Less-liquid deposits	81.7	115.9	131.5	152.6	128.1
<b>Total</b>	<b>165.4</b>	<b>181.9</b>	<b>285.8</b>	<b>241.5</b>	<b>415.6</b>

<sup>a</sup> Excluding devaluation and linkage differentials.<sup>b</sup> Including devaluation and linkage differentials.<sup>c</sup> After the advance repayment of IL 148.7 million in foreign debts.

## AVERAGE ANNUAL INCREASE IN FINANCIAL ASSETS

	IL million				
	1958	1959	1960	1961	1962 <sup>a</sup>
<b>Sources</b>					
Accumulation of foreign currency assets	5.6	93.3	117.0	146.5	286.2
Expansion of credit to the public	57.2	82.2	115.5	176.2	109.3
Expansion of credit to the Government	60.6	0.5	2.2	-29.4	-90.3
Other factors, net	0.3	7.9	-7.3	-2.1	-3.4
<b>Total</b>	<b>123.7</b>	<b>183.9</b>	<b>227.4</b>	<b>291.2</b>	<b>301.8</b>
<b>Components</b>					
Money supply	85.3	80.8	99.6	147.7	163.9
Less-liquid deposits	38.4	103.1	127.8	143.5	137.9
<b>Total</b>	<b>123.7</b>	<b>183.9</b>	<b>227.4</b>	<b>291.2</b>	<b>301.8</b>

<sup>a</sup> Excluding devaluation and linkage differentials.<sup>b</sup> Including devaluation and linkage differentials.<sup>c</sup> After the advance repayment of IL 148.7 million in foreign debts.

## V-1

## PUBLIC, BY SOURCE AND COMPONENT, 1958-63

		Per cent						
1962 <sup>b</sup>	1963	1958	1959	1960	1961	1962 <sup>a</sup>	1962 <sup>b</sup>	1963
733.1	222.4 <sup>c</sup>	78.0	60.4	63.7	34.1	67.4	138.8	17.6 <sup>c</sup>
231.7	198.6	18.7	24.0	26.3	24.1	17.3	29.4	19.5
-295.4	118.7 <sup>d</sup>	12.5	1.4	-1.1	-13.4	-19.7	-19.4	824.3 <sup>d</sup>
-27.2	-65.1	.	.	.	.	.	.	.
642.2	474.6	22.2	20.0	26.2	17.5	25.7	39.7	21.0
287.5	352.7	14.5	10.0	21.3	10.1	29.7	29.7	28.1
354.7	121.9	48.8	46.4	35.9	30.7	19.7	54.6	12.1
642.2	474.6	22.2	20.0	26.2	17.5	25.7	39.7	21.0

<sup>d</sup> Including IL 148.7 million in credit from the Bank of Israel for the advance repayment of foreign debts by the Government.

<sup>a</sup> 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.

## V-2

## THE PUBLIC, BY SOURCE AND COMPONENT, 1958-63

		Per cent						
1962 <sup>b</sup>	1963	1958	1959	1960	1961	1962 <sup>a</sup>	1962 <sup>b</sup>	1963
632.0	388.2 <sup>c</sup>	4.6	74.0	53.3	43.5	59.3	130.9	34.8 <sup>c</sup>
168.3	205.3	18.7	22.6	25.9	31.4	14.8	22.8	22.7
-299.4	-21.7 <sup>d</sup>	20.7	0.1	0.6	-8.3	-27.7	-91.8	-81.6 <sup>d</sup>
-14.8	-41.7	.	.	.	.	.	.	.
486.1	530.1	17.2	21.8	22.1	23.2	19.5	31.4	26.1
163.9	351.2	15.2	12.5	13.7	17.9	16.8	16.8	39.9
322.2	178.9	24.0	52.0	42.4	33.4	24.1	56.3	20.0
486.1	530.1	17.2	21.8	22.1	23.2	19.5	31.4	26.1

<sup>d</sup> Including IL 148.7 million in credit from the Bank of Israel for the advance repayment of foreign debts by the Government.

<sup>a</sup> 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.

As in 1962, the decisive factor in the monetary expansion was the accumulation of foreign exchange reserves. The bigger flow of investment capital and transfers from abroad, which had started after the devaluation of February 1962, was sustained in 1963. During the last quarter of 1962 and the first months of 1963, there was also a marked improvement in the current account in the balance of payments. Consequently, the net foreign currency assets of the banking system increased during these two years by \$ 202 million, despite the advance repayment of some \$ 50 million in foreign debts by the Government in 1963. The accumulation of foreign exchange reserves totalled \$ 128 million in 1962 and \$ 74 million in 1963. However, the monetary impact of the 1963 accumulation was greater than would appear from the data, since these include, as already mentioned, a decline of \$ 50 million due to the advance repayment of foreign debts, which was not accompanied by a contraction of the money supply. The big increase in foreign exchange reserves enabled the Government to repay foreign liabilities ahead of maturity, thus saving on interest payments in foreign currency.<sup>1</sup>

Ordinary Government transactions with the banking system during the year as a whole had a somewhat contractionary monetary effect;<sup>2</sup> although the Government's net debt to the banking system grew by IL 118.7 million, this figure includes additional credit of IL 148.7 million from the Bank of Israel for the advance repayment of foreign obligations.

The increase in bank credit to the public totalled IL 199 million; however, this includes credit from provident funds granted through the banks as well as some other types of credit, none of which has an expansionary monetary effect.

The large-scale accumulation of foreign exchange reserves in 1963 might have caused a still greater expansion of the money supply were it not for the tight restrictions imposed by the Bank of Israel. Most of the incremental reserves were converted into money, the bulk of which was deposited in banking institutions. As a result, their liquid assets swelled by IL 174 million between the end of 1962 and the end of 1963, an unprecedented amount for a 12-month period. Most of this increment was sterilized by raising the liquidity ratio, thus preventing an enormous expansion of bank credit to the public and a further growth of the money supply.

In January 1963 the formal liquidity ratio was raised by 3 points, from 64 to 67 per cent, and in July by another two points, from 67 to 69 per cent. Banking institutions were ordered to implement these increases gradually, at the rate of half a point per month, between January and October.

<sup>1</sup> Under a special arrangement the Bank of Israel granted the Government a credit of IL 150 million for the early repayment of debts maturing during the years 1964-67. Between April and December 1963, such repayments totalled IL 148.7 million.

<sup>2</sup> A comprehensive analysis of the Government's influence on aggregate domestic demand will be found in Chapters VII and XVI.

Moreover, the Bank of Israel did not permit the full utilization of the 22 per cent quota of controlled credit exempted from the liquidity requirements, the absolute size of which expanded steadily with the rapid growth of deposits subject to liquidity. This action was equivalent to an additional increase in the liquidity ratio. The banks were permitted to use the unexploited balance of the quota to purchase outstanding bills of exchange from the Bank of Israel;<sup>1</sup> the increase in the outstanding balance of bills purchased in this manner came to IL 20 million in 1963.<sup>2</sup> Furthermore, certain banking institutions still had to cover "recognized deficiencies" created when the liquidity ratio was raised in 1961 and which they did not succeed in covering in 1962.<sup>3</sup> As a result of these measures, the average liquidity ratio for banking institutions rose from 39.4 per cent at the end of 1962 to 46.6 per cent at the end of 1963. If we add to the liquid assets the aforementioned bill purchases, we find that the effective liquidity ratio rose even more—from 41.1 per cent at the end of 1962 to 49.8 per cent at the end of 1963.<sup>4</sup>

However, this appreciable increase in the liquidity ratio, together with the real decrease of IL 30 million in the Government's liabilities to the banking system (exclusive of credit granted for the advance repayment of foreign debts), was unable to prevent an excessive expansion of the money supply, the chief source of which was the large-scale foreign currency conversion. In 1963 the possibilities of monetary control through the main instrument available to the Bank of Israel were almost fully exploited. The marginal liquidity ratio was as high as 100 per cent, or nearly 100 per cent, during most of the year. The effectiveness of this instrument in curbing aggregate domestic demand diminishes the higher the liquidity ratio is set, since this encourages the development of other means of financing which are accompanied by a growth in the turnover velocity of the money supply. Any attempt to offset the inflationary effects of foreign currency conversion on a scale as large as that of the last two years entails further monetary and fiscal policy measures to absorb the excess demand and excess liquidity of the economy. It should be noted that so long as the marginal liquidity ratio does not exceed 100 per cent, raising the ratio can only eliminate the secondary effects of foreign currency conversion—i.e. the expansion of credit—but it cannot prevent the excessive growth of the money supply stemming from

<sup>1</sup> Bills of the general public rediscounted at the Bank of Israel by the banking institutions and Government bills.

<sup>2</sup> As regards the volume of bank credit, this was merely a bookkeeping operation which increased the amount of credit from banking institutions and decreased that from the Bank of Israel.

<sup>3</sup> See the Bank of Israel Report for 1962, Chapter XIV, p. 331. The "recognized deficiency" declined by IL 11 million in 1963.

<sup>4</sup> From the eve of devaluation (the end of January 1962) until the end of December 1963, the average effective liquidity ratio (including bill purchases) rose from 32.3 to 49.8 per cent.

the conversion itself. The large sources of liquidity were not subject to control by the Bank of Israel; moreover, the Bank could not sponge up and sterilize excess purchasing power through open-market operations. The raising of the liquidity ratio—severe as it was in 1963—was in itself insufficient to prevent the excessive injection of liquid means into the economy. Reduction of the pressure which confronted monetary and fiscal policy during the last two years would have required a much tighter control over the grant of permits for foreign credit (from overseas suppliers and other sources), as well as over capital imports for undesirable purposes, such as speculation in real estate or shares. Moreover, action by the Bank of Israel can only affect the growth of the money supply, and when the relative importance of the money supply decreases following the rapid accumulation of other liquid assets, the effectiveness of the instrument applied to the means of payment naturally diminishes too. Hence the growing need to provide the central bank with a wider range of instruments, and to increase the degree of coordination between all the public authorities whose operations have a marked monetary impact.

The consolidated balance sheet of the Israeli banking system shows that bank credit to the public rose by IL 198.6 million, or 19.5 per cent, but the real contribution of this factor to the expansion of the money supply was much more limited than these data indicate. For this sum includes IL 39 million granted from deposits of the public earmarked for loans (chiefly deposits of provident funds), which do not augment the money supply; it also includes IL 42 million in foreign currency credit granted from deposits of foreign residents and other foreign currency resources at the disposal of the banking institutions, which is not subject to the ordinary liquidity requirements. In part, such credit substitutes for that previously obtained from abroad and thus is not a cause of monetary expansion. Ordinary local currency loans granted by the banking institutions to the public actually increased by IL 105 million, most of it for financing exports. Against this amount must be set off the item "other factors, net" appearing in Table XV-1, which totalled IL 65 million and consisted chiefly of the banks' incremental equity capital,<sup>1</sup> net of investments in subsidiary companies, nongovernmental securities, and real estate. There was also an increase of IL 12 million in rediscounts by the Bank of Israel; the entire amount actually represented the Bank's participation in joint industrial export finance funds, which were considerably enlarged in 1963.<sup>2</sup>

In addition to the expansion of bank credit to the public, the year 1963 witnessed a big increase in the volume of credit granted through the intermediation of banking institutions. The outstanding balance of such credit rose from IL 260 million at the end of 1962 to IL 430 million at the end of 1963, i.e.

<sup>1</sup> The increase in the banks' equity capital (paid-up share capital plus reserve funds) totalled IL 81 million between the end of 1962 and the end of 1963.

<sup>2</sup> See section 4 (c) below.

by IL 170 million. To the extent that the channelling of funds to this market was at the expense of other uses, it had no inflationary effect. But that part of the incremental credit deriving from "dormant" money balances or from the liquidation of local or foreign currency time deposits augments domestic demand. The rise in the velocity of demand deposits in 1963 was apparently due in part to the expansion of the bill market. The big increase in the economy's liquidity and the repeated raising of the liquidity ratio during 1963 gave a strong fillip to this market, which was actively fostered by the banking institutions.<sup>1</sup>

The monetary expansion of 1963 did not proceed at a uniform pace. In fact, most of the increase in the money supply and less liquid deposits took place during the first six months of the year. The money supply grew during this period by IL 256 million, or an average of over 3 per cent per month, as compared with an increase of IL 97 million, or an average monthly rate of only 1 per cent, during the second half of the year. The volume of less liquid deposits grew by IL 69 million during the first half of 1963, and by IL 53 million in the second half. These developments were decisively affected by the seasonal fluctuations in the accumulation of foreign exchange reserves. Nearly all of the additional reserves were accumulated during the first five months of the year, in line with the seasonal pattern prevailing in most of the last several years. The net increment to foreign exchange reserves during these months totalled \$ 120 million, but to this should be added \$ 26 million used for the advance repayment of foreign debts which, as already mentioned, was not accompanied by monetary contraction. In other words, the accumulation of foreign exchange reserves which had an expansionary monetary effect totalled \$ 146 million. The considerable decline in the Government's net liabilities to the banking system during the first four months of 1963 could only partly offset the monetary growth caused by the accumulation of reserves on such a scale. During the last seven months of the year the reserves decreased, but the contractionary monetary effect of this development was nullified by the expansion of bank credit to the public and to the Government; the money supply therefore continued to rise, although at a much slower rate than during the first half of the year.

The detrimental consequences of the enormous rise in the liquidity of the economy, as regards both commodity and service prices and the balance of payments, were not fully reflected by developments in 1963. Despite the swelling of the money supply, prices of final products from current output went up to only a moderate degree, while the balance on current account actually showed an improvement. The stronger pressures on the demand side were felt chiefly

<sup>1</sup> A more detailed discussion of the bill brokerage trade and its inflationary effect will be found in the Bank of Israel Annual Report for 1962, Chapter XIV, section 4(c).

in the securities and real estate markets, where prices mounted very rapidly. Prices of many services also moved upward to some extent.

It would thus appear that the demand generated by the additional purchasing power injected into the economy was in the main channelled to a relatively narrow sector. This undoubtedly facilitated the Government's efforts to prevent price increases by exerting pressure on producers. The intensified trade in shares, commercial paper, other financial assets, and real estate, which was partly of a speculative nature, tied down a considerable portion of the incremental means of payment,<sup>1</sup> thus preventing the generation of further demand pressure for local and imported commodities. Moreover, part of the capital imports and foreign currency conversion was directly due to the lively trade in these markets, being specifically intended from the outset for operations therein.<sup>2</sup> Such a situation, however, cannot last very long, and the mopping up of excess liquidity is thus a precondition for averting disastrous developments in respect of price stability and the balance of payments. And indeed, during the second half of 1963 and the first months of 1964 the trade balance began to worsen, owing first and foremost to a big increase in imports, and also to a slower expansion of exports.

These developments in the equity, financial assets, and real estate markets were reflected by a rise in the velocity of demand deposits in banks—i.e. an increase in the ratio between debits to these accounts and their aggregate balance. The velocity of demand deposits was on the average 5.59 per cent higher in 1963 than in 1962. On the other hand, there was a big rise in the ratio between the money supply and national income or total resources available to the economy<sup>3</sup> (i.e. the gross national product plus the import surplus), since the larger growth of the money supply was not fully reflected by the rise in GNP prices and the import surplus. The ratio between the public's liquid assets and transactions in final commodities and services from current local production and import therefore increased. However, it is impossible to ascertain what happened to the ratio between the money supply and total transactions in the economy, including those in financial assets, real estate, and other assets not derived from current production. The rise in the ratio between the money supply

<sup>1</sup> This development was particularly prominent in the equity market. The volume of share transactions on the Stock Exchange reached IL 242 million in 1963 as against only IL 68 million in 1962. These figures do not include the matching of buying and selling orders received by banks and stockbrokers. New share issues totalled IL 175 million as compared with IL 34 million in 1962, and the new regulations introduced in April 1963, which stipulate that anyone desiring to subscribe to a new share issue must deposit in advance half the amount of his order, tied up a much larger sum of money than in the past. See Chapter XX, "The Securities Market".

<sup>2</sup> There was an especially striking increase in the volume of private transfers other than personal restitution from West Germany, part of which was due to the raising of capital abroad by Israeli financial institutions for the purpose of buying up land and various financial assets.

<sup>3</sup> See Table XV-6.

and national income was apparently influenced also by expectations of stability, which were bolstered by the nonincrease of commodity prices over a period of several months.

## 2. THE MONEY SUPPLY

Between the end of December 1962 and the end of December 1963, the money supply expanded by IL 352.7 million, or 28.1 per cent, as compared with a rise of 29.7 per cent the year before. The average annual level of the money supply was 30.9 per cent higher in 1963 than in 1962. These growth rates are the fastest since 1951. Demand deposits expanded by IL 237 million, or 28 per cent, between the end of 1962 and the end of 1963, while the amount of cash in circulation increased by IL 115.7 million, or 28.3 per cent. Accordingly, there was practically no change in the relative proportion of cash within the money supply, which stood at 32.6 per cent.

The expansion of the money supply did not proceed at a uniform rate. As in 1962, it was most rapid during the three months February to April, when it averaged 3.9 per cent, as compared with a monthly average of 2 per cent for the year as a whole. This rapid increase was due to the seasonal concentration of foreign currency accumulation and conversion during the early months of the year. In the second half of 1963, foreign exchange reserves contracted and the growth of the money supply slowed down considerably, accounting for only 28 per cent of the total increment for the year. During the first six months of 1963, the average monthly increase in the money supply was 3.1 per cent, as against 1.0 per cent during the last six months. In the last quarter it dropped to only 0.6 per cent.

The downtrend in the percentage of cash in the money supply which prevailed for the past several years came to a halt in 1963. At the end of December 1963 the proportion of cash was 32.6 per cent, the same as at the end of December 1962. A comparison of annual averages shows a slight decline, from 33.7 per cent in 1962 to 33.3 per cent in 1963, but this reflects the downward movement in 1962. The big increase in cash holdings of the public thus prevented a more rapid growth of the banking institutions' liquid assets during the year reviewed (see Table XV-15).

The cessation of the decline in the proportion of cash in 1963 was largely due to developments in February and March, when cash withdrawals from banks increased as a result of the official discussions concerning the abolition of bank secrecy for purposes of income tax inspection. During these two months the public increased its cash holdings by IL 58.2 million, which represented more than half the total increase for the year. The halting of the decline in the relative share of cash in 1963 was apparently of a temporary nature, and presumably the long-run downward trend will reassert itself in the future.

Table XV-3

## ANNUAL INCREASE IN THE MONEY SUPPLY, 1958-63

(IL million)

Year	Balance at end of year	Change in end-year balance		Average annual balance	Change in average annual balance	
		IL m.	%		IL m.	%
<b>Cash</b>						
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
1963	525.0	115.7	28.3	496.0	113.2	29.6
<b>Demand deposits</b>						
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
1963	1,084.3	237.0	28.0	992.9	238.0	31.5
<b>Money supply</b>						
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
1963	1,609.3	352.7	28.1	1,488.9	351.2	30.9

Table XV-4

## THE MONEY SUPPLY, BY MONTHS, 1963

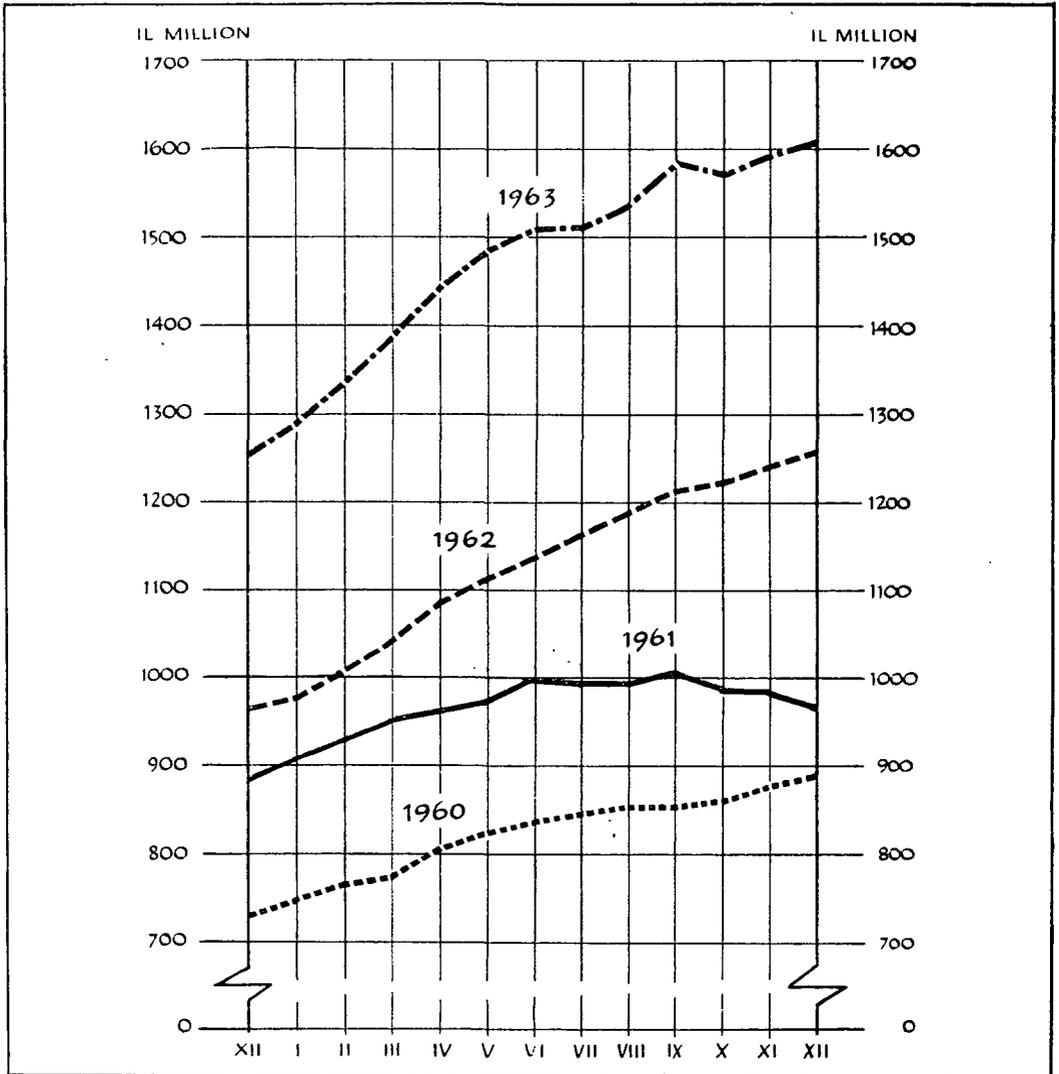
(IL million)

(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 m.	%		IL m.	%		IL m.	%
December 1962	409.3	-6.0	-1.4	847.3	21.5	2.6	1,256.6	15.5	1.2
1963 January	417.9	8.6	2.1	872.5	25.2	3.0	1,290.4	33.8	2.7
February	448.6	30.7	7.3	890.7	18.2	2.1	1,339.3	48.9	3.8
March	476.1	27.5	6.1	913.2	22.5	2.5	1,389.3	50.0	3.7
April	483.6	7.5	1.6	963.2	50.0	5.5	1,446.8	57.5	4.1
May	493.5	9.9	2.0	991.0	27.8	2.9	1,484.5	37.7	2.6
June	501.1	7.6	1.5	1,011.1	20.1	2.0	1,512.2	27.7	1.9
July	508.1	7.0	1.4	1,006.5	-4.6	-0.5	1,514.6	2.4	0.2
August	510.3	2.2	0.4	1,029.1	22.6	2.2	1,539.4	24.8	1.6
September	523.9	13.6	2.7	1,057.4	28.3	2.7	1,581.3	41.3	2.7
October	528.7	4.8	0.9	1,045.4	-12.0	-1.1	1,574.1	-7.2	-0.5
November	535.3	6.6	1.2	1,049.8	4.4	0.4	1,585.1	11.0	0.7
December	525.0	-10.3	-1.9	1,084.3	34.5	3.3	1,609.3	24.2	1.5

Diagram XV-1

THE MONEY SUPPLY, BY MONTHS, 1960-63



The rapid expansion of the money supply in 1963 was accompanied by a decline of 6.2 per cent in its circulation velocity relative to national income, and of 12.4 per cent relative to total resources at the disposal of the economy. From the aspect of its influence on total demand for final commodities and services, this development apparently reflects a weakening of the pressures generated by monetary expansion. The decrease in velocity was presumably due to growing expectations of stability and the increasing tendency of part of the public to

hold other financial assets such as securities. In 1962 the picture was just the opposite: expectations of rapid price increases after the devaluation caused a flight from cash to commodities, and the circulation velocity of the money supply went up.

Table XV-5

CASH AS A PERCENTAGE OF TOTAL MONEY  
SUPPLY, 1958-63

Annual average	
1958	38.7
1959	36.8
1960	35.0
1961	35.0
1962	33.7
1963	33.3
End of month	
1963 January	32.3
February	33.5
March	34.3
April	33.4
May	33.2
June	33.1
July	33.5
August	33.1
September	33.1
October	33.6
November	33.8
December	32.6

In contrast to the decline in the income velocity, the velocity of demand deposits rose during 1963 by 5.59 per cent, reaching its highest level since 1955. The increased drawing on deposits was undoubtedly connected with the brisk trade in the share and real estate markets, and reflects the much larger volume of transactions in financial and other existing assets. Transactions in such assets apparently require the holding of relatively smaller sums of money than transactions in currently produced final commodities.

The weight of checking accounts went up in 1963, continuing a trend begun in 1962. The proportion of such accounts to total demand deposits advanced from 62.4 per cent at the end of 1962 to 64.6 per cent at the end of 1963. The velocity of these deposits considerably exceeds that of deposits not drawable by check, so that the rise in their weight is reflected by a rise in the velocity of total demand deposits. The rapid spread of the bill brokerage trade, which was apparently fed in part from funds withdrawn from nonchecking accounts,

was undoubtedly one of the factors in the changed composition of demand deposits. The decrease in the proportion of nonchecking accounts constitutes a reversal of the trend which prevailed before 1962, when the velocity of demand deposits tended to decline.

**Table XV-6**  
**INDICATORS OF THE CIRCULATION VELOCITY OF**  
**THE MONEY SUPPLY, 1955-63**

Year	Average annual circulation velocity of money supply in relation to:		Average annual velocity of demand deposits <sup>c</sup>
	National income <sup>a</sup>	Total available resources <sup>b</sup>	
1955	4.35	6.76	19.6
1956	4.36	7.00	18.8
1957	4.30	6.57	18.8
1958	4.25	6.50 <sup>d</sup>	17.8
1959	4.30 <sup>d</sup>	6.47 <sup>d</sup>	17.7
1960	4.25 <sup>d</sup>	6.32 <sup>d</sup>	16.4
1961	4.28 <sup>d</sup>	6.51 <sup>d</sup>	16.2
1962	4.38 <sup>d</sup>	7.05 <sup>d</sup>	17.9
1963	4.11	6.18	18.9

<sup>a</sup> Nominal national income divided by the average annual money supply.

<sup>b</sup> Gross national product at current prices plus import surplus, divided by the average annual money supply.

<sup>c</sup> Total debits to local currency demand deposit accounts in banks divided by the average annual volume of these deposits. Deposits of credit cooperative societies are not included.

<sup>d</sup> Revised figures.

### 3. OTHER FINANCIAL ASSETS HELD BY THE PUBLIC<sup>1</sup>

The less liquid bank deposits of the public expanded relatively slowly in 1963. Between the end of 1962 and the end of 1963, they grew by IL 122 million, or 12 per cent—a far lower rate than in previous years (see Table XV-1). In 1962 the increase came to IL 128 million, or 19.7 per cent.<sup>2</sup> The slower growth rate in 1963 was due to a decrease of IL 31 million in foreign currency deposits. Local currency deposits, including time deposits linked to the

<sup>1</sup> All bank deposits of the public other than demand deposits and deposits of foreign residents (Patach). The latter are here defined as liabilities to the rest of the world, and as such are deducted from total foreign currency assets at the banking system's disposal when computing the net balance of such assets (see Table XV-10).

<sup>2</sup> Excluding differentials from the revaluation of outstanding foreign currency items after the devaluation of February 1962, as well as linkage differentials. In 1963 linkage differentials were not excluded as they were of a negligible amount.

Table XV-7

## LESS LIQUID DEPOSITS OF THE PUBLIC IN BANKING INSTITUTIONS, 1958-63

(End of period)

Period	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 local currency	Deposits in foreign currency <sup>a</sup>	Grand total
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	254.7 <sup>b</sup>	16.7	250.1 <sup>c</sup>	693.4	311.3 <sup>d</sup>	1,004.7
1963	124.3	54.2	287.5	30.7	349.4	846.1	280.5	1,126.6
1963 January	110.4	64.6	253.4	18.3	253.2	699.9	323.7	1,023.6
February	108.6	63.0	259.6	20.3	259.1	710.6	324.4	1,035.0
March	109.5	61.3	265.8	21.9	265.8	724.3	320.1	1,044.4
April	110.2	61.6	266.5	22.3	273.2	733.8	332.8	1,066.6
May	111.6	59.7	268.3	23.6	282.8	746.0	324.2	1,070.2
June	112.4	58.3	269.5	29.2	290.5	759.9	313.8	1,073.7
July	113.0	56.9	272.1	28.4	297.1	767.5	307.8	1,075.3
August	113.6	55.7	275.9	27.8	303.8	776.8	296.5	1,073.3
September	114.8	55.1	280.4	31.4	312.9	794.6	302.4	1,097.0
October	116.6	55.1	281.9	30.8	323.4	807.8	286.6	1,094.4
November	119.2	53.8	282.5	28.9	339.6	824.0	282.0	1,106.0
December	124.3	54.2	287.5	30.7	349.4	846.1	280.5	1,126.6

<sup>a</sup> Excluding deposits of foreign residents (Patach).<sup>b</sup> An increase of IL 26.8 million was due to linkage differentials computed in December 1962. Linkage differentials accruing in 1963 totalled IL 1.5 million only.<sup>c</sup> An increase of IL 65.8 million was due to the revaluation of these deposits on devaluation day (February 9, 1962).<sup>d</sup> An increase of IL 132.7 million was due to the revaluation of these deposits on devaluation day.

exchange rate (Pazak), showed a bigger growth than in 1962, reaching IL 153 million. The relatively slow expansion of total less-liquid deposits<sup>1</sup> over the last two years can partly be attributed, as already mentioned, to the rapid spread of the bill brokerage trade and increased sales of the Government Short-Term Loan issue, which no doubt are competing with certain types of time deposits.<sup>2</sup>

The biggest increase occurred in Pazak accounts, which expanded by IL 99.3 million. On the other hand, the balance of Tamam accounts contracted by IL 13.5 million, probably because the rate of interest on these deposits was reduced in February 1963. The aggregate balance of Pazak and Tamam accounts, most of which belong to recipients of German restitution, went up by \$ 29 million, as compared with \$ 46 million in 1962, despite the fact that the amount of restitution received was about the same in both years. The lowering of the interest rate on Tamam accounts and the boom in the share and real estate markets were no doubt among the chief factors stimulating the conversion of current restitution transfers and existing deposits into local currency.

Other deposits showing an increase during the year reviewed were those earmarked for loans (up IL 33 million), those in approved saving schemes (IL 20 million), and deposits against liabilities in Israeli currency (IL 14 million). On the other hand, local currency time deposits continued downward for the third consecutive year, the decrease in 1963 totalling IL 13 million. There was also a decline of IL 26 million in foreign currency deposits against liabilities.

1. *Pazak deposits:* The relatively big increase of IL 99.3 million, or \$ 33.1 million, in Pazak balances in 1963, as compared with \$ 30 million the year before, was apparently connected with the transfer of funds from Tamam to Pazak accounts after the reduction of the interest rate on the former. The advantages of holding Tamam as against Pazak deposits gradually disappeared during the last two years, and when differential interest rates were introduced in February 1963, a switch from Tamam to Pazak followed. The maximum interest payable on Pazak deposits held for 12 months remained 7 per cent per annum, while the interest on Tamam deposits was reduced from 7 to 4.5 per cent. Interest on restitution monies deposited in Tamam and Pazak accounts is tax-free. By the end of 1963 the outstanding balance of Pazak accounts reached IL 349.4 million (\$ 116.5 million).

2. *Tamam deposits:* After having expanded steadily since their inception in 1956, Tamam deposits fell by IL 13.5 million in 1963. This occurred despite the raising of the share of restitution funds which recipients are allowed to deposit in such accounts from 25 to 33 per cent, and is presumably explained by the reduction of the interest rate from 7 to 4.5 per cent. Already in 1962

<sup>1</sup> Excluding the revaluation of foreign currency deposits in February 1962.

<sup>2</sup> See section 1 above.

Tamam deposits started to grow more slowly than Pazak deposits, owing on the one hand to the reduction of the number of uses to which foreign currency held in Tamam accounts could be put, and on the other hand to the enlargement of foreign currency allocations for foreign travel, which decreased the advantages of holding Tamam as opposed to Pazak deposits. When the interest rate was cut in February 1963, the growth of Tamam deposits virtually came to an end, and in June 1963 a downtrend set in which continued until the end of the year. Some Tamam funds, as already mentioned, were transferred to Pazak accounts, while others were apparently invested in foreign securities,<sup>1</sup> especially in debentures of the Jewish Agency subsidiary Hollis, the yield on which is higher than that on Tamam holdings, reaching 6 per cent per annum net. At the end of December 1963, the outstanding balance of Tamam accounts was IL 213.1 million (\$ 71 million). The outstanding balance of Tamam and Pazak deposits together was IL 562.5 million, or about \$ 188 million.

3. *Deposits earmarked for loans:* The increase in this item totalled IL 32.8 million, of which IL 31.3 million represented new deposits and IL 1.5 million linkage differentials. In 1962 these deposits expanded by IL 43.8 million (exclusive of linkage differentials). In the main these are deposits of various financial institutions and provident funds earmarked for loans to specific clients or other purposes specified in advance. To the extent that they are utilized for approved purposes, they are not subject to the ordinary liquidity requirements.<sup>2</sup> Credits granted from them are usually medium-term and linked. The deposits themselves are for the most part linked and fixed for a period of several years. Their outstanding balance at the end of 1963 was IL 287.5 million, most of it monies of provident funds deposited with banking institutions—either directly or through the financial institutions affiliated with Hevrat Ovdim, the Histadrut holding company. The latter institutions issue debentures, which are taken up by the provident funds; the proceeds are deposited with banking institutions and earmarked for loans.

Approved provident funds, which are exempt from income tax, have to put 80 per cent of their resources into “authorized investments”. Under an agreement between the Treasury and the funds, half of this type of investment is earmarked for financing the development budget, while the remaining half may be granted as credit to various enterprises, with the approval of the Government, through financial and banking institutions.<sup>3</sup>

4. *Deposits in approved saving schemes:* The upward trend in these deposits ceased in the middle of 1961, and a period of stagnation ensued until the middle

<sup>1</sup> This is one of the three purposes for which foreign currency held in Tamam accounts may be used. The other two are foreign travel and legal expenses abroad in connection with personal restitution claims.

<sup>2</sup> Banking institutions must maintain a 90 per cent liquidity ratio against that part of the deposits not yet utilized for approved purposes.

<sup>3</sup> See Chapter XVIII, “Provident Funds and Insurance Companies”.

Table XV-8

**FOREIGN CURRENCY DEPOSITS OF THE PUBLIC IN BANKING INSTITUTIONS,  
1958-63\***

(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 <sup>b</sup>	226.6	34.3	15.4	35.0	311.3
1963	213.1	8.5	21.8	37.1	280.5
1963 January	229.1	31.4	16.9	46.3	323.7
February	233.0	31.4	19.4	40.6	324.4
March	233.6	29.7	18.0	38.8	320.1
April	234.6	23.7	22.2	52.3	332.8
May	235.6	19.2	22.3	47.1	324.2
June	231.7	15.6	19.5	47.0	313.8
July	226.8	14.0	21.7	45.3	307.8
August	222.4	11.4	21.9	40.8	296.5
September	219.8	12.4	23.6	46.6	302.4
October	220.0	10.3	21.0	35.3	286.6
November	215.8	8.7	19.9	37.6	282.0
December	213.1	8.5	21.8	37.1	280.5

<sup>a</sup> Excluding deposits of foreign residents (Patach), which are defined as liabilities to foreign countries; and as such are deducted from the total when the net foreign currency assets of the banking system are computed.

<sup>b</sup> The revaluation increment due to the 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, and other foreign currency deposits—IL 21.0 million.

of 1962, when saving schemes linked to the consumer price index were introduced and the interest rates on nonlinked deposits were raised. The deposits then resumed their growth, which was sustained throughout 1963.<sup>1</sup> Between the end of 1962 and the end of 1963, the outstanding balance showed a rise of IL 20 million, as compared with IL 18.9 million in 1962. Most of the expansion

<sup>1</sup> Details of the terms of the various saving schemes were presented in the Bank of Israel Annual Report for 1962, p. 319.

occurred in linked, secondary education, and children's saving schemes. Non-linked saving schemes, which still account for most of the total, showed virtually no movement. The aggregate balance of approved saving schemes reached IL 124.3 million at the end of 1963.<sup>1</sup>

5. *Time deposits*: The balance of local currency time deposits declined for the third straight year. In mid-1961 the figure stood at some IL 106 million, but by the end of 1963 it had dipped to only IL 54 million—a decrease of IL 52 million within two and a half years. The contraction slowed down in 1963, when it amounted to IL 13.4 million as compared with IL 18.3 million the year before. Most of these deposits are not linked and carry relatively low interest rates. The rapid expansion of the bill market in recent years was partly fed by monies withdrawn from time deposits. The transfer of such funds to the bill market, where the yield is higher than that on time deposits, was encouraged by the banks.

6. *Deposits against liabilities in Israeli currency*: The increase in this item, which in recent years has been relatively small, totalled IL 14 million in 1963. The upward trend actually began in 1962, and by the end of 1963 the outstanding balance reached IL 30.7 million, most of it representing importers' deposits. Under existing regulations importers have to deposit local currency for up to 50 per cent of the value of their import orders when opening letters of credit, if the terms of financing provide for cash payment on presentation of the documents.

7. *Deposits against liabilities in foreign currency*: Most of these deposits provide cover for documentary credits opened in connection with import transactions. Prior to devaluation, banks and importers were interested in obtaining foreign currency before carrying out an import transaction, in order to hedge themselves against the anticipated alteration of the exchange rate. Now that expectations of devaluation have disappeared, a new situation has developed. Import financing procedures have recently undergone a change, the present practice being to pay cash against documents, or—in cases where letters of credit are opened—to pay cash upon presentation of the documents. This method does away with the need to purchase foreign currency when letters of credit are opened. Between the end of February 1962 and the end of December 1963, deposits against liabilities in foreign currency contracted from IL 74.3 million to only IL 8.5 million. Thus, within less than two years some IL 66.0 million of frozen funds were released—a development which had an expansionary monetary effect. The decline in such deposits in 1963 totalled IL 25.8 million.

<sup>1</sup> The balance breaks down as follows: ordinary nonlinked schemes—IL 71.8 million; children's saving schemes—IL 26.4 million; linked schemes—IL 18.1 million; saving for secondary education—IL 7.4 million; and saving for private vehicles—IL 0.6 million.

## CONSOLIDATED BALANCE SHEET OF THE

(II)

(End of period)

Assets and liabilities	1958	1959	1960	1961	1962 <sup>a</sup>	1963	Jan.
<b>Credit to the public<sup>b</sup></b>							
From the Bank of Israel	27.6	31.7	52.0	56.4	71.9	85.7	63.4
From banking institutions	377.5	470.5	582.1	730.7	946.9	1,131.8	949.5
<b>Total</b>	<b>405.1</b>	<b>502.2</b>	<b>634.1</b>	<b>787.1</b>	<b>1,018.8</b>	<b>1,217.4</b>	<b>1,012.9</b>
<b>Investment of banking institutions</b>							
In nongovernmental securities	21.4	31.2	44.2	49.6	29.3	76.9	63.7
In subsidiary companies	5.8	6.4	9.2	24.7	60.8	39.1	29.3
<b>Total</b>	<b>17.2</b>	<b>37.6</b>	<b>53.4</b>	<b>74.3</b>	<b>90.1</b>	<b>116.0</b>	<b>93.0</b>
<b>Credit to the Government</b>							
From the Bank of Israel	289.1	317.7	316.8	275.6	-31.1	43.5	-92.5
From banking institutions <sup>c</sup>	67.7	44.2	41.0	34.2	45.5	89.6	54.5
<b>Total</b>	<b>356.8</b>	<b>361.9</b>	<b>357.8</b>	<b>309.8</b>	<b>14.4</b>	<b>133.1</b>	<b>-37.9</b>
<b>Net foreign exchange reserves<sup>d</sup></b>							
With the Bank of Israel	162.0	199.4	342.1	477.4	1,247.2	1,543.5	1,349.0
With banking institutions	-12.1	41.1	51.7	50.8	14.1	-59.8	26.0
<b>Total</b>	<b>149.9</b>	<b>240.5</b>	<b>393.8</b>	<b>528.2</b>	<b>1,261.3</b>	<b>1,483.7</b>	<b>1,375.0</b>
<b>Balances in transit</b>	7.8	0.8	4.2	2.2	9.7	13.8	10.0
<b>Less: Nonliquid deposits</b>							
In local currency	206.3	270.6	358.3	460.8	693.4	846.1	699.0
In foreign currency	43.7	95.3	139.1	189.2	311.3	280.5	323.0
<b>Total</b>	<b>250.0</b>	<b>365.9</b>	<b>497.4</b>	<b>650.0</b>	<b>1,004.7</b>	<b>1,126.6</b>	<b>1,023.0</b>
<b>Equity capital and other accounts (net)</b>	26.9	51.2	65.7	82.5	133.0	228.1	141.0
<b>Money supply<sup>e</sup></b>	<b>659.9</b>	<b>725.9</b>	<b>880.2</b>	<b>969.1</b>	<b>1,256.6</b>	<b>1,609.3</b>	<b>1,290.0</b>

<sup>a</sup> Including devaluation and linkage differentials.<sup>b</sup> Excluding foreign loans.<sup>c</sup> Including Government securities.

## BANKING SYSTEM, 1958-63

(million)

1963										
Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
61.0	53.3	42.3	51.7	43.9	55.1	49.6	53.2	55.4	55.1	85.7
971.4	1,020.0	1,022.0	1,010.5	1,046.3	1,057.2	1,082.3	1,112.5	1,117.7	1,141.7	1,131.8
032.4	1,073.4	1,064.3	1,062.2	1,090.2	1,112.3	1,131.9	1,165.7	1,173.1	1,196.8	1,217.4
64.1	66.9	67.1	66.0	64.3	68.9	69.5	82.5	70.2	73.3	76.9
30.4	31.1	32.0	32.2	36.1	36.5	36.8	39.0	39.4	40.7	39.1
94.5	98.0	99.1	98.2	100.4	105.4	106.3	121.5	109.6	114.0	116.0
136.5	-180.5	-193.0	-155.9	-127.6	-90.7	-47.1	16.5	73.7	80.9	43.5
62.2	52.9	55.7	78.6	90.7	89.1	76.5	61.7	74.1	82.2	89.6
-74.3	-127.7	-137.4	-77.3	-36.9	-1.6	29.4	78.2	147.8	163.1	133.1
442.6	1,557.5	1,625.7	1,627.9	1,603.8	1,567.7	1,550.3	1,530.9	1,478.2	1,487.0	1,543.5
12.5	-12.6	3.5	-5.3	-15.0	-24.3	-35.6	-41.2	-66.8	-68.6	-59.8
455.1	1,544.9	1,629.3	1,622.6	1,588.8	1,543.4	1,514.7	1,489.7	1,411.4	1,418.4	1,483.7
14.0	4.9	15.6	10.1	11.2	1.6	14.0	15.9	15.9	9.1	13.8
710.6	724.3	733.8	746.0	759.9	765.5	776.8	794.6	807.8	824.0	846.1
324.4	320.1	332.8	324.2	313.8	307.8	296.5	302.4	286.6	282.0	280.5
035.0	1,044.4	1,066.6	1,070.2	1,073.7	1,075.3	1,073.3	1,097.0	1,094.4	1,106.0	1,126.6
147.4	159.8	157.5	161.1	167.9	171.3	183.6	192.7	189.3	210.3	228.1
339.3	1,389.3	1,446.8	1,484.5	1,512.2	1,514.6	1,539.4	1,581.3	1,574.1	1,585.1	1,609.3

<sup>d</sup> Including foreign loans.<sup>e</sup> Including demand deposits with the Israel Bank of Agriculture, which are included in the money supply statistics.

Table XV-10

**FOREIGN CURRENCY ASSETS AND LIABILITIES OF  
THE BANKING SYSTEM, 1958-63**

(IL million)

(End of period)

Period	Total assets	Less		Net foreign currency assets (1)-(2)-(3)
		Deposits of foreign residents	Other foreign liabilities <sup>a</sup>	
	(1)	(2)	(3)	(4)
1958	249.6	30.9	68.8	149.9
1959	317.2	36.8	39.9	240.5
1960	514.8	65.0	56.0	393.8
1961	706.5	144.5	33.8	528.2
1962	1,622.7	297.4	64.0	1,261.3 <sup>b</sup>
1963	1,950.7	332.0	135.0	1,483.7
1963 January	1,737.7	296.8	64.7	1,376.2
February	1,822.8	305.9	61.8	1,455.1
March	1,918.8	303.9	70.0	1,544.9
April	2,003.8	297.4	77.2	1,629.2
May	2,004.7	294.4	87.7	1,622.6
June	1,995.1	306.9	99.4	1,588.8
July	1,957.1	309.5	104.2	1,543.4
August	1,913.7	301.5	97.5	1,514.7
September	1,898.8	302.1	107.0	1,489.7
October	1,852.8	303.9	137.5	1,411.4
November	1,870.5	303.8	148.3	1,418.4
December	1,950.7	332.0	135.0	1,483.7

<sup>a</sup> Mainly loans received from foreign banks and balances held for foreign banks.

<sup>b</sup> An increase of IL 377.3 million was due to the revaluation of foreign currency assets following the change in the rate of exchange in February 1962.

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

The increase in the money supply and the less liquid assets of the public in banking institutions reached IL 475 million, or 21 per cent, in 1963. The main source of this growth, as already noted, was the larger volume of foreign currency assets at the disposal of the banking system. Bank credit to the public was also expanded. On the other hand, there was a slight decline in the Government's debt to the banking system (net of credit for the repayment of foreign liabilities ahead of maturity).

However, striking changes occurred in the impact of the various growth factors during the course of the year. In the first four months, when monetary

expansion reached a peak, the accelerated accumulation of foreign currency assets was practically the only factor. As from May, foreign currency assets began to shrink, and this trend—which continued until October—had a contractionary monetary effect. On the other hand, the Government's debt to the banking system declined appreciably during the first four months of the year, but went up steadily between May and November. Bank credit to the public showed less severe fluctuations, expanding throughout most of 1963, though at a faster rate during the second half.

(a) *Accumulation of foreign exchange reserves*

The continued large-scale import of capital during 1963 and the marked improvement in the balance on current account at the end of 1962 and the early months of 1963 resulted in a considerable accumulation of foreign exchange reserves—particularly during the first four months of 1963—and made possible the advance repayment of foreign debts.

The net increase in foreign currency assets at the disposal of the banking system between the end of 1962 and the end of 1963 totalled IL 222.4 million (\$ 74.1 million), while advance foreign debt repayments totalled IL 148.7 million (\$ 49.6 million). All the additional assets were concentrated at the Bank of Israel, since the banking institutions showed a larger increase in foreign liabilities than in foreign currency assets.

At the end of the year reviewed, foreign currency assets at the disposal of the banking system reached IL 1,950 million (\$ 650 million). Of this sum, \$ 537 million was held by the Bank of Israel and \$ 113 million by the banking institutions. The foreign liabilities of the banking system totalled IL 467 million (\$ 156 million) at the end of 1963. Thus net foreign exchange reserves reached IL 1,484 million (\$ 495 million).

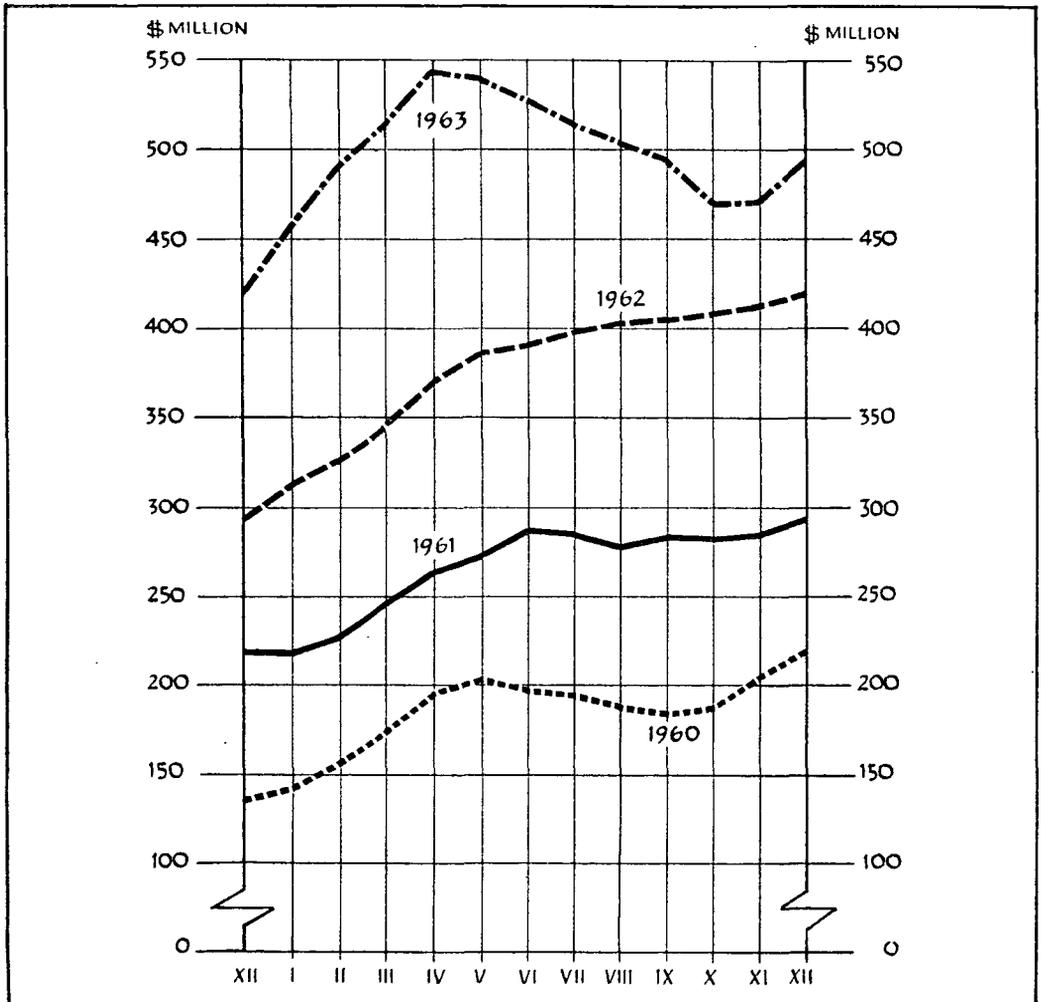
The main foreign liability item is deposits of foreign residents (Patach). The outstanding balance stood at IL 332 million (about \$ 111 million) at the end of 1963, after having risen by IL 35 million during the year. Most of these are fixed-term deposits, and the banking institutions are obliged to deposit 15 per cent of the balance with the Bank of Israel. The remainder may be used for granting credits to foreign residents, as well as to local residents under specific permits from the Controller of Foreign Exchange and the Bank of Israel.

The seasonal pattern of foreign currency accumulation in 1963 was similar to that of former years, apart from 1962 (see Diagram XV-2). From January to April net foreign currency assets rose by \$ 123 million, from May to October they dropped by \$ 73 million, and in November and December they went up by \$ 24 million.<sup>1</sup>

<sup>1</sup> If advance repayments of foreign debts are added to the reserves accumulated, the following picture emerges: January-May—a rise of \$ 146 million; June-October—a decline of \$ 47 million; November-December—a rise of \$ 25 million; and for the year as a whole—a rise of \$ 134 million.

Diagram XV-2

FOREIGN EXCHANGE RESERVES, BY MONTHS, 1960-63



(b) *Credit to the Government*

The Government's net liabilities to the banking system rose by IL 118.7 million between the end of 1962 and the end of 1963. However, this figure includes a IL 148.7 million credit granted by the Bank of Israel under a special arrangement for the advance repayment of foreign debts. Net of this credit, which had no expansionary effect on the money supply, the Government's liabilities to the banking system show a decline of IL 30 million.

As in 1962, the decrease in the Government's debt was concentrated during the first four months of the year reviewed. Between January and April, the

Table XV-11

## THE GOVERNMENT'S DEBT TO THE BANKING SYSTEM, 1958-63

(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: Deposits (net)	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 <sup>a</sup>	16.2 <sup>b</sup>	60.8	31.5 <sup>c</sup>	45.5	14.4
1963	-155.9	221.6	22.3	43.5	44.6 <sup>d</sup>	64.2	19.2	89.6	133.1
1963 January	-305.5	238.1	24.8	-92.2	14.6	69.2	28.9	54.9	-37.3
February	-342.2	232.6	26.8	-136.5	15.0	73.8	26.6	62.2	-74.3
March	-396.9	242.5	26.1	-180.5	15.9	62.8	25.8	52.9	-127.7
April	-409.6	243.0	26.5	-193.0	16.3	64.0	24.6	55.7	-137.4
May	-349.5	221.6	28.1	-155.9	41.6	61.6	24.6	78.6	-77.3
June	-306.5	208.3	29.4	-127.6	52.9	60.8	23.0	90.7	-36.9
July	-270.3	212.1	32.5	-90.7	54.1	57.1	22.1	89.1	-1.6
August	-236.7	221.4	31.7	-47.1	42.6	54.7	20.9	76.5	29.4
September	-171.2	223.1	35.3	16.4	39.9	42.1	20.3	61.7	78.3
October	-99.9	221.6	43.0	73.7	41.3	53.1	20.3	74.1	147.8
November	-96.5	220.1	42.6	80.9	46.7	54.2	18.8	82.2	163.1
December	-155.9	221.6	22.3	43.5	44.6	64.2	19.2	89.6	133.1

<sup>a</sup> Including a decrease of IL 229.0 million due to revaluation according to new exchange rate.<sup>b</sup> Including an increase of IL 1.5 million due to revaluation according to new exchange rate.<sup>c</sup> Including an increase of IL 7.0 million due to linkage differentials.<sup>d</sup> Including IL 21.5 million in Government securities purchased from the Bank of Israel in 1963.

Government's liabilities to the banking system contracted to the substantial extent of IL 152 million, and less the credit for the advance foreign debt repayments, by IL 172 million. This decline was due to the seasonal excess of receipts over payments during the last quarter of the fiscal year, which in turn was largely connected with the increased tax collections during the months January to March. These developments enabled the Government to exert a contractionary monetary influence during the very period when the money supply tends to expand rapidly owing to the seasonal concentration of foreign currency conversion. On the other hand, the Government's debt mounted rapidly and steadily between May and November: excluding the credit for the repayment of foreign obligations, it went up by IL 174 million, and including the credit, by IL 300 million. In December it dropped by over IL 30 million.

The IL 118.7 million increase in the Government's liabilities to the banking system consisted of a IL 74.6 million growth in its debt to the Bank of Israel and one of IL 44.1 million in its debt to the banking institutions. However, the incremental debt to the banking institutions includes purchases of Government securities from the Bank of Israel within the framework of the unutilized balance of the 22 per cent of controlled credit not subject to the liquidity regulations. These purchases totalled IL 21.5 million, and were recorded as a decrease in Bank of Israel credit to the Government and an increase in Government credit to the banking institutions.<sup>1</sup>

(c) *Bank credit to the public*

1. *The expansion of credit:* The outstanding balance of bank credit to the public went up during 1963 by IL 198.6 million, or 19.5 per cent, as compared with a rise of 17.3 per cent in 1962<sup>2</sup> and an average annual rise of 23.4 per cent during the years 1958 to 1961. The increment in 1963 included IL 38.9 million out of third-party deposits earmarked for loans, which did not affect the size of the money supply.<sup>3</sup> The expansion of ordinary bank credit to the public thus totalled IL 159.7 million. This figure breaks down as follows: IL 12.3 million—rediscounts by the Bank of Israel;<sup>4</sup> IL 105.2 million—local currency bank

<sup>1</sup> The IL 22.6 million balance includes credit for IL 8.7 million from the bank's free resources obtained for the purpose of preventing the expansion of credit to the public; this sum was deposited by the Government with the Bank of Israel.

<sup>2</sup> Excluding devaluation and linkage differentials.

<sup>3</sup> Such credit is mostly medium-term and linked to the consumer price index. It is not subject to the ordinary liquidity requirements, and may be drawn on in full for approved purposes. However, liquid assets must be held at the rate of 90 per cent against that part of the deposits not yet utilized.

<sup>4</sup> According to Table XV-12, the volume of rediscounts increased by IL 13.8 million, but this includes IL 1.5 million in repurchases of bills previously sold by the Bank of Israel to banks within the framework of the 22 per cent credit quota exempted from the liquidity requirements.

credit; and IL 42.2 million—foreign currency bank credit. Most of the incremental ordinary bank credit to the public in 1963 was for financing exports (see below).

Table XV-12

CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM,  
1958-63<sup>a</sup>

(IL million)

(End of period)

Period	From Bank of Israel	From banking institutions	Total bank credit	Against Govt. deposits	From Govt. 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 <sup>b</sup>	946.9 <sup>c</sup>	1,018.8	84.9	258.2 <sup>d</sup>	1,361.9
1963	85.7	1,131.8	1,217.4	45.4	314.1	1,576.9
1963 January	63.4	949.5	1,012.9	80.8	259.4	1,353.1
February	61.0	971.4	1,032.4	75.5	258.9	1,366.8
March	53.3	1,020.1	1,073.4	80.1	257.1	1,410.6
April	42.3	1,022.0	1,064.3	73.8	256.6	1,394.7
May	51.7	1,010.5	1,062.2	68.4	267.4	1,398.0
June	43.9	1,046.3	1,090.2	64.3	274.9	1,429.4
July	55.1	1,057.2	1,112.3	60.1	272.7	1,445.2
August	49.6	1,082.3	1,131.9	55.1	296.9	1,483.9
September	53.2	1,112.5	1,165.7	53.0	299.2	1,517.9
October	55.4	1,117.7	1,173.1	47.8	298.0	1,518.9
November	55.1	1,141.7	1,196.8	45.3	318.3	1,560.4
December	85.7	1,131.8	1,217.4	45.4	314.1	1,576.9

<sup>a</sup> Excluding foreign loans.

<sup>b</sup> Including an increase of IL 33.0 million due to the revaluation of the outstanding balance of foreign currency credits upon devaluation.

<sup>c</sup> Including devaluation and linkage differentials totalling IL 62.5 million.

<sup>d</sup> Including linkage differentials totalling IL 14.7 million.

The larger volume of Bank of Israel rediscounts actually reflects *in toto* the Bank's participation in joint export financing funds, which were considerably enlarged in 1963. The increase in the volume of foreign currency bank credits

to the public was particularly great.<sup>1</sup> Such credit was given from deposits of foreign residents or other sources of foreign currency at the disposal of banking institutions, and was not subject to the ordinary liquidity requirements. It was granted only against special permits from the Controller of Foreign Exchange and the Bank of Israel, and was mainly utilized for financing imports,<sup>2</sup> exports, and the activities of Israeli companies abroad. Part of it substituted for credits formerly extended to local importers from abroad for financing imports-for-export,<sup>3</sup> and therefore had no expansionary effect on the money supply.

Of the IL 105.2 million additional ordinary local currency bank credit, IL 8.5 million was granted under Bank of Israel direction within the framework of exemptions from the liquidity requirements. The Bank of Israel did not permit the full utilization of the 22 per cent quota of controlled credit exempt from the liquidity regulations—a quota the absolute size of which expanded together with the rapid growth of deposits against which liquid assets must be held. The portion of the quota which the banking institutions did utilize went to purchase outstanding Government bills from the Bank of Israel portfolio. Credit from the Export Financing Fund, which is exempt from the liquidity requirements, was expanded by more than IL 33 million; most of the increment consisted of new credits, though a small part represented transfers from former export financing funds. The outstanding balance of controlled credit granted for purposes other than the financing of exports was reduced.

Ordinary local currency bank credit not subject to Bank of Israel control grew by IL 96.7 million. This occurred despite the raising of the liquidity ratio by 5 points during the months January–October 1963, at the rate of half a point per month. The expansion was due to the swelling of the volume of liquid assets at the banking institutions' disposal by IL 174 million during the year reviewed (see Table XV–16). The banking institutions also increased their equity capital by IL 81 million,<sup>4</sup> and this led to a rise in their surplus liquid assets, which in turn permitted an expansion of credit and other investments.<sup>5</sup> Part of the additional new credit caused an increase in the banks' unauthorized

<sup>1</sup> The balance of such credit declined by IL 3.3 million in 1962, if the revaluation differentials on the balance outstanding on devaluation day are excluded.

<sup>2</sup> Mainly imports-for-export.

<sup>3</sup> In particular, the purchase of raw materials, which was included in the scope of the export funds' activities.

<sup>4</sup> An increase of IL 44 million in paid-up share capital and IL 37 million in reserve funds.

<sup>5</sup> A distinction must be made between the significance of a growth in equity capital for the individual bank and for banking institutions as a whole. An individual bank increases its liquid assets when it increases its equity capital, but all banking institutions together will increase their liquid assets only when the new capital originates from abroad or from cash holdings of the public. To the extent that the new capital is mobilized from deposits of the public against which liquid assets must be held, liquid assets are released for additional credits and investments, but the sum total of the banking institutions' liquid assets is not affected.

liquidity deficiency, which grew by IL 10 million between the end of 1962 and the end of 1963.

Besides the expansion of ordinary bank credit to the public, the year 1963 also saw the continued rapid growth of credit granted through the intermediation of banking institutions. The outstanding balance of the bill brokerage trade went up from IL 260 million at the end of 1962 to IL 430 million at the end of the year reviewed, i.e. by IL 170 million. At the end of 1963, some 64 per cent of such credit was guaranteed by banking institutions.

These transactions differ from ordinary bank credit in that they do not generate new means of payment, but simply transfer purchasing power from the lender to the borrower. However, there can be no doubt that the spread of this trade has expanded aggregate demand in the economy by increasing the circulation velocity of the money supply.<sup>1</sup> At the beginning of 1964 the Bank of Israel submitted a draft amendment to the Banking Ordinance, which *inter alia* would enable the central bank to limit the volume of financial guarantees granted in connection with such transactions.

Credit extended through the banking institutions against Government deposits (chiefly for the payment of tax debts) decreased between the end of 1962 and the end of 1963 to the substantial extent of IL 39.5 million. This decline was connected with the payment of debts arising from the imposition, after devaluation, of surtaxes on stocks imported at the old exchange rate, and with the contraction of credit to firms owing income tax. Credit from Government deposits expanded by IL 55.9 million; this is long-term credit granted from the Government's development budget. Some of the increment was not new credit, but represented the transfer to banking institutions of outstanding debts owed directly to the Government.

2. *The destination of credit:* Most of the incremental ordinary bank credit to the public in 1963 was granted through special funds for financing industrial exports. Today exporters obtain all their credit requirements—from the financing of imported raw materials and production to the financing of export shipments—at 6 per cent interest. The new export financing funds started to operate in the second half of 1962, but their development took place mainly in 1963, causing a considerable increase in the volume of credit available to exporters and a significant reduction in their financing costs. In fact, the entire increment of Bank of Israel rediscounts and of credit within the framework of liquidity exemptions was earmarked for this purpose, as was a substantial proportion of ordinary bank credit.

A large part of the exporters' import requirements is today financed through special funds and arrangements administered by the Bank of Israel. The Bank participates in a special fund for the financing of imports-for-export to the

<sup>1</sup> A more detailed discussion of the bill brokerage trade and its inflationary influence was presented in the Bank of Israel Annual Report for 1962, Chapter XIV, section 4 (c).

extent of 30 per cent, in the form of rediscounts. The remaining 70 per cent is put up by banking institutions from lines of foreign credit or from deposits of foreign residents. The share of the Bank in financing diamond imports is smaller—a little over 20 per cent at the end of 1963. The low rediscount rate

Table XV-13

CREDIT GRANTED TO THE PUBLIC, BY SOURCE AND DESTINATION,  
DECEMBER 31, 1963<sup>a</sup>

Destination	Controlled by the Bank of Israel <sup>b</sup>	Not controlled by the Bank of Israel	Total bank credit (1) + (2)	Credit against Government deposits	Total (3) + (4)
	(1)	(2)	(3)	(4)	(5)
<b>IL million</b>					
Agriculture	87.3	81.6	168.9	1.3	170.2
Industry	163.9	322.6	486.5	31.0	517.5
Construction	8.2	63.4	71.6	3.4	75.0
Commerce	26.2	87.1	113.3	4.5	117.8
Public services	22.9	7.1	30.0	0.1	30.1
Local authorities	5.7	53.7	59.4	—	59.4
Financial and credit institutions	0.8	27.8	28.6	0.1	28.7
National Institutions	20.9	5.2	26.1	0.1	26.2
Services	6.5	50.0	56.5	1.1	57.6
Private individuals	—	121.5	121.5	2.0	123.5
Miscellaneous <sup>c</sup>	5.2	48.9	55.0	1.8	56.8
<b>Total</b>	<b>347.6</b>	<b>869.8</b>	<b>1,217.4</b>	<b>45.4</b>	<b>1,262.8</b>
<b>Percentages</b>					
Agriculture	25.1	9.4	13.9	2.9	13.5
Industry	47.2	37.1	40.0	68.3	41.0
Construction	2.4	7.3	5.9	7.5	5.9
Commerce	7.5	10.0	9.3	9.9	9.3
Public services	6.6	0.8	2.5	0.2	2.4
Local authorities	1.6	6.2	4.9	—	4.7
Financial and credit institutions	0.2	3.2	2.3	0.2	2.3
National Institutions	6.0	0.6	2.1	0.2	2.1
Services	1.9	5.7	4.6	2.4	4.6
Private individuals	—	14.0	10.0	4.4	9.8
Miscellaneous <sup>c</sup>	1.5	5.7	4.5	4.0	4.5
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Including linkage differentials.

<sup>b</sup> Including Bank of Israel rediscounts and controlled credit granted by banking institutions.

<sup>c</sup> Including credit to artisans.

of the central bank reduces the average rate of interest under such arrangements to 6 per cent per annum.<sup>1</sup> The total balance of credit within this framework reached IL 72.3 million at the end of 1963.

A separate and still larger fund finances purchases of local raw materials, as well as production and export shipments until receipt of payment. This fund was created in September 1962, with the participation of the Ministry of Finance, Ministry of Commerce and Industry, Bank of Israel, and the banking institutions. The combined share of the Government and the Bank of Israel comes to 40 per cent, and that of the banking institutions to 60 per cent; half of the latter's quota is furnished from their free resources, and half within the framework of controlled credit exempted from the liquidity regulations. Interest on credits granted from this fund was reduced at the beginning of 1963 from 7.5 to 6 per cent per annum. The outstanding balance of the fund rose from IL 31.4 million at the end of 1962 to IL 144.6 million at the end of 1963—an increase of IL 113.2 million, of which some IL 22 million was due to transfers from other export financing funds to the new fund. These other funds are being gradually liquidated and their functions taken over by the new fund. The net increment of credit extended by the new fund thus totalled IL 91 million. In addition, foreign currency bank credit, mostly for financing export shipments, was expanded during the year reviewed by IL 8.6 million.<sup>2</sup> The total increase in ordinary bank credit to the public—exclusive of that from deposits earmarked for loans—came to IL 159.7 million in 1963.

The new export financing arrangements and the rapid development of the funds financing industrial exports were reflected by changes in the distribution of bank credit between the various economic sectors. Almost three-quarters of the additional bank credit granted to the public in 1963 was channelled to industry. There was a particularly conspicuous increase in this sector's share of controlled bank credit—a rise of IL 72 million, compared with a decline in the share of the other sectors. The weight of industry in total bank credit to the public rose from 33.5 per cent at the end of 1962 to 40 per cent at the end of 1963. On the other hand, there was a decrease of IL 19 million in the volume of credit granted to the industrial sector against Government deposits, primarily to companies owing taxes. If credit of this type is added to ordinary bank credit to the public, the increase in the industrial sector's share is slightly smaller—from 35.4 per cent in 1962 to 41 per cent.

The share of agriculture in the total volume of bank credit to the public has been falling for several years, chiefly because of the declining weight of this sector in investment and exports. In 1963 there was even an absolute decrease in the amount of credit granted to agriculture (see Table XV-14), but this reflected the reduction of controlled credit to citrus growers following the steep

<sup>1</sup> Credits for the financing of diamond imports are granted at  $6\frac{1}{8}$  per cent per annum.

<sup>2</sup> The bulk of such credits were for financing diamond exports.

Table XV-14

**BANK CREDIT GRANTED TO THE PUBLIC, BY SECTOR  
OF DESTINATION, 1958-63<sup>a</sup>**

(End of period)

Sector	1958	1959	1960	1961	1962 <sup>b</sup>	1963 <sup>c</sup>
<b>IL million</b>						
Agriculture	114.4	129.7	143.4	157.4	176.6	170.2
Industry	130.5	163.6	214.4	264.4	392.5	517.5
Construction	28.2	36.9	42.6	52.1	62.5	75.0
Commerce	54.0	68.1	77.1	82.2	114.1	117.8
Public services	21.4	24.4	33.9	31.8	38.5	30.1
Local authorities	7.0	7.7	10.3	32.7	58.5	59.4
Financial and credit institutions	7.5	13.9	14.3	21.9	27.5	28.7
National Institutions	14.8	17.6	29.0	34.7	38.4	26.2
Services	25.9	29.4	36.2	44.7	47.2	57.6
Miscellaneous <sup>d</sup>	66.7	78.6	97.0	119.5	152.1	180.3
<b>Total</b>	<b>470.4</b>	<b>569.9</b>	<b>698.4</b>	<b>841.4</b>	<b>1,107.9</b>	<b>1,262.8</b>
<b>Percentages</b>						
Agriculture	24.3	22.7	20.5	18.7	15.9	13.5
Industry	27.8	28.7	30.7	31.4	35.4	41.0
Construction	6.0	6.5	6.1	6.2	5.6	5.9
Commerce	11.5	11.9	11.4	9.8	10.3	9.3
Public services	4.5	4.4	4.7	3.8	3.5	2.4
Local authorities	1.5	1.3	1.5	3.9	5.3	4.7
Financial and credit institutions	1.6	2.4	2.0	2.6	2.5	2.3
National Institutions	3.1	3.1	4.2	4.1	3.5	2.1
Services	5.5	5.2	5.2	5.3	4.3	4.6
Miscellaneous <sup>d</sup>	14.2	13.8	13.8	14.2	13.7	14.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Including loans against Government deposits for the payment of tax debts.<sup>b</sup> Including devaluation differentials of IL 61.2 million and linkage differentials of IL 34.3 million. Most of the devaluation increment was in credit to industry, public services, and the National Institutions, while most of the linkage increment was in credit to industry and local authorities.<sup>c</sup> Including linkage differentials.<sup>d</sup> Including credit to private individuals.

rise in their export earnings, whereas credit to other branches of agriculture was expanded somewhat.

## 5. THE LIQUIDITY OF BANKING INSTITUTIONS<sup>1</sup>

In 1963 there was a considerable increase in the liquidity of banking institutions. The average annual liquidity ratio rose from 36.7 per cent in 1962 to 42.4 per cent in 1963,<sup>2</sup> and between the end of 1962 and the end of 1963 the ratio went up from 39.4 to 46.6 per cent.<sup>3</sup> Aggregate ordinary liquid assets held by banking institutions expanded by IL 174 million, or roughly 50 per cent. Moreover, the banking institutions purchased an additional IL 20 million worth of bills from the Bank of Israel from the unutilized portion of credits exempted from the liquidity requirements. The volume of deposits subject to the ordinary liquidity requirements grew during the year reviewed by IL 233 million, or 26 per cent.

The big increase in liquidity was chiefly due to the large-scale acquisition of foreign currency by the Bank of Israel, together with the tightening of the liquidity requirements. The accelerated accumulation of foreign currency in 1963, especially during the early months of the year, was reflected by a sharp rise in the volume of liquid assets at the disposal of banking institutions, since most of the incremental foreign currency was converted into Israeli pounds and a considerable part of the conversion proceeds was deposited by the public in banking institutions. However, the raising of the liquidity ratio by 5 points during the months January–October 1963 forced the banking institutions to sterilize most of their additional liquid assets, thus preventing their use for the expansion of credit. The formal liquidity ratio was raised from 64 per cent at the end of December 1962 to 69 per cent at the end of October 1963, the increase being implemented at the rate of half a point per month. Moreover, the Bank of Israel did not permit the full utilization of the 22 per cent quota of controlled credit exempt from the liquidity requirements, this being tantamount to the further raising of the effective liquidity ratio. The banks were entitled to purchase outstanding bills of the Government and the public from the portfolio of the Bank of Israel with the unexploited part of their controlled credit quota, and to the extent that they availed themselves of this right, the real rise in the actual liquidity ratio is not reflected in Table XV–16.<sup>4</sup>

<sup>1</sup> The reference here is to ordinary liquidity ratios in Israeli currency only; i.e. to deposits which at the end of 1962 required a liquid cover to the extent of 64 per cent—a requirement raised to 69 per cent during 1963.

<sup>2</sup> The average annual liquidity ratio in 1961 was 33.6 per cent.

<sup>3</sup> If purchases of bills from the Bank of Israel within the framework of liquidity exemptions are added, the increase is even larger—from 41.1 per cent at the end of 1962 to 49.8 per cent at the end of 1963.

<sup>4</sup> The figures for liquid assets in Tables XV–15 and XV–16 do not include bills purchased from the Bank of Israel.

Table XV-15

CHANGES IN THE LIQUID ASSETS OF BANKING INSTITUTIONS,<sup>a</sup> BY SOURCE, 1958-63

(IL million)

(End of period)

Period	Credit from the Bank of Israel		Net foreign currency at the Bank of Israel	Net balances in transit between banking institutions	Total (1) + (2) + (3) + (4)	Less :				
	To the public, net <sup>b</sup>	To the Govt. <sup>c</sup>				Cash held by the public <sup>d</sup>	Net foreign currency balances of banking institutions at the Bank of Israel	Liquid assets in Israeli currency against deposits requiring 90% or 100% liquid cover <sup>e</sup>	Total deductions (6) + (7) + (8)	Ordinary liquid assets in Israeli 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	177.8
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
1963	79.3	43.3	1,543.5	0.3	1,666.6	525.1	575.0	34.5	1,134.6	532.0

1963 January	51.5	-92.2	1,349.5	2.0	1,310.8	418.0	495.3	25.6	938.9	371.9
February	43.0	-136.5	1,442.6	0.3	1,349.4	448.7	504.9	26.0	979.6	369.8
March	29.4	-180.5	1,557.5	2.8	1,409.2	476.2	524.7	24.5	1,024.5	383.8
April	36.3	-193.0	1,625.7	0.5	1,469.5	483.7	521.7	27.9	1,033.3	436.2
May	43.3	-155.9	1,627.9	1.4	1,516.7	493.5	533.7	30.0	1,057.2	459.5
June	38.1	-127.6	1,603.8	1.9	1,516.2	501.2	533.3	35.5	1,070.0	446.2
July	50.0	-90.7	1,567.7	0.7	1,527.7	508.2	538.0	33.1	1,079.3	448.4
August	41.3	-47.1	1,550.3	1.2	1,545.7	510.4	537.2	31.2	1,078.8	466.1
September	41.3	16.5	1,530.9	1.9	1,590.6	524.0	549.0	33.6	1,106.6	484.0
October	46.4	73.7	1,478.2	2.2	1,600.5	528.8	556.8	32.4	1,118.0	482.5
November	46.7	80.9	1,487.0	1.8	1,616.4	535.4	567.3	31.4	1,134.1	482.3
December	79.3	43.5	1,543.5	0.3	1,666.6	525.1	575.0	34.5	1,134.6	532.0

<sup>a</sup> Net of liquid assets held against deposits requiring 90 per cent or 100 per cent cover.

<sup>b</sup> Net of deposits of financial institutions, including investment banks, with the Bank of Israel. Data for 1962 and 1963 are from the Bank of Israel balance sheet and are therefore affected by purchases and sales of bills by banking institutions from the unexploited portion of the 22 per cent of controlled credit exempt from the liquidity regulations.

<sup>c</sup> Balances for 1963 include credit from the Bank of Israel for the advance repayment of foreign debts, which actually had no effect on the liquid assets of the banking institutions. They also include purchases and sales of Government bills to banking institutions within the framework of the unexploited part of the 22 per cent of controlled credit exempt from the liquidity regulations.

<sup>d</sup> Including cash at the Israel Bank of Agriculture.

<sup>e</sup> Excluding demand deposits held for banking institutions, which appear net in column (4).

The data for 1963 presented in Table XV-15 (columns 2 and 3), which are taken from the Bank of Israel balance sheet, include a IL 148.7 million credit granted to the Government for the advance repayment of foreign debts, which did not involve an increase in the banking institutions' liquid assets. After deducting this sum, it is evident that almost the sole factor increasing liquidity during 1963 was the acquisition of foreign currency by the Bank of Israel. The changes in net credit granted to the public and the Government in 1962 and 1963 include purchases and sales of bills by banking institutions.

On the other hand, the steep rise in the amount of cash held by the public prevented an even larger expansion of the banking institutions' liquid assets. Cash in the hands of the public went up by IL 115.7 million in 1963, as compared with a growth of IL 65.2 million the year before. Consequently, the contractionary effect of this factor was appreciably stronger in 1963, being particularly striking during the first quarter of the year when the cash holdings advanced by some IL 67 million.<sup>1</sup> The net foreign currency balances of banking institutions with the Bank of Israel also increased during the year reviewed—by IL 84.6 million. This figure actually represents that part of the foreign currency acquired by the Bank of Israel and not converted into Israeli pounds—in particular Pazak balances, which are deposited *in toto* with the Bank of Israel<sup>2</sup>—and which therefore did not lead to any growth in the liquid assets of the banking institutions.

The increase in liquid assets and in the reserve requirements was not even, in general following the seasonal pattern of foreign currency accumulation. During the first five months of the year the liquidity ratio went up from 39.4 to 43.8 per cent, between June and November it remained more or less at the end-May level, but in December there was another substantial rise, to 46.6 per cent. The increase during the first five months of the year is attributable to the concentration of foreign currency accumulation during this period. Between June and November foreign currency balances actually contracted, but at the same time the Bank of Israel expanded its credit to the Government. The rise in the liquidity ratio in December was partly connected with the resale of bills by banking institutions to the Bank of Israel in order to show a better liquidity position in their balance sheets for the year. Moreover, the same month witnessed a decrease in the amount of cash held by the public, while foreign currency accumulation was resumed. The resale of bills to the Bank of Israel in December totalled more than IL 17 million. If we add the balance of bills purchased within the framework of the 22 per cent of liquidity exemptions to the banking institutions' total liquid assets, the rise in the liquidity ratio in December becomes much more moderate—from 48.5 to 49.8 per cent, in contrast to the rise from 43.6 to 46.6 per cent shown in Table XV-16.

<sup>1</sup> See section 2 above.

<sup>2</sup> The volume of Tamam balances, as already mentioned, decreased.

The "recognized deficiency" in liquid assets totalled IL 27 million at the end of 1963, as compared with IL 38 million at the end of 1962. On the other hand, the unauthorized deficiency increased over the same period from IL 8 million to IL 18 million.

Table XV-16

THE LIQUIDITY OF BANKING INSTITUTIONS\* IN  
ISRAELI CURRENCY, 1958-63

(IL million)

(End of period)

Period	Liquid balances at the Bank of Israel	Cash held by banking institutions	Net balances in transit between banking institutions	Less :	Total ordinary liquid assets (1) + (2) + (3) - (4)	Deposits requiring ordinary liquid cover	Liquidity ratio (5) / (6) × 100 (7)
				Liquid assets held against deposits requiring 90% or 100% liquid cover <sup>b</sup>			
	(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
1963	540.8	25.3	0.3	34.5	531.9	1,142.1	46.6
1963 January	370.8	24.7	2.0	25.6	371.9	932.9	39.9
February	370.6	25.0	0.3	26.0	369.8	951.9	38.8
March	378.1	27.4	2.8	24.5	383.8	974.6	39.4
April	433.9	29.7	0.5	27.9	436.2	1,022.3	42.7
May	461.5	26.6	1.4	30.0	459.5	1,049.8	43.8
June	451.8	28.1	1.9	35.5	446.3	1,066.6	41.8
July	451.4	29.4	0.7	33.1	448.4	1,063.9	42.1
August	468.8	28.0	1.2	31.2	466.8	1,085.1	43.0
September	485.6	30.0	1.9	33.6	483.9	1,114.3	43.4
October	482.9	29.7	2.2	32.4	482.4	1,104.3	43.7
November	483.6	28.4	1.8	31.4	482.4	1,106.3	43.6
December	540.8	25.3	0.3	34.5	531.9	1,142.1	46.6

\* The figures in this table differ somewhat 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 cited here are based on the balance sheet of the Bank of Israel, whereas the data of the Examiner of Banks are based on the balance sheets of the banking institutions. Data relating to ordinary liquid assets, deposits requiring ordinary liquid cover, and the effective liquidity ratios have been calculated after deduction of deposits requiring 90 or 100 per cent liquid cover and of the liquid assets held as cover against these deposits.

<sup>b</sup> Excluding demand deposits held for other banks, which are listed net in column (3).

## 6. DEVELOPMENT OF BANKING INSTITUTIONS

The rapid expansion of the banking institutions' business continued in 1963, though somewhat more slowly than in 1962 when the growth rate was particularly high. Their consolidated balance sheet went up by 20 per cent in 1963, reaching IL 4,485 million at the end of the year. The increase in 1962 was 56 per cent if revaluation differentials are included, and 37 per cent if they are excluded.

On the asset side, there was a marked rise in balances held at the Bank of Israel, which accounted for almost 50 per cent of the total increment (excluding contingent accounts). This increase consisted mainly of additional local currency and Pazak deposits with the Bank of Israel. There was also a relatively big expansion of credit to the public, including that from deposits of provident funds and financial institutions earmarked for loans and foreign currency credit to local residents. The large increase in loans to the Government must be ascribed to purchases of outstanding Government bills from the Bank of Israel with the unexploited portion of funds exempt from the liquidity requirements; these purchases do not reflect any real expansion of credit to the Government.

On the liability side, there was a striking increase in equity capital. The year 1963 was characterized by the large-scale mobilization of funds by many banking institutions, in both the domestic and foreign capital markets. The decreased weight of equity capital in many banking institutions in 1962 following the rapid growth of their balance sheets, together with the especially brisk trade on the Stock Exchange in 1963, prompted many banks to turn to the capital market for raising additional funds. Total equity capital rose by IL 81 million, or 76 per cent, during the year reviewed. The weight of this item—which consists of paid-up share capital and open reserves—in total liabilities (including contingent accounts) went up from 2.9 per cent in 1962 to 4.2 per cent in 1963.

Contingent accounts rose by IL 183 million, or 18.6 per cent. Most of the growth was connected with the larger volume of bank guarantees following the expansion of the trade bill market.

As in 1962, there was only a slight increase in the banks' branch network. The number of new branches opened during the year was 28, as compared with 33 in 1962, 98 in 1961, and 79 in 1960. In 1963 no permits for the opening of new branches were issued by the Governor of the Bank of Israel, except for those in development areas and Arab villages and in cases where agreements had been signed before May 24, 1961, the date on which the law requiring a special permit from the Governor of the Bank of Israel for this purpose came into effect.

Of the 28 new branches, 12 belonged to the three big banks, 12 to the other banks, and four to credit cooperative societies. One credit cooperative went

Table XV-17

## ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1962-63

(End of period)

	IL million		Percentages		Increase or decrease (-) from 1962 to 1963	
	1962 <sup>a</sup>	1963	1962	1963	IL m.	%
<b>Assets</b>						
Cash and balances at the Bank of Israel	932.7	1,206.3	33.9	36.4	273.6	29.3
Loans to the public	946.7	1,137.7 <sup>b</sup>	40.0	34.3	191.0	20.2
Loans to the Government	17.1	45.2	0.6	1.4	28.1	164.3
Loans to the public from Govt. deposits	343.2	359.6	12.5	10.8	16.4	4.8
Foreign currency assets	310.7	339.3	11.4	10.2	28.6	9.2
Securities	150.8	180.1	5.5	5.4	29.3	19.4
Real estate	41.1	47.3	1.5	1.4	6.2	15.1
Net balances with banking institutions	5.1	1.8	0.2	0.1	-3.3	-64.7
<b>Total</b>	<b>2,747.4</b>	<b>3,317.3</b>	<b>100.0</b>	<b>100.0</b>	<b>569.9</b>	<b>20.7</b>
<b>Liabilities</b>						
Demand deposits	846.3	1,082.8	30.8	32.6	236.5	27.9
Nonliquid deposits	1,004.6	1,132.5 <sup>c</sup>	36.6	34.1	127.9	12.7
Foreign liabilities <sup>d</sup>	352.8	456.9	12.8	13.8	104.1	29.5
Government deposits	375.8	379.3	13.7	11.4	3.5	0.9
Equity capital	106.6	187.5	3.9	5.7	80.9	75.9
Other accounts (net)	61.3	78.3	2.2	2.4	17.0	27.7
<b>Total</b>	<b>2,747.4</b>	<b>3,317.3</b>	<b>100.0</b>	<b>100.0</b>	<b>569.9</b>	<b>20.7</b>
<b>Contingent accounts</b>						
Balances held by and for banking institutions	54.0	59.7			5.7	10.6
Clients' liabilities and guarantees	722.2	900.5			178.3	24.7
Other accounts	207.9	207.3			-0.6	-0.3
<b>Total</b>	<b>984.1</b>	<b>1,167.5</b>			<b>183.4</b>	<b>18.6</b>
<b>Grand total</b>	<b>3,731.5</b>	<b>4,484.8</b>			<b>753.3</b>	<b>20.2</b>

<sup>a</sup> Including devaluation and linkage differentials.<sup>b</sup> This figure exceeds that cited in Table XV-12 by IL 5.9 million, since it includes Bank of Israel loans to banks for this amount.<sup>c</sup> This figure exceeds that cited in Table XV-7 by IL 5.9 million, since it includes Bank of Israel loans to banks for this amount.<sup>d</sup> Including deposits of foreign residents.

out of existence in 1963 after merging with another cooperative, reducing their number to 25.

Table XV-18

**BANKING INSTITUTIONS AND THEIR BRANCHES, 1955-63**

(End of period)

	1955	1956	1957	1958	1959 <sup>a</sup>	1960	1961	1962 <sup>a</sup>	1963
<b>The 3 big banks</b>									
Head offices	3	3	3	3	3	3	3	3	3
Branches	104	114	193	219	244	289	335	351	363
Total	107	117	196	222	247	292	338	354	366
<b>Other banks</b>									
Head offices	21	22	22	22	22	23	23	23	23
Branches	52	61	67	72	83	111	151	168	180
Total	73	83	89	94	105	134	174	191	203
<b>Credit cooperatives</b>									
Head offices	94	93	59	52	42	29	27	26	25
Branches	74	79	49	48	54	60	72	72	76
Total	168	172	108	100	96	89	99	98	101
<b>All banking institutions</b>									
Head offices	118	118	84	77	67	55	53	52	51
Branches	230	254	309	339	381	460	558	591	619
Total	348	372	393	416	448	515	611	643	670

<sup>a</sup> Revised figures.

The weight of the three big banks in total banking business declined in 1963. Their share of credit to the public fell from 69 to 67 per cent, and their share of local currency demand deposits from 65 to 63 per cent. The weight of credit cooperative societies also decreased—a trend in evidence for the past several years. On the other hand, the weight of the smaller banks went up in most of the major consolidated balance sheet items (see Table XV-19). The rise in the relative importance of the smaller banks has continued uninterruptedly for several years.

**Table XV-19**  
**CASH AND BALANCES AT THE BANK OF ISRAEL, CREDIT, AND**  
**DEPOSITS, BY TYPE OF BANKING INSTITUTION, 1955-63**

(percentages)

(End of period)

	The 3 big banks	Other banks	Credit cooperatives	Total
<b>Cash and balances with the Bank of Israel</b>				
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
1963	65	29	6	100
<b>Loans to the public from resources of the banking institutions<sup>a</sup></b>				
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 <sup>b</sup>	69	23	8	100
1963	67	26	7	100
<b>Local currency demand deposits</b>				
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 <sup>b</sup>	64	25	11	100
1962 <sup>b</sup>	65	25	10	100
1963	63	27	10	100
<b>Other deposits<sup>c</sup></b>				
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 <sup>b</sup>	71	22	7	100
1962 <sup>b</sup>	71	24	5	100
1963	72	24	4	100

<sup>a</sup> Including credit to foreign residents.

<sup>b</sup> Revised figures.

<sup>c</sup> Including deposits of foreign residents (Patach).

## 7. INCOME AND EXPENSES OF BANKING INSTITUTIONS

The appreciable growth in the banking institutions' business in 1963 was reflected by a big rise in several income items. Total operating income advanced by IL 50.9 million, or some 25 per cent, during the year. There was a particularly large growth in income from service charges—40 per cent approximately—after a 29 per cent increase in 1962. This sharp rise must be ascribed chiefly to the spread of the bill brokerage trade and the larger volume of transactions in securities—spheres in which the banking institutions actually fulfill the function of brokers. Service charges accounted for nearly a third of

**Table XV-20**

### INCOME AND EXPENSES OF BANKING INSTITUTIONS, 1962-63

	IL million		Per cent of total		Increase from 1962 to 1963	
	1962	1963	1962	1963	IL m.	%
<b>Operating income</b>						
Interest and commission on loans and bills discounted	102.0	117.8	49.6	45.9	15.8	15.5
Service charges	41.0	57.2	19.9	22.3	16.2	39.5
Interest on deposits with the Bank of Israel and other banks	38.4	50.7	18.7	19.8	12.3	32.0
Other income	24.4	31.0	11.8	12.1	6.6	27.0
Total operating income	205.8	256.7	100.0	100.0	50.9	24.7
<b>Operating expenses</b>						
Wages, salaries, and fringe benefits	70.7	87.8	37.4	38.8	17.1	24.2
Interest paid on deposits	80.6	95.7	42.6	42.3	15.1	18.7
Other expenses	37.7	42.7	20.0	18.9	5.0	13.3
Total operating expenses	189.0	226.2	100.0	100.0	37.2	19.7
<b>Profits<sup>a</sup></b>						
Operating profit	16.8	30.5	68.6	65.6	13.7	81.5
Capital gains (net)	7.7	16.0	31.4	34.4	8.3	107.8
Total profits	24.5	46.5	100.0	100.0	22.0	89.8
Operating profit as a percentage of operating income	8.2	11.9				
Operating profit as a percentage of equity capital <sup>b</sup>	20.9	21.5				
Total profits as a percentage of equity capital <sup>b</sup>	30.5	32.7				

<sup>a</sup> Before deduction of income tax and company profits tax.

<sup>b</sup> Average annual equity capital, excluding hidden reserves.

the total increase in operating income in 1963—IL 16.2 million out of IL 50.9 million. This exceeds the incremental income from interest on bank loans, which came to IL 15.8 million.

Income from interest on loans, the main income item, reached IL 118 million in 1963—15.5 per cent more than in 1962, as compared with a rise of over 18 per cent in 1962. The slower growth in 1963 was due to the reduction of interest on credits granted through the export funds to 6 per cent, and to the considerably higher proportion of cheap export credits in total credit.

Expenses expanded more slowly than operating income, going up by approximately 20 per cent in 1963. The biggest increase was in outlay on wages and fringe benefits, which rose by 24 per cent, about the same rate as in 1962. This increase was due partly to a growth of over 10 per cent in the number of employees, and partly to a substantial rise in average wages, despite the fact that the pay of bank employees is among the highest in the country. Interest paid to depositors increased to a much lesser extent than in 1962, when foreign currency deposits were revalued at the new exchange rate and interest rates were raised.

The total increase in expenses in 1963 came to IL 37 million, as compared with IL 51 million in operating income. Operating profit thus rose by IL 14 million, or more than 81 per cent. Operating profit before income tax and company profits tax totalled IL 30.5 million in 1963. There was also an extraordinarily big growth in capital gains, which more than doubled as compared with 1962, reaching IL 16 million. Total profits, before taxes, amounted in 1963 to IL 46 million—or 33 per cent of the banking institutions' equity capital. Operating profit amounted to more than 21 per cent of their equity capital. Despite the big increase in profits, these rates of return are only slightly higher than in 1962, for in 1963 the banking institutions expanded their equity capital to an exceptionally marked extent—more than 75 per cent. The ratio between operating profit and total operating income, however, went up substantially—from 8.2 per cent in 1962 to 11.9 per cent in 1963.