

CHAPTER XV

MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. MAJOR MONETARY DEVELOPMENTS

IN SHARP CONTRAST to the rapid monetary expansion of 1962 and 1963, the year 1964 witnessed an appreciable deceleration of the upward trend. Between the beginning and the end of the year reviewed the money supply rose by IL 98 million, or 6.1 percent—the slowest annual increase since the establishment of the State. Less liquid deposits of the public with the banking system expanded by 18.6 percent. The total increase in the money supply and less liquid deposits was 10.4 per cent, compared with 22 percent in 1963 and 39.8 percent in 1962. The average level of the money supply went up by 13 percent in 1964, which only slightly exceeded the rise in the national product at constant prices. In 1963 the average level of the money supply was approximately 31 percent higher than in the previous year.

The slower monetary expansion of 1964 was also reflected in the smaller increase in other types of near-money (financial assets of relatively high liquidity). The outstanding balance of the Government Short-Term Loan and bank-negotiated bill credits went up by IL 239 million all told, as against IL 284 million the year before. The rise in the latter item came to IL 179 million and that in the Short-Term Loan to IL 60 million, as compared with IL 170 million and IL 114 million respectively in 1963.

The main reason for the lower rate of monetary expansion during the year reviewed was the sharp decline in the accumulation of foreign exchange reserves, which in turn was due to the larger deficit in the country's goods and services account. In recent years the rapid accumulation of foreign currency has been the chief cause of monetary expansion. The influence of the rapid monetary growth of 1963 on commodity prices and the balance of payments was not entirely reflected by developments that year. In 1962 the increased liquidity of the economy largely found expression in intensified activity in the real estate and share markets and the mounting of prices therein, while upward pressure on the commodity and service markets apparently exerted itself only after some time-lag. This, together with the recession that hit the real estate and share markets in the second half of 1963, augmented demand for commodities and services from current local production and import. This demand continued to grow in 1964, causing—along with some other factors—

Table XV-1

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1959-64

	IL million							Percent increase or decrease (-) as against previous year						
	1959	1960	1961	1962 ^a	1962 ^b	1963	1964	1959	1960	1961	1962 ^a	1962 ^b	1963	1964
Sources														
Accumulation of foreign currency assets	90.6	153.3	134.4	355.8	733.1	227.4 ^c	42.2	60.4	63.7	34.1	67.4	138.8	18.0 ^d	2.8
Expansion of credit to the public ^d	60.2	93.7	95.5	99.9	169.3	155.3	148.2	16.3	21.9	18.3	16.2	27.4	19.7	15.7
Expansion of credit to the Govt.	5.1	-4.1	-48.0	-60.9	-295.4	118.7 ^e	95.4	1.4	-1,1	-13.4	-19.7	-95.4	824.3 ^c	71.7
Others factors, net	-9.8	2.2	4.2	-22.9	-35.5	-59.6	-31.8	f	f	f	f	f	f	f
Total	146.1	245.1	186.1	371.9	571.5	441.8	254.0	17.0	24.4	14.9	25.9	39.8	22.0	10.4
Components														
Money supply	66.0	154.3	88.9	287.5	287.5	352.7	98.1	10.0	21.3	10.1	29.7	29.7	28.1	6.1
Less-liquid deposits ^g	80.1	90.8	97.2	84.4	284.0	89.1	155.9	40.5	32.7	26.4	18.1	60.9	11.9	18.6
Total	146.1	245.1	186.1	371.9	571.5	441.8	254.0	17.0	24.4	14.9	25.9	39.8	22.0	10.4

^a Excluding increments from value-linkage and from the devaluation of foreign currency balances after the alteration of the exchange rate in February 1962.

^b Including devaluation and linkage increments.

^c After the advance repayment of IL 148.7 million in foreign debts.

^d Excluding credit from deposits earmarked for loans.

^e Including credit of IL 148.7 million from the Bank of Israel for the advance repayment of foreign debts.

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

^g Net of deposits earmarked for loans.

a considerable increase in the trade deficit¹ and a rise in service prices. The inflow of foreign capital, with its expansionary monetary impact, was greater in 1964 than in 1963, but the marked rise of the adverse balance on current account led to a steep decline in foreign currency accumulation. The net growth of the banking system's foreign currency assets came to only \$ 14 million in 1964, compared with \$ 76 million in 1963 (and this after advance foreign debt repayments of \$ 50 million in 1963) and \$ 128 million in 1962.

The monetary expansion of 1964 was caused primarily by the larger volume of credit granted to the Government and the public. The Government's net debt to the banking system increased by IL 95 million,² while ordinary bank credit to the public was expanded by some IL 148 million, compared with IL 155 million in 1963.³ Of this increment, only some IL 49 million represented uncontrolled Israeli currency credit granted within the framework of the ordinary liquidity requirements, as compared with a rise of IL 96 million in such credit in 1963. Most of the additional credit during the year reviewed was extended in the form of Bank of Israel rediscounts or through the Export Finance Fund—which type of credit is exempt from the liquidity requirements—and also in the form of foreign currency credits to local residents—this too exempt from the ordinary liquidity requirements.

The relatively small increase in the volume of ordinary credit granted to the public within the framework of the liquidity regulations was due to the non-growth of the banking institutions' liquid assets during the year surveyed. The positive external drain resulting from the expansion of credit to the Government and the public by the Bank of Israel did not augment the amount of liquid assets held by the banking institutions, being instead reflected by the larger volume of cash in circulation. In 1962–63 the banking institutions' liquid assets doubled in volume in consequence of the accumulation of foreign exchange reserves by the Bank of Israel. The expansion of uncontrolled credit by IL 49 million was made possible by the utilization of excess liquid assets at the disposal of certain banking institutions (especially those which had increased their

¹ See Chapter III, "The Balance of Payments".

² After the repayment of IL 38 million to the Bank of Israel on account of a IL 150 million advance granted in 1963 for the early repayment of foreign debts. If the effect of this repayment is subtracted, the net increase in the Government's debt to the banking system amounted to approximately IL 133 million.

³ In contrast to previous Bank of Israel Annual Reports, the figures cited here do not include credit granted from deposits of the public earmarked for loans (chiefly provident fund deposits). Such credit is normally extended for medium or long terms and linked to the consumer price index; it does not involve any expansion of the money supply. Data on such credit are presented in Table XV-9. The discussion on the economic destination of credit in section 4(c) of this chapter covers this type of credit as well.

equity capital), and by larger liquidity deficiencies in other cases. These developments were reflected by a slightly lower effective liquidity ratio at the end of 1964 as compared with the end of 1963.¹

In order to prevent an excessive expansion of bank credit to the public, the high liquidity ratio was maintained in 1964; during the January–April period, when most of the seasonal accumulation of foreign exchange reserves takes place, the ratio was even raised further by the Bank of Israel. Besides the existing formal liquidity ratio of 69 percent, the banking institutions were required during these four months to increase by 20 percent the liquid cover on their incremental deposits subject to liquidity. The temporary increase in the liquidity ratio was rescinded as from May and it returned to its former level of 69 percent. The liquid assets released thereby were utilized, under a special agreement between the Government and the banks, for the purchase of Government bonds and not for the expansion of credit to the public.

In 1964 liquidity deficiencies assumed serious proportions, averaging 75 percent more than in the previous year. As a result, the Bank of Israel raised the fines levied on such deficiencies, as from February 1, 1965. The flat rate of 10 percent formerly in effect was superseded by progressive fines at rates rising from 10 percent (on deficits of up to 2 percent of deposits subject to liquidity) to 20.5 percent (on deficits of 9 percent or more).

As in previous years, the monetary expansion did not proceed at a uniform pace in 1964. The growth of the money supply occurred mainly during the first five months of the year, which accounted for some 92 percent of the total annual increase. As usual, the seasonal acceleration of foreign currency accumulation was the main cause of monetary expansion during these months. The outstanding balance of the Government Short-Term Loan and of bills traded through the intermediation of banks rose by IL 198 million all told during the first half of 1964, as against only IL 41 million during the second half. On the other hand, the public's less liquid deposits with banking institutions exhibited a contrary trend, expanding mainly during the last six months of the year.

These developments reflect the slower rate of monetary growth during the second half of 1964 and the changes that occurred in the demand for various liquid assets. Toward the end of 1964 there was a shift from nonlinked liquid assets yielding a relatively high rate of return to assets linked to the exchange rate. This development found expression in a decline in the outstanding balance of the Short-Term Loan and the slower expansion of the bill brokerage trade on the one hand, and on the other in an accelerated increase in Pazak and

¹ See section 5 of this chapter.

Tamam deposits and an advance in prices of dollar-linked debentures, of dollars from Natad accounts,¹ and of black market dollars and gold.

The reduced liquidity of the economy was reflected toward the end of the year by a rise in the rate of interest paid in the bill brokerage market—a development to be expected under such conditions. The decline in liquidity may also have been one of the factors in the slump of the stock market during the year reviewed.

The smaller conversion of current personal restitution transfers and existing Pazak and Tamam balances into local currency in 1964 led to a relatively big increase in the public's less liquid deposits with banking institutions as compared with 1963. Most of this growth stemmed from the expansion of Pazak and Tamam balances by IL 129 million during 1964—as against a rise of IL 99.3 million the year before—despite the somewhat smaller amount of personal restitution received during the year reviewed. This development moderated the expansion of the money supply. The increase in Pazak and Tamam deposits in 1964 far exceeded the growth of the banking system's foreign exchange reserves during the year, which came to only some IL 42 million. Thus there was actually a net conversion of means of payment into foreign currency for effecting payments abroad—a phenomenon typical of the second half of 1964 and which had a marked contractionary effect on the money supply.

2. THE MONEY SUPPLY

The increase in the money supply between the end of 1963 and the end of 1964 totalled IL 98.1 million, or only 6.1 percent, in contrast to 28.1 percent the year before. The average monthly growth came to only IL 8.2 million, as against IL 29.4 million in 1963, while the average annual volume was 13 percent greater. Demand deposits expanded by IL 32.8 million between the end of 1963 and the end of 1964, or by 3 percent only, while cash in circulation with the public went up by IL 65.3 million, or 12.4 percent. Accordingly, the proportion of cash within the money supply advanced from 32.6 percent at the end of 1963 to 34.6 percent at the end of the year reviewed. The relatively large increase in cash holdings of the public helped to prevent an expansion of the banking institutions' liquid assets (see Table XV-13).

The growth of the money supply did not proceed at a uniform rate. During the first five months of 1964 the increase was relatively rapid, averaging 1.1 per cent per month as compared with a monthly average of 0.5 percent for the whole of the year. This was due to the seasonal concentration of foreign

¹ Foreign securities dividend accounts. These are foreign currency deposits generated by sales of and receipt of dividends on foreign securities, and which may be utilized solely for the purchase of such securities. Local residents are permitted to buy foreign securities only by purchasing foreign currency from holders of Natad accounts.

Table XV-2
ANNUAL INCREASE IN THE MONEY SUPPLY, 1958-64
(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.	%
Cash						
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
1964	590.3	65.3	12.4	584.5	88.5	17.8
Demand deposits						
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
1964	1,117.1	32.8	3.0	1,098.2	105.3	10.6
Money supply						
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
1964	1,707.4	98.1	6.1	1,682.7	193.8	13.0

currency accumulation and conversion during the January-April period. In the second half of 1964 there was a decline in aggregate foreign currency balances, while Pazak and Tamam deposits expanded appreciably; as a result, the growth of the money supply slowed down to a marked extent. Some 92 per cent of the total annual increase in means of payment occurred during the first five months of the year, while the remaining seven months showed virtually no change.

Table XV-3

THE MONEY SUPPLY, BY MONTHS, 1964
(IL million)

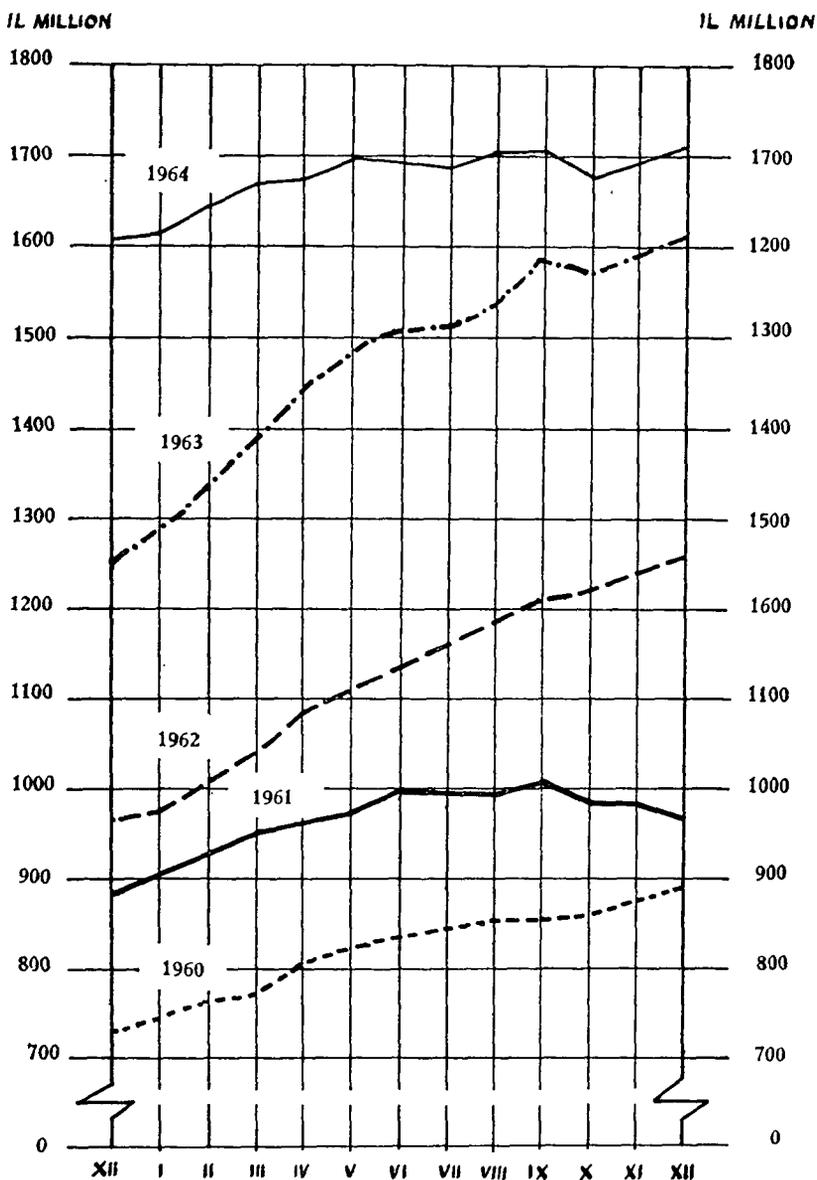
End of month	Cash			Demand deposits			Money supply		
	Total	Increase or decrease (-) from end of previous month		Total	Increase or decrease (-) from end of previous month		Total	Increase or decrease (-) from end of previous month	
		IL m.	%		IL m.	%		IL m.	%
1963 December	525.0	-10.3	-1.9	1,084.3	34.5	3.3	1,609.3	24.2	1.5
1964 January	537.2	12.2	2.3	1,080.5	-3.8	-0.4	1,617.7	8.4	0.5
February	555.0	17.8	3.3	1,100.2	19.7	1.8	1,655.2	37.5	2.3
March	583.6	28.6	5.2	1,089.9	-10.3	-0.9	1,673.5	18.3	1.1
April	578.1	-5.5	-0.9	1,102.0	12.1	1.1	1,680.1	6.6	0.4
May	580.6	2.5	0.4	1,118.8	16.8	1.5	1,699.4	19.3	1.1
June	583.0	2.4	0.4	1,109.1	-9.7	-0.9	1,692.1	-7.3	-0.4
July	593.1	10.1	1.7	1,096.1	-13.0	-1.2	1,689.2	-2.9	-0.1
August	598.2	5.1	0.9	1,105.4	9.3	0.8	1,703.6	14.4	0.9
September	606.6	8.4	1.4	1,100.0	-5.4	-0.5	1,706.6	3.0	0.2
October	601.5	-5.1	-0.8	1,076.0	-24.0	-2.2	1,677.5	-29.1	-1.7
November	606.6	5.1	0.8	1,083.7	7.7	0.7	1,690.3	12.8	0.8
December	590.3	-16.3	-2.7	1,117.1	33.4	3.1	1,707.4	17.1	1.0

The much slower expansion of the money supply in 1964 was chiefly reflected in the balance of checking accounts, which grew by only IL 14 million. The volume of deposits not drawable by check expanded to a greater extent, though far more slowly than in 1963. Following the considerable increase in the quantity of cash during the year reviewed, its share in the total money supply went up, averaging 34.7 percent as against 33.3 percent in 1963. This was in continuation of the trend which began in 1963, when the decline in the proportion of cash, characteristic of the preceding years, came to an end. However, it is still difficult to determine if we are witnessing a temporary change caused by special conditions or a new long-term trend.

A major factor in this development was the decreased volume of transactions on the Tel Aviv Stock Exchange during the second half of the year. These transactions are mostly financed from demand deposits, part of which are opened against special credits granted for this purpose. Such credit unquestionably

Diagram XV-1

THE MONEY SUPPLY, BY MONTHS, 1960-64



contracted in 1964, causing the liquidation of many demand deposits. Moreover, in an effort to cut their liquidity deficiencies, several banking institutions reduced their credit to the public by selling bills from their portfolios to owners of deposit accounts, thus bringing down the volume of deposits still further.

The circulation velocity of the money supply in relation to the national income

Table XV-4
PERCENTAGE OF CASH IN MONEY
SUPPLY, 1958-64

Annual average		
1958		38.7
1959		36.8
1960		35.0
1961		35.0
1962		33.7
1963		33.3
1964		34.7
End of month		
1964	January	33.2
	February	33.5
	March	34.9
	April	34.4
	May	34.2
	June	34.5
	July	35.1
	August	35.1
	September	35.5
	October	35.9
	November	35.9
	December	34.6

or to total resources available to the economy rose slightly in 1964, after having declined in the previous year (see Table XV-5). Relative to national income, the percentage of means of payment came to 23.3 percent in 1964 as against 23.9 percent in 1963, while relative to total resources it amounted to 15.3 and 15.9 percent respectively.

The velocity of demand deposits showed only a slight rise in 1964, after a more striking one in the two preceding years. One of the reasons for this was undoubtedly the decline in 1964 in the volume of transactions in financial assets and real estate, which apparently require the holding of relatively less money than transactions in final products from current output.

Table XV-5
INDICATORS OF THE CIRCULATION VELOCITY
OF THE MONEY SUPPLY, 1955-64

Year	Average annual circulation velocity of money supply relative to:		Average annual velocity of demand deposits ^c
	National income ^a	Total available resources ^b	
	(1)	(2)	
1955	4.35	6.76	19.6
1956	4.36	7.00	18.8
1957	4.30	6.57	18.8
1958	4.25	6.50	17.8
1959	4.30	6.47	17.7
1960	4.28 ^d	6.33 ^d	16.4
1961	4.29 ^d	6.53 ^d	16.2
1962	4.38	7.09 ^d	17.9
1963	4.18 ^d	6.28 ^d	18.9
1964	4.30 ^d	6.53 ^d	19.1

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

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

^c Total debits to local currency demand deposit accounts in banks divided by the average annual volume of such deposits. Deposits with cooperative credit societies are excluded.

^d Revised data.

3. LESS LIQUID DEPOSITS OF THE PUBLIC¹

The balance of less liquid deposits of the public in banking institutions grew more rapidly than in 1963—by IL 156 million, or 18.6 percent, as against IL 89 million, or 11.9 percent.

Nearly all of the increase during the year reviewed occurred in Pazak deposits (up IL 128 million) and approved saving scheme deposits (up IL 31 million); other time deposits continued to contract. Tamam balances remained virtually unchanged, after having decreased in 1963. At the end of 1964 Pazak and Tamam together constituted about 70 percent of the public's less liquid deposits.

¹ In contrast to previous Bank of Israel Annual Reports, deposits earmarked for loans which consist mainly of linked long-term deposits of provident funds and financial institutions) have been excluded from the deposits of the public. The assumption is that earmarked deposits are dissimilar to other liquid assets of the public, which affect the level of demand.

Table XV-6

LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS,
1958-64

(IL million)

End of period	Saving schemes	Time deposits	Deposits against liabilities	Total less-liquid deposits in local currency ^a	Deposits linked to the exchange rate (Pazak)	Tamam foreign currency deposits	Other foreign currency deposits	Grand total ^a
1958	52.8	75.4	11.1	139.3	14.9	16.3	27.4	197.9
1959	59.7	78.8	9.9	148.4	34.3	39.6	55.7	278.0
1960	71.4	98.2	7.8	177.4	52.4	72.1	66.9	368.8
1961	85.4	86.0	10.3	181.7	95.1	107.6	81.6	466.0
1962	104.3	67.6	16.7	188.6	250.1 ^b	226.6 ^c	84.7 ^d	750.0
1963	124.3	54.2	30.7	209.2	349.4	213.1	67.4	839.1
1964	155.5	43.7	32.8	232.0	476.9	214.9	71.2	995.0
1964 January	126.2	52.8	31.6	210.6	359.5	210.9	67.5	848.5
February	127.1	52.0	37.0	216.1	368.9	208.2	62.4	855.6
March	128.4	51.1	33.9	213.4	380.2	207.1	56.5	857.2
April	129.8	49.5	30.8	210.1	392.1	206.3	53.4	861.9
May	131.9	48.6	34.1	214.6	399.6	206.1	49.9	870.2
June	134.8	48.6	34.4	217.8	407.7	204.5	49.4	879.4
July	138.4	46.3	32.7	217.4	418.4	201.4	50.6	887.8
August	141.2	45.5	30.7	217.4	426.2	200.3	53.4	897.3
September	143.4	45.6	31.3	220.3	434.1	202.0	58.4	914.8
October	146.4	44.1	32.3	222.8	449.9	205.5	48.0	926.2
November	149.6	43.6	32.3	225.5	464.2	209.5	60.9	960.1
December	155.5	43.7	32.8	232.0	476.9	214.9	71.2	995.0

^a Revised figures. Net of deposits of the public earmarked for loans; most of these belong to provident funds and financial institutions.

^b An increase of IL 65.8 million was due to the revaluation of these deposits on devaluation day.

^c An increase of IL 74.3 million was due to the revaluation of these deposits on devaluation day.

^d An increase of IL 58.4 million was due to the revaluation of these deposits on devaluation day.

Though the volume of personal restitution payments from Germany was similar in 1963 and 1964, totalling \$ 139 million and \$ 134 million respectively, Pazak and Tamam balances grew by \$ 43 million during the year reviewed, compared with only \$ 29 million the previous year. The boom in the real estate and share markets in 1963 undoubtedly stimulated the conversion of Pazak and Tamam funds into local currency. On the other hand, the depressed state of these markets in 1964 and the growing demand for foreign currency assets during the last months of the year explain the relatively big increase in these balances despite the slight decline in personal restitution payments.

(a) *Pazak deposits*

Pazak balances continued to mount rapidly in 1964, going up by IL 127.5 million (\$ 42.5 million), as against IL 99.3 million (\$ 33.1 million) in 1963. The diminishing over the past two years of the advantages enjoyed by holders of Tamam deposits over those owning Pazak accounts, as well as the cutting of the interest rate on the former in February 1963, induced a switch from Tamam to Pazak. In addition, the growing demand for assets linked to foreign currency toward the end of 1964 resulted in a smaller conversion of personal restitution monies while accelerating the growth of Pazak deposits. At the end of 1964 the outstanding balance of Pazak accounts stood at IL 476.9 million (\$ 159 million).

(b) *Tamam deposits*

The reduction of the number of uses to which foreign currency held in Tamam accounts could be put¹ and the enlargement of the foreign currency allocations for foreign travel after the devaluation of 1962 decreased the advantages of holding Tamam as opposed to Pazak accounts. The cutting of the interest rate on Tamam deposits from 7 to 4.5 percent in February 1963² led to a transfer of funds from these accounts to Pazak and to foreign securities yielding a higher return.

In June 1963 the balance of Tamam deposits began to contract, and it continued downward until August 1964; the decline over this period totalled IL 35 million. Toward the end of 1964 the uptrend reasserted itself. The turning point came with the accentuation of the public's demand for foreign currency assets, which drove up the rate of exchange Tamam owners could receive for their foreign currency. The latter supplied the demand of other Israeli residents wishing to purchase foreign securities, as well as the demand of owners of blocked accounts wanting to transfer their money abroad. These developments increased the local currency return on Tamam deposits by some 5 percent over and above the official exchange rate of IL 3/\$ 1, and conferred a new advantage on Tamam owners which they had not previously enjoyed. With the improvement in the relative profitability of Tamam deposits, recipients of personal restitution increased their investment in such accounts. Tamam balances rose by IL 14.6 million during the last four months of 1964, after having shrunk by IL 12.8 million during January-August. Altogether, they expanded by IL 1.8 million in 1964, as compared with a decline of IL 13.5 million in 1963. The outstanding balance at the end of December 1964 totalled IL 214.9 million, or some \$ 72 million.

¹ Foreign currency may now be withdrawn from Tamam accounts only for foreign travel, the purchase of foreign securities, and for legal expenses abroad in connection with restitution claims.

² On deposits for 12 months. Interest on deposits for shorter periods was also reduced.

(c) *Deposits in approved saving schemes*

Banking institutions stepped up their efforts in 1964 to raise funds through saving schemes, which the existing regulations permit to be wholly utilized for investment and credit. As a result, the uptrend in such deposits picked up momentum. The outstanding balance rose by IL 31 million during the year reviewed, compared with IL 20 million in 1963, to reach IL 155.5 million. The accumulation proceeded particularly fast during the second half of the year, when the increase totalled IL 20 million, in contrast to IL 11 million in the first half.

The rapid accumulation in saving accounts was largely connected with the improved terms offered savers and the greater variety of schemes, especially in the second half of the year. Whereas in 1963 there were scarcely any new schemes, six additional ones were introduced after April 1964. The prolonged depression in the securities market may also have caused the diversion of funds to saving schemes.

What distinguishes the new saving schemes is that the saver has the right to choose, upon termination of the period of the deposit, between a high rate of interest without linkage of the principal and a lower rate of interest with the principal linked to the consumer price index. The usual term of the deposits is five years, and the interest received by the saver at the end of this period, if he has decided to waive his right to linkage, reaches 9 percent net per annum. If the saver decides to link his deposit to the consumer price index, the interest is only 4 percent net per annum. The link can be applied only from the third year, while the principal is wholly linked only if the deposit is kept for five years. Persons holding accounts under the older saving schemes have been granted the right to switch to the new schemes.

The accumulation in new saving schemes during the year reviewed amounted to IL 33 million, consisting partly of monies transferred from older schemes and partly of deposits by new savers. The old schemes contracted by IL 14 million. Saving schemes for children, youth, secondary education, and car purchases expanded by IL 12 million altogether. Most of the savings are deposited with the three big banks, which account for some 95 percent of the total. The balance of the saving schemes at the end of 1964 breaks down as follows: new schemes—IL 33 million; ordinary nonlinked schemes—IL 58 million; linked schemes—IL 18 million; children's saving schemes—IL 33 million; saving for secondary education—IL 11 million; saving for vehicle purchases—IL 3 million.

(d) *Time deposits*

The balance of local currency time deposits declined by IL 10.5 million in 1964, following a drop of IL 13.4 million in 1963. The Government Short-Term Loan and the bill brokerage trade have been competing successfully

with these deposits, which are not linked and yield a relatively low return, Their outstanding balance at the end of 1964 was down to IL 43.7 million, or only 4.4 percent of all less liquid deposits at banking institutions. A few years ago the weight of time deposits was appreciably greater; at the end of 1960, they totalled IL 98 million, or 26.6 percent of the public's less liquid deposits.

(e) *Deposits against liabilities in foreign currency*

These deposits showed a slight decrease of IL 2 million, following a steep decline of IL 26 million in 1963. With the change in import financing procedures—the payment of cash against documents or, in the case of letters of credit, upon presentation of the documents—purchases of foreign currency prior to the execution of import transactions were done away with, and the balance of deposits against foreign currency liabilities contracted from IL 74 million at the end of February 1962 to IL 6.6 million at the end of December 1964.

(f) *Deposits against liabilities in Israeli currency*

These deposits, most of which are made by importers upon opening letters of credit, went up to the small extent of IL 2 million, after an increase of IL 14 million in 1963. The deceleration of the growth rate, despite the steep rise in the volume of imports, can be ascribed to the concessions granted importers, who under the regulations must deposit up to 50 percent of the value of their orders in Israeli currency when opening letters of credit, as well as to the introduction of import financing methods which do not involve the opening of letters of credit. The balance of deposits against liabilities in Israeli currency reached IL 33 million at the end of December 1964.

(g) *Other foreign currency deposits*

There was little change in the balance of these deposits during 1964.

4. SOURCES OF THE INCREASE IN FINANCIAL ASSETS

The increase in the money supply and less liquid deposits of the public totalled IL 254 million, or 10.4 percent, in 1964, compared with IL 442 million, or 22 percent, in 1963.

The lower growth rate was chiefly due to the much slower accumulation of foreign exchange reserves, which in the last few years has been the main cause of expansion—in 1964 the reserves rose by only IL 42 million. On the other hand, there was a much larger increase in bank credit to the public (IL 148 million) and to the Government (IL 95 million). The influence of these sources on the growth of the money supply and less liquid deposits was offset to the

extent of IL 32 million by the item "other factors, net",¹ which consists mainly of the difference between the increase in equity capital and investment in securities and real estate.²

Some striking changes occurred in the relative importance of the various sources of monetary expansion during the year reviewed. The accumulation of foreign currency was the major growth factor during the first four months, while the decline in the Government's debt to the banking system had a contractionary effect during that period. Between June and the end of November, the net amount of foreign currency assets decreased. However, in April the Government's net debt to the banking system began to rise, and it continued upward almost uninterruptedly until the end of the year. The increase in bank credit to the public proceeded throughout most of the year.

(a) *Accumulation of foreign currency assets*³

As a result of the marked rise of the adverse balance on Israel's goods and service transactions in 1964, the net increase in foreign currency assets at the disposal of the banking system came to only IL 42 million (\$ 14 million), despite the fact that capital imports were somewhat larger than in 1963. This foreign currency accumulation was the lowest in recent years. The net average annual increase in foreign currency assets during the period 1959-63 totalled approximately \$ 82 million. At the end of 1964 the gross balance of such assets came to IL 2,101 million (\$ 700 million). Of this, IL 1,712 million (\$ 571 million) was held by the Bank of Israel, and IL 389 million (\$ 129 million) by the banking institutions. The banking system's foreign liabilities amounted to IL 570 million (\$ 190 million)⁴ at the end of 1964, so that the net total of foreign currency assets was IL 1,531 million (\$ 510 million).

The foreign liabilities item consists mainly of nonresidents' deposits in Israeli banks (Patach). These expanded by IL 47 million (about \$ 16 million) during the year reviewed, their outstanding balance reaching IL 378.6 million (about \$ 126 million) at the end of December. The banking institutions must deposit 15 percent of such monies with the Bank of Israel, but may use the balance for granting credit to nonresidents, as well as to local residents under specific permits from the Controller of Foreign Exchange and the Bank of Israel. The remaining foreign liabilities consist predominantly of credit from foreign banks.

¹ See Table XV-1.

² The increase in paid-up capital and reserves totalled IL 59 million in 1964. Besides capital accounts and investments, "other factors, net" include a number of small miscellaneous items.

³ Foreign currency assets are here defined as claims of the Israeli banking system on foreign borrowers. Foreign currency credits to Israeli residents are not included with foreign currency assets, while local residents' foreign currency deposits are not included with foreign liabilities.

⁴ Inclusive of nonresidents' deposits (Patach).

Table XV-7

FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM
1958-64

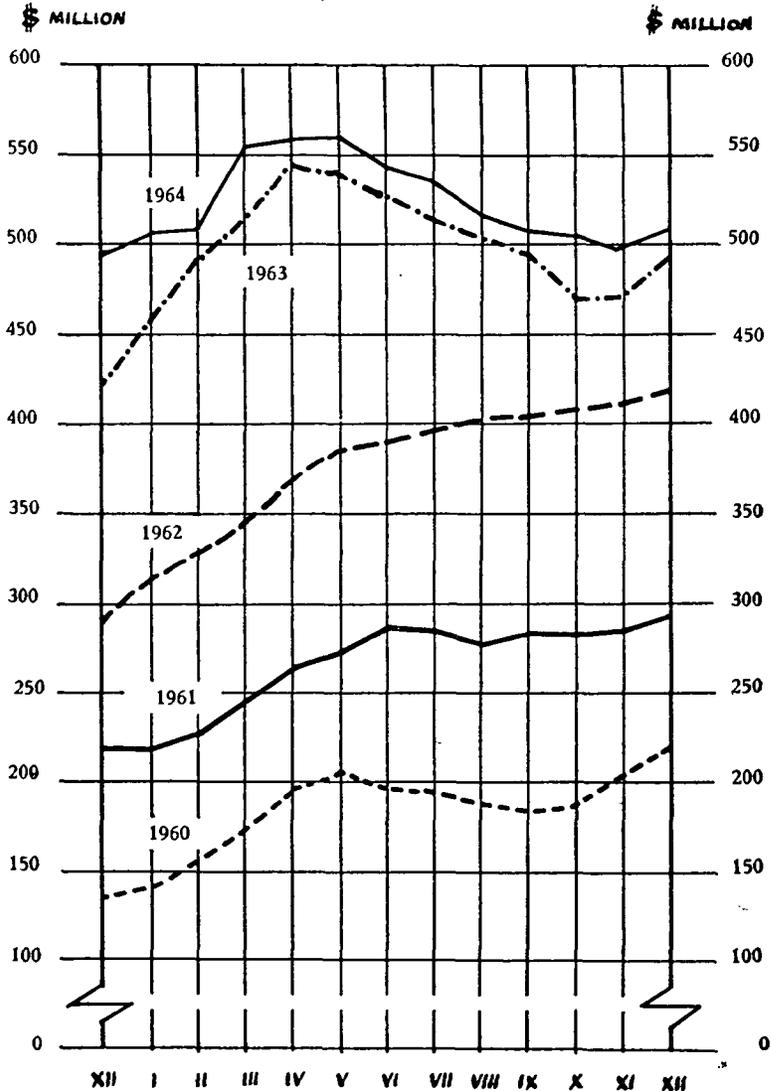
(IL million)

End of period	Total assets	Less:		Net assets (1)-(2)-(3)
		Deposits of nonresidents	Other foreign liabilities ^a	
	(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 ^b
1963	1,955.7	332.0	135.0	1,488.7
1964	2,101.2	378.6	191.7	1,530.9
1964 January	1,978.3	330.0	123.8	1,524.5
February	1,991.0	335.2	118.8	1,537.0
March	2,129.6	344.6	115.4	1,669.6
April	2,175.8	355.4	118.1	1,702.3
May	2,208.2	370.7	133.0	1,704.5
June	2,149.3	365.9	139.8	1,643.6
July	2,146.4	374.5	145.5	1,626.4
August	2,085.9	380.5	142.1	1,563.3
September	2,089.1	374.5	161.0	1,553.6
October	2,128.6	370.0	221.4	1,537.2
November	2,111.4	366.1	225.6	1,519.7
December	2,101.2	378.6	191.7	1,530.9

^a Mainly loans from foreign banks and balances held for foreign banks.^b An increase of IL 377.3 million was due to the revaluation of foreign currency balances following the alteration of the exchange rate in February 1962.

Diagram XV-2

FOREIGN EXCHANGE RESERVES, BY MONTHS, 1960-64



During the year surveyed such credit was expanded by IL 57 million (\$ 19 million), owing mainly to the greater amount provided for financing imports of raw diamonds, stocks of which were considerably enlarged in 1964.

The seasonal pattern of foreign currency accumulation in 1964 was similar to that of previous years (see Diagram XV-2). During the months January-May net foreign currency assets increased by \$ 72 million, while between June and

November there was a decline of \$ 62 million, and in December a rise of some \$ 4 million.

(b) *Credit to the Government*

The financial transactions of the Government with the banking system had an expansionary monetary effect in 1964. In the course of the year the net debt of the Government to the banking system rose by IL 95.4 million.¹

The Government debt exhibited diverse movements during the year. From January to April it contracted by IL 127 million, as compared with a decrease of IL 172 million during the same months of 1963. This decline, which was mainly due to the seasonal excess of receipts over payments in the last quarter of the fiscal year, offset much of the expansionary influence of foreign currency accumulation during these months.

On the other hand, the debt mounted rapidly and continuously from May to December. During this period the increase totalled IL 222 million, as against IL 142 million during the corresponding months of 1963. The comparison with 1963 shows a particularly striking rise in the last two months of 1964—IL 102 million as against a decrease of IL 15 million during the same months of the previous year.

The growth of the debt in the latter part of 1964 is largely ascribable to the marked decline in sales of the Government Short-Term Loan, in contrast to the budgetary estimates. In fact, during the last four months of the year the outstanding balance of this loan fell by IL 36 million, compared with an increase of IL 45 million during the corresponding months of 1963. This was the main cause of the Government's cash deficit during this period.

If we deduct IL 21.5 million in purchases of Government bills by the Bank of Israel from banking institutions,² we find that the IL 95 million rise in the Government's net debt to the banking system actually consisted of a IL 64 million increase in the amount owed to the Bank of Israel³ and one of IL 31 million in liabilities to the banking institutions. The latter sum includes approximately IL 9 million in purchases from the special series of the Government Short-Term Loan, under the agreement between the Government and the banks for the grant of a IL 50 million credit to the Government from funds subject to the ordinary liquidity requirements.

¹ This figure is after deducting IL 38 million in partial repayment of an advance received by the Government from the Bank of Israel in 1963 for the early redemption of foreign debts. If we discount this advance, which is being repaid to the Bank of Israel instead of abroad, the net increase in the debt to the banking system becomes IL 133.4 million. See the Bank of Israel Annual Report for 1963, p. 316.

² These bills had previously been sold to the banking institutions from the Bank of Israel portfolio, within the framework of the unutilized balance of the 22 percent of controlled credit not subject to the liquidity requirements.

³ Mainly due to the reduction of Government deposits with the Bank of Israel.

Table XV-8

THE GOVERNMENT'S DEBT TO THE BANKING SYSTEM, 1958-64
(IL million)

End of 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 ^a	16.2 ^b	60.8	31.5 ^c	45.5	14.4
1963	-155.9	221.6	22.3	43.5	44.6 ^d	64.2	19.2	89.6	133.1
1964	-90.4	241.1	21.1	129.6	30.0	83.0	14.1	98.9	228.5
1964 January	-186.9	209.1	23.0	-0.8	60.6	71.5	19.1	113.0	112.2
February	-154.4	202.1	24.3	23.4	70.4	69.7	19.7	120.4	143.8
March	-284.5	205.1	26.9	-106.3	70.5	69.9	18.9	121.5	15.2
April	-280.6	192.0	29.9	-118.5	75.8	69.9	20.7	125.0	6.5
May	-251.8	168.4	31.4	-114.8	88.2	69.7	19.6	138.3	23.5
June	-231.9	187.7	31.4	-75.6	75.0	72.6	14.5	133.1	57.5
July	-233.2	200.8	34.2	-66.6	62.8	75.5	13.8	124.5	57.9
August	-177.7	206.8	34.5	-5.4	56.8	79.9	14.3	122.4	117.0
September	-168.5	216.6	42.1	6.0	47.8	76.4	14.6	109.6	115.6
October	-160.7	220.5	40.2	19.6	44.5	76.1	13.6	107.0	126.6
November	-106.6	241.1	44.3	90.2	24.2	75.6	13.0	86.8	177.0
December	-90.4	241.1	21.1	129.6	30.0	83.0	14.1	98.9	228.5

^a Including a decrease of IL 229 million due to revaluation according to new exchange rate.

^b Including an increase of IL 1.5 million due to revaluation according to new exchange rate.

^c Including IL 7.0 million in linkage increments.

^d Including IL 21.5 million worth of Government bills purchased from the Bank of Israel in 1963.

(c) *Bank credit to the public*

1. *The expansion of credit:* Ordinary bank credit to the public rose by IL 148.2 million, or 15.7 percent, in 1964, as against IL 155.3 million, or 19.7 percent, the previous year. These figures do not include credit from deposits earmarked for loans, which consist mainly of monies belonging to provident funds and various financial institutions, as this type of credit is normally given for longer periods than ordinary bank credit¹ and does not involve an expansion of the money supply. The increase in the volume of credit from deposits earmarked for loans totalled IL 72.3 million in 1964, as against IL 37.2 million in 1963.

¹ This credit was for the most part linked to the consumer price index.

Table XV-9

CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1958-64^a
(IL million)

End of period	From Bank of Israel	From banking institutions	Total bank credit	From deposits of the public earmarked for loans ^b	Against Govt. deposits	From Govt. deposits earmarked for loans	Balance of bill brokerage trade ^c
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1958	27.6	341.0	368.6	38.1	64.7	101.0	—
1959	31.7	397.1	428.8	74.8	67.4	116.2	—
1960	52.0	470.5	522.5	109.5	65.4	118.1	—
1961	56.4	561.6	618.0	169.6	53.5	177.1	—
1962 ^d	71.9	715.4	787.3	235.5	84.9	258.2	263.0
1963	85.6	857.0	942.6	272.7	45.4	314.1	434.0
1964	115.6	975.2	1,090.8	345.0	46.4	335.3	613.0
1964 January	81.2	871.1	952.3	273.9	44.9	313.0	459.3
February	89.5	862.9	952.4	279.2	47.8	311.6	471.4
March	96.6	907.1	1,003.7	287.7	50.1	310.5	487.4
April	93.3	877.9	971.2	295.0	52.9	309.2	513.9
May	100.6	898.3	998.9	298.4	48.9	311.5	544.1
June	108.6	935.0	1,043.6	301.1	48.0	326.5	556.0
July	114.5	939.2	1,053.7	305.3	45.9	323.1	567.3
August	118.6	953.6	1,072.2	310.3	42.1	329.2	579.9
September	123.7	994.8	1,118.5	316.1	40.4	328.2	576.5
October	127.6	981.4	1,109.0	326.0	38.6	329.1	599.6
November	114.2	987.8	1,102.0	331.0	43.5	330.6	605.5
December	115.6	975.2	1,090.8	345.0	46.4	335.3	613.0

^a Excluding loans to foreign borrowers.

^b Mainly credit from deposits of provident funds and financial institutions.

^c Until 1963 bank-negotiated bill transactions were not recorded; the figure for the end of 1962 is therefore an estimate only.

^d Including devaluation and linkage increments.

Foreign currency credit to the public was expanded to about the same extent as in 1963. This type of credit is given by banking institutions from nonresidents' deposits and other foreign currency at their disposal against special permits and outside the ordinary liquidity framework. The incremental foreign currency credit granted to Israeli residents¹ totalled IL 36 million in 1964, compared with IL 38.6 million in 1963. The major part of such credit was for financing imports-for-export (in particular uncut diamonds, stocks of which were appreciably enlarged in 1964).

¹ Loans to foreign borrowers are included in this chapter with foreign currency assets at the disposal of the banking system.

Table XV-10.

INCREASE IN BANK CREDIT TO THE PUBLIC, 1961-64^a
(IL million)

	1961	1962 ^b	1963	1964
Bank of Israel rediscounts	4.4	-1.1	12.3	30.5
Bank credit				
In local currency				
From the 22% exempt from liquidity	15.8	24.2	8.5	32.9
Other	61.4	80.1	95.9	48.8
Total	77.2	104.3	104.4	81.7
In foreign currency	13.9	-3.3	38.6	36.0
Total bank credit	91.1	101.0	143.0	117.7
Total credit from the banking system	95.5	99.9	155.3	148.2
Credit from and against Government deposits	47.1	97.8	16.4	22.2
Credit from deposits of the public earmarked for loans	60.1	39.8	37.2	72.3
Total credit through the banking system	202.7	237.5	208.9	242.7

^a In this table the effect of sales of bills by the Bank of Israel to banking institutions has been deducted.

^b Excluding revaluation and linkage increments.

The increase in ordinary local currency bank credit to the public thus totalled IL 112.2 million in 1964, as contrasted with IL 116.7 million the year before. Of the 1964 increment, about 60 percent (IL 68 million) was granted through the various export funds.¹

The proportion of credit directed by the Bank of Israel was especially high during the year reviewed. The volume of rediscounts expanded by IL 30.5 million, while controlled credit not subject to the liquidity requirements went up by IL 33 million, and uncontrolled local currency credit by IL 49 million.

The increase in Bank of Israel rediscounts actually reflects *in toto* the Bank's participation in the joint export funds, since the outstanding balance of re-

¹ Of this sum, IL 64 million was granted through the Industrial Export Fund and IL 4 million through the Agricultural Export Fund.

discounts for other purposes remained unchanged during the year reviewed.¹ In 1963 the balance of rediscounted bills rose by only IL 12 million—despite the bigger increase in the export funds and in the Bank of Israel's participation therein—as rediscounts for other purposes were reduced. Some two-thirds of the outstanding balance of rediscounts at the end of 1964 was earmarked for financing exports and imports-for-export.

Controlled credit granted by banking institutions outside the framework of the ordinary liquidity requirements was expanded by IL 33 million, as against only IL 8.5 million in 1963. Approximately half the increment of such credit in 1964 was extended through the Industrial Export Fund. Because of the relatively big rise in loans granted within the framework of the exemptions from the liquidity requirements on the one hand, and the slow increase in the balance of deposits requiring liquid cover on the other, the year reviewed witnessed a sharp drop in the unutilized portion of the 22 percent quota exempted from the liquidity regulations. The banking institutions were permitted to purchase bills from the Bank of Israel out of this unutilized balance. The return on such bills was higher than the interest paid by the Bank of Israel on banking institution deposits held with it.

Ordinary local currency credit to the public not subject to Bank of Israel control was augmented by IL 49 million, of which some IL 19 million represented the banking institutions' participation in the Industrial Export Fund (30 percent of the total). This credit growth took place despite the nonincrease in the banking institutions' liquid assets, and was partly made possible by the utilization of the excess liquid assets at the disposal of some banking institutions as a result of increases in their equity capital. The equity capital of these institutions went up by IL 59 million during 1964, enabling them to considerably enlarge their investments in subsidiary companies and real estate and to increase somewhat their volume of lending to the public.² In addition, part of the credit increment stemmed from the IL 15 million rise in liquidity deficiencies. In consequence of these developments and the nonincrease in liquid assets available to the banking institutions, the effective liquidity ratio dropped slightly during 1964 (see section 5 below).

Besides the expansion of bank credit to the public, the volume of credit granted through the intermediation of banks continued upward in 1964. The outstanding balance of bank-negotiated bills rose from IL 434 million at the end of 1963 to IL 613 million at the end of 1964—an advance of IL 179 million, following one of IL 170 million in 1963. This type of credit, however,

¹ The weight of Bank of Israel rediscounts in the balance of Industrial Export Fund credits actually came to 32 percent in 1964, instead of the 20 percent fixed as its quota. The remainder covered the deficit in the Government's participation in the Fund.

² The paid-up capital of these banks increased by IL 35 million, and their reserves by IL 24 million (there are no data on the increase in undisclosed reserves). Their investment in subsidiary companies rose by IL 20 million, and that in real estate by IL 22 million.

Table XV-11

**OUTSTANDING CREDIT TO THE PUBLIC, BY SOURCE AND DESTINATION,
DECEMBER 31, 1964^a**

Destination	Controlled by the Bank of Israel ^b	Not controlled by the Bank of Israel	Total (1) + (2)	Credit against Govt. deposits	Total (3) + (4)
	(1)	(2)	(3)	(4)	(5)
IL million					
Agriculture	101.3	93.9	195.2	1.5	196.7
Industry	216.0	390.1	606.1	30.1	636.2
Construction	6.9	72.5	79.4	4.9	84.3
Commerce	20.6	97.8	118.4	3.2	121.6
Public services	8.8	10.3	19.1	0.1	19.2
Local authorities	3.2	61.1	64.3	0.1	64.4
Credit and financial institutions	0.5	45.3	45.8	—	45.8
National Institutions	27.7	5.9	33.6	—	33.6
Business services	16.2	65.6	81.8	1.6	83.4
Private individuals	—	137.1	137.1	1.9	139.0
Miscellaneous ^c	4.0	51.0	55.0	3.0	58.0
Total	405.2	1,030.6	1,435.8	46.4	1,482.2
Percentages					
Agriculture	25.0	9.1	13.6	3.2	13.3
Industry	53.3	37.9	42.2	64.9	42.9
Construction	1.7	7.0	5.5	10.6	5.7
Commerce	5.1	9.5	8.2	6.9	8.2
Public services	2.2	1.0	1.3	0.2	1.3
Local authorities	0.8	5.9	4.5	0.2	4.3
Credit and financial institutions	0.1	4.4	3.2	—	3.1
National Institutions	6.8	0.6	2.3	—	2.3
Business services	4.0	6.4	5.7	3.4	5.6
Private individuals	—	13.3	9.6	4.1	9.4
Miscellaneous ^c	1.0	4.9	3.9	6.5	3.9
Total	100.0	100.0	100.0	100.0	100.0

^a Including credit from deposits of the public earmarked for loans, which cannot be classified by sector on the basis of existing data.

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

^c Including credit to artisans.

did not expand at a uniform rate throughout the year reviewed. In the first half the average monthly increase amounted to approximately IL 20 million, while during the last six months, when the decline in the economy's liquidity began to make itself felt and the interest rate in the bill market went up, the average monthly growth in the volume of transactions slowed down to some IL 9 million. Toward the end of the year a number of banks sold bills from their own portfolios to lenders in this market, with the object of reducing their liquidity deficiencies which were exceptionally large during these months. This operation was recorded as a decrease in ordinary bank credit and an increase in bank-negotiated bill credit.

The rising weight of the three big banks in the bill brokerage trade (these banks normally guarantee all such transactions), together with the growing tendency to regard the banking institutions as guaranteeing the lenders' money granted through their intermediation even when no formal guarantee is involved, brought up the proportion of credit formally guaranteed by the banks from 61.3 percent of the balance of bill transactions at the end of 1963 to 75.8 percent at the end of 1964. There was actually an absolute decrease in the outstanding balance of unguaranteed credit, all the additional credit being granted on a guaranteed basis. In March 1965 new Bank of Israel regulations went into effect, under which the volume of financial guarantees banking institutions are permitted to grant is limited to three times the value of their equity capital or 150 percent of their liquid assets, whichever is lower.

During 1964 there was a relatively big expansion of credit extended by banks from earmarked deposits of the Government and public. Such credit differs from ordinary bank credit in that it is usually long-term, is linked to the consumer price index, and does not involve an increase in the money supply. Credit from earmarked deposits, belonging mainly to provident funds and various financial institutions,¹ rose by IL 72 million, as already indicated, while credit from Government deposits went up by some IL 21 million. The latter type of credit, which is also long-term, is granted through the Government's development budget. Some of the increment does not constitute new credit, but the transfer of existing liabilities to banking institutions. Credit against Government deposits showed virtually no change in 1964. The reference here is primarily to various tax debts owed the Government, the collection of which has been transferred, by agreement, to banking institutions in return for the creation of a special Government deposit. The Government may draw upon this deposit on agreed dates, which normally correspond to the maturity dates of the tax debts.

2. *The destination of credit:* The data on the sectorial distribution of credit

¹ Including credit from financial institution deposits earmarked for consortial loans through the banking institutions.

Table XV-12

**DISTRIBUTION OF OUTSTANDING BANK CREDIT TO THE PUBLIC,
BY SECTOR OF DESTINATION, 1958-64^a**

(End of period)

Sector	1958	1959	1960	1961	1962 ^b	1963	1964
IL million							
Agriculture	114.4	129.7	143.4	157.4	176.6	170.2	196.7
Industry	130.5	163.6	214.4	264.4	392.5	517.5	636.2
Construction	28.2	36.9	42.6	52.1	62.5	75.0	84.3
Commerce	54.0	68.1	77.1	82.2	114.1	117.8	121.6
Public services	21.4	24.4	33.9	31.8	38.5	30.1	19.2
Local authorities	7.0	7.7	10.3	32.7	58.5	59.4	64.4
Credit and financial institutions	7.5	13.9	14.3	21.9	27.5	28.7	45.8
National Institutions	14.8	17.6	29.0	34.7	38.4	26.2	33.6
Business services	25.9	29.4	36.2	44.7	47.2	57.6	83.4
Miscellaneous ^c	66.7	78.6	97.0	119.5	152.1	180.3	197.0
Total	470.4	569.9	698.4	841.4	1,107.9	1,262.8	1,482.2
Percentages							
Agriculture	24.3	22.7	20.5	18.7	15.9	13.5	13.3
Industry	27.8	28.7	30.7	31.4	35.4	41.0	42.9
Construction	6.0	6.5	6.1	6.2	5.6	5.9	5.7
Commerce	11.5	11.9	11.4	9.8	10.3	9.3	8.2
Public services	4.5	4.4	4.7	3.8	3.5	2.4	1.3
Local authorities	1.5	1.3	1.5	3.9	5.3	4.7	4.3
Credit and financial institutions	1.6	2.4	2.0	2.6	2.5	2.3	3.1
National Institutions	3.1	3.1	4.2	4.1	3.5	2.1	2.3
Business services	5.5	5.2	5.2	5.3	4.3	4.6	5.6
Miscellaneous ^c	14.2	13.8	13.8	14.2	13.7	14.2	13.3
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

^a Including credit against Government deposits for payment of tax debts and credit from deposits of the public earmarked for loans.

^b Including IL 61.2 million in devaluation increments and IL 34.3 million in linkage increments. Most of the devaluation increments were in credit to industry, public services, and the National Institutions, while most of the linkage increments were in credit to industry and local authorities.

^c Including credit to private individuals.

include loans from earmarked deposits of the public;¹ the outstanding balance of such loans reached IL 345 million at the end of 1964, following a rise of IL 72 million during the year. Of the total credit increment of IL 219 million, industry received approximately IL 119 million, or about 54 percent. The proportion of credit channelled to this sector continued to rise, reaching 43 percent of the total at the end of 1964, compared with 41 percent at the end of 1963. The weight of agriculture within the total remained unchanged, after having declined steadily for several years. This sector received some IL 27 million in additional credit, the rate of increase here corresponding to that in aggregate credit.

The relative share of industry in the total increment of bank credit granted under Bank of Israel control² was exceptionally large—approximately 90 percent, in contrast to 20 percent in agriculture and a decrease in the other sectors taken together. The amount of such credit extended to the public services sector fell off appreciably, though credit to the business services sector was expanded.

The relatively big increase in the amount of credit channelled to industry was largely due to the continued rapid growth of the Industrial Export Fund during the year reviewed.³ The outstanding balance of this Fund rose from IL 145 million at the end of 1963 to IL 209 million at the end of 1964, i.e. by IL 64 million. Industrial exports were also financed by over IL 10 million worth of foreign currency bank credits.⁴ Most of the incremental bank credit for financing industrial exports went to the diamond branch.

In addition to the Industrial Export Fund, a separate fund was established in February 1964 to finance agricultural exports. Set up by the Bank of Israel in cooperation with the Treasury, the Ministry of Agriculture, and the banking institutions, it operates along the same lines as that for the industrial sector. It provides credit to finance shipments of agricultural exports other than citrus. As regards citrus and the production of certain other exportable farm commodities, special financing arrangements exist within the framework of controlled credit exempted from the liquidity requirements and in other forms. Between February 1964 and the end of the year, the amount of credit granted by the Agricultural Export Fund totalled approximately IL 4 million.

¹ The present method of reporting does not permit a differentiation between credit granted from deposits earmarked for loans, classified according to the sector of destination, and total credit.

² Through rediscounts, exemptions from liquidity requirements, and controlled credit from saving scheme funds.

³ The structure of this fund is explained in the Bank of Israel Annual Report for 1963, p. 323.

⁴ Apart from these amounts, industry received credit from foreign suppliers and loans from lines of foreign credit. While these were used to finance exports, they do not come under the category of bank credit.

5. THE LIQUIDITY OF BANKING INSTITUTIONS

In the course of 1964 the effective liquidity ratio of banking institutions declined, after having risen for several consecutive years. The decrease was from 46.6 percent at the end of December 1963 to 45.4 percent at the end of December 1964. However, the average monthly liquidity ratio went up from 42.4 percent in 1963 to 43.2 percent in 1964, reflecting the considerable increase in the liquidity ratio during the second half of 1963.

Following the swelling of the banking institutions' liquid assets by IL 174 million during 1963 and of deposits subject to liquidity requirements by IL 233 million, both items remained virtually stationary in 1964, the former even dropping by IL 2 million. Moreover, the banking institutions pared IL 21 million from the balance of bills purchased from the Bank of Israel with the unutilized portion of funds not requiring liquid cover. The volume of deposits subject to the ordinary liquidity requirements went up by only IL 25 million during the year reviewed.

The termination of the uptrend in the banking institutions' liquid assets in 1964 was due to the sharp contraction of foreign currency accumulation by the Bank of Israel, the expansion of Pazak deposits with the Bank of Israel (which are not considered liquid assets), and the relatively big increase in the amount of cash held by the public, which together offset the expansionary effect of the rise in Bank of Israel credit to the Government and the public.

Foreign exchange reserves at the Bank of Israel were augmented by IL 85 million, but on the other hand there was a big rise of IL 139 million in the banking institutions' foreign currency deposits with the Bank, especially Pazak deposits. This offset—though not completely—the expansionary effect of foreign currency accumulation and the additional credit granted by the Bank of Israel to the public and the Government which together totalled IL 120 million. Furthermore, there was a relatively large growth of some IL 65 million in the quantity of cash in circulation with the public, which also acted to reduce the liquidity of the banking institutions. These cash withdrawals more than offset the aforementioned expansionary factors, with the result that the amount of liquid assets decreased by IL 2 million (see Table XV-13).

In line with the seasonal pattern of previous years, the accumulation of foreign currency had an expansionary effect during the first four months of 1964. In order to prevent an overrapid expansion of the money supply during these months, the liquidity ratio was raised at the beginning of the year reviewed and remained at its new level for the first four months only. During this period banking institutions were obligated to maintain an additional 20 percent liquid cover on the incremental deposits subject to the liquidity requirements, so that the formal liquidity ratio went up to 89 percent. The contractionary effect of the higher liquidity ratio was not felt to any great extent, since deposits rose by only IL 16 million during these months—chiefly because of the acceler-

Table XV-13

CHANGES IN THE LIQUID ASSETS OF BANKING INSTITUTIONS,^a BY SOURCE, 1958-64

(IL million)

End of period	Credit from the Bank of Israel		Net foreign currency at Bank of Israel	Net balances in transit between banking institutions	Total (1) + (2) + (3) + (4)	Cash held by the public ^c	Less:			Ordinary liquid assets in local currency (5)-(9)
	To the public, net ^b	To the Govt.					Net foreign currency balances of banking institutions at Bank of Israel	Liquid assets in local currency held against deposits requiring 90% or 100% liquidity ^d	Total deductions (6) + (7) + (8)	
	(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	43.5 ^a	1,543.5	0.3	1,666.6	525.1	575.0	34.5	1,134.6	532.0
1964	113.7	129.6	1,628.8	1.6	1,873.7	590.4	713.8	39.6	1,343.8	529.9
1964 January	68.7	-0.8	1,570.4	1.4	1,639.7	537.3	583.9	33.5	1,154.7	485.0
February	74.3	23.4	1,587.0	2.8	1,687.5	555.0	588.3	41.0	1,184.3	503.2
March	66.4	-106.3	1,737.3	1.5	1,698.9	583.6	604.9	35.8	1,224.3	474.6
April	82.7	-118.5	1,782.4	1.5	1,748.1	578.1	610.2	37.1	1,225.4	522.7
May	75.4	-144.8	1,797.3	2.2	1,760.1	580.7	620.5	39.6	1,240.8	519.3
June	88.3	-75.6	1,738.7	2.6	1,754.0	582.9	625.8	35.4	1,244.1	509.9
July	100.4	-66.6	1,720.1	0.5	1,754.4	593.2	630.8	33.8	1,257.8	496.6
August	106.3	-5.4	1,664.6	0.5	1,766.0	598.3	639.0	32.3	1,269.6	496.4
September	111.2	6.0	1,652.0	0.8	1,770.0	606.7	648.1	34.1	1,288.9	481.1
October	108.6	19.6	1,647.3	1.9	1,777.4	601.6	670.4	35.1	1,307.1	470.3
November	103.2	90.2	1,616.9	1.5	1,811.8	606.7	691.2	33.3	1,331.2	480.6
December	113.7	129.6	1,628.8	1.6	1,873.7	590.4	713.8	39.6	1,343.8	529.9

^a Net of liquid assets held against deposits requiring 90 percent or 100 percent cover.^b Net of deposits of financial institutions (including investment banks) with the Bank of Israel.^c Including cash at the Israel Bank of Agriculture.^d Excluding demand deposits held for banking institutions which are listed net in column (4)

Table XV-14

THE LIQUIDITY OF BANKING INSTITUTIONS IN LOCAL CURRENCY,^a
1958-64
(IL million)

End of period	Liquid balances at Bank of Israel	Cash held by banking institutions	Net balances in transit between banking institutions	Less: Liquid assets held against deposits requiring 90% or 100% cover ^b	Total ordinary liquid assets (1) + (2) + (3) - (4)	Deposits requiring ordinary liquid cover	Liquidity ratio
							(5) / (6) × 100 (6)
	(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
1964	541.6	26.3	1.6	39.6	529.9	1,167.0	45.4
1964 January	488.5	28.6	1.4	33.5	485.0	1,136.5	42.7
February	511.2	30.2	2.8	41.0	503.2	1,155.2	43.6
March	476.2	32.5	1.5	35.8	474.4	1,145.9	41.4
April	527.5	30.7	1.5	37.1	522.6	1,158.2	45.1
May	524.5	32.3	2.2	39.6	519.4	1,172.8	44.3
June	510.3	32.4	2.6	35.4	509.9	1,170.0	43.6
July	501.4	28.5	0.5	33.8	496.6	1,149.4	43.2
August	494.2	34.0	0.5	32.3	496.4	1,156.9	42.9
September	479.7	34.7	0.8	34.1	481.1	1,152.4	41.7
October	473.0	30.5	1.9	35.1	470.3	1,124.3	41.8
November	480.2	32.2	1.5	33.3	480.6	1,134.2	42.4
December	541.6	26.3	1.6	39.6	529.9	1,167.0	45.4

^a The figures in this table differ somewhat from those published by the Examiner of Banks for two reasons: first, they do not include the Israel Bank of Agriculture; and secondly, the liquid balances cited here are taken from the balance sheet of the Bank of Israel, whereas the data of the Examiner of Banks are according to the balance sheets of the banking institutions. Data on ordinary liquid assets, deposits against which ordinary liquid assets must be held, and the effective liquidity ratio are net of deposits requiring 90 percent or 100 percent liquid cover and of the liquid assets held against them.

^b Excluding demand deposits held for other banks, which are listed net in column(3).

ated withdrawal of cash by the public. In May the liquidity ratio was restored to its former level of 69 percent, but the liquid assets released thereby were not utilized for the expansion of credit to the public, being instead transferred to the Government as part of a IL 50 million credit for financing the State budget.

The "recognized deficiency" in liquid cover remained virtually unchanged

in 1964, since the institutions still having such deficiencies hardly enlarged their deposits. Deficits of this kind must be reduced by a certain percentage of the increase in deposits requiring liquid cover. The total "recognized deficiency" at the end of 1964 was IL 28 million. The unauthorized deficiency went up appreciably, from IL 18 million at the end of 1963 to IL 33 million at the end of 1964. The average weekly deficiency in 1964 came to approximately IL 30 million—75 percent more than in the previous year. The fine imposed on such deficits was raised in February 1965 in order to prevent their expansion.

6. DEVELOPMENT OF THE BANKING INSTITUTIONS

The growth of banking business slowed down somewhat in 1964. The consolidated balance sheet of the banking institutions rose by 17 percent during the year, compared with 20 percent in 1963. The deceleration was even more pronounced if the contingent accounts are disregarded—an increase of 14 as against 21 percent. This development can be attributed to the tight monetary policy and the slower growth of liquidity in the economy.

On the assets side of the balance sheet, ordinary credit to the public and credit from deposits earmarked for loans increased by about the same rate as in 1963. On the other hand, there was a striking deceleration in the growth of the "cash and balances at the Bank of Israel" item—IL 142 million as against IL 274 million in 1963. This was connected with the slower expansion of local currency deposits subject to the liquidity requirements. Most of the increase in this item occurred in Pazak balances, which are deposited in full at the Bank of Israel, and was also reflected in the growth of nonliquid deposits on the liabilities side of the balance sheet.

The decline in loans to the Government was due to the repurchase of Government bills by the Bank of Israel, and consequently does not reflect a real decrease in credit to the Government.

On the liabilities side, the most conspicuous feature was the small rise in demand deposits—IL 33 million as compared with IL 237 million in 1963. Equity capital continued to expand rapidly, though a little less so than in 1963 when the increase assumed exceptional proportions. Paid-up capital and open reserves went up in 1964 by IL 65 million, or 35 percent. The weight of this item in the balance sheet, inclusive of contingent accounts, continued upward, reaching 4.8 percent at the end of 1964 as against 4.2 percent at the end of 1963.¹

The 27 percent increase in contingent accounts was chiefly due to the large volume of guarantees given by banking institutions in connection with the bill brokerage trade.

¹ The weight of equity capital in the balance sheet, excluding the contingent accounts, went up from 5.7 percent at the end of 1963 to 6.7 percent at the end of 1964 (see Table XV-15). The equity capital item here includes a small amount of debentures issued by one of the banking institutions.

Table XV-15

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1963-64

End of period	IL million		Percent		Increase or decrease (-) from 1963 to 1964	
	1963	1964	1963	1964	IL m.	%
Assets						
Cash and balances at Bank of Israel	1,206.3	1,348.4	36.3	35.7	142.1	11.8
Loans to the public ^a	862.8	986.8	26.0	26.1	124.0	14.4
Loans to the Government	45.2	30.9	1.4	0.8	-14.3	-31.6
Loans to the public						
From Govt. deposits	359.6	381.7	10.8	10.1	22.1	6.1
From deposits earmarked for loans	272.7	345.0	8.2	9.1	72.3	26.5
Foreign currency assets	344.3	389.1	10.4	10.3	44.8	13.0
Securities	180.1	223.3	5.4	5.9	43.2	24.0
Real estate	47.3	69.0	1.4	1.8	21.7	45.9
Net balances with banking institutions	1.8	2.8	0.1	0.1	1.0	55.6
Total	3,320.1	3,777.0	100.0	100.0	456.9	13.8
Liabilities						
Demand deposits	1,082.8	1,116.0	32.6	29.5	33.2	3.1
Less liquid deposits ^a	852.7	1,014.0	25.7	26.9	161.3	18.9
Foreign liabilities ^b	456.9	552.6	13.8	14.6	85.7	20.9
Government deposits	379.3	396.6	11.4	10.5	17.3	4.6
Deposits earmarked for loans	282.7	352.3	8.5	9.3	69.6	24.6
Equity capital and debentures	187.5	252.9	5.6	6.7	65.4	34.9
Other accounts, net	78.2	92.6	2.4	2.5	14.4	18.4
Total	3,320.1	3,777.0	100.0	100.0	456.9	13.8
Contingent accounts						
Balances held by and for banking institutions	59.7	73.1			13.4	22.4
Clients' liabilities and guarantees	900.5	1,159.0			258.5	28.7
Other accounts	207.3	247.9			40.6	19.6
Total	1,167.5	1,480.0			312.5	26.8
Grand total	4,487.6	5,257.0			769.4	17.1

^a The figure for 1963 is IL 5.9 million higher than in Tables XV-6 and XV-9, and that for 1964 is IL 11.6 million higher, since they include Bank of Israel loans to the banking institutions for these amounts.

^b Including deposits of nonresidents.

Table XV-16
BANKING INSTITUTIONS AND THEIR BRANCHES, 1955-64

End of period	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964
The 3 big banks										
Head offices	3	3	3	3	3	3	3	3	3	3
Branches	104	114	193	219	244	289	335	351	363	372
Total	107	117	196	222	247	292	338	354	366	375
Other banks										
Head offices	21	22	22	22	22	23	23	23	23	23
Branches	52	61	67	72	83	111	151	168	180	194
Total	73	83	89	94	105	134	174	191	203	217
Credit cooperatives										
Head offices	94	93	59	52	42	29	27	26	25	23
Branches	74	79	49	48	54	60	72	72	76	79
Total	168	172	108	100	96	89	99	98	101	102
All banking institutions										
Head offices	118	118	84	77	67	55	53	52	51	49
Branches	230	254	309	339	381	460	558	591	619	645
Total	348	372	393	416	448	515	611	643	670	694

As in the previous two years, the banking institutions extended their branch network only slightly in 1964. The slower rate of branch openings over the last three years is ascribable to the law requiring a special permit for this purpose, which came into force in May 1961. In 1964, 26 branches were established as compared with 28 in 1963. Approximately half the new branches were opened in development areas and Arab villages. The three big banks opened nine new branches, while the other banks opened 14, and cooperative credit societies—three. The number of credit cooperatives dropped from 25 at the end of 1963 to 23 at the end of 1964 following two mergers—one with a bank and the second between two cooperatives.

The downtrend in the weight of the three big banks in aggregate banking business, which persisted for several years, came to an end in 1964. The share of the Big Three in loans to the public rose from 67 to 68 percent, in demand deposits, from 63 to 64 percent, and in less liquid deposits, from 72 to 76 percent. On the other hand, there was a slight decline in the weight of the other banks. The credit cooperatives' share of banking business remained unchanged in 1964, after having dropped steadily for several years.

Table XV-17

**CASH AND BALANCES AT THE BANK OF ISRAEL, CREDIT, DEPOSITS,
AND BALANCE OF BILL BROKERAGE TRADE, 1958-64**
(percentages)

End of period	The 3 big banks	Other banks	Credit cooperatives	Total
Cash and balances at the				
Bank of Israel				
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
1964	67	27	6	100
Loans to the public from				
banking institutions^a				
1958	63	21	16	100
1959	66	20	14	100
1960	67	21	12	100
1961	67	22	11	100
1962	69	23	8	100
1963	67	26	7	100
1964	68	26	6	100
Local currency demand				
deposits				
1958	62	24	14	100
1959	64	23	13	100
1960	66	23	11	100
1961	64	25	11	100
1962	65	25	10	100
1963	63	27	10	100
1964	64	26	10	100
Other deposits^b				
1958	68	21	11	100
1959	69	22	9	100
1960	70	21	9	100
1961	71	22	7	100
1962	71	24	5	100
1963	72	24	4	100
1964	76	20	4	100
Bill brokerage				
1962	36	54	10	100
1963	37	50	13	100
1964	43	46	11	100

^a Including credit to nonresidents.

^b Including deposits of nonresidents (Patach).

7. INCOME AND EXPENSES OF BANKING INSTITUTIONS

The slower monetary expansion of 1964 resulted in a much smaller increase in banking institution income as compared with the two preceding years. The rise in expenses did not slow down, and consequently profits fell somewhat. Profitability, however, declined appreciably, since equity capital was enlarged by nearly 50 percent on the average.

The composition of operating income showed no striking changes in 1964, all items rising more or less at the same rate, in contrast to 1963 when most items went up at a faster rate than interest on loans and bills discounted. Income from service charges in connection with bill brokerage and securities transactions grew somewhat more rapidly in 1964 than the other income items but, in contrast to 1963, no pronounced changes occurred in the composition of banking business.

The increase in interest from deposits at the Bank of Israel and other institutions stemmed from the marked rise in Pazak accounts during the year, which was also reflected in the larger amount paid on deposit interest. The institutions' local currency deposits grew only slightly during the year reviewed.

The banking institutions' operating expenses exhibited similar growth rates and trends as in the previous year. Outlay on wages and fringe benefits went up notably. The number of employees increased by nearly 9 percent on the average, and the average wage bill per employee—by approximately 13 percent.

The more rapid rise in interest outlay was due, as stated, to the marked growth of Pazak and Tamam deposits, and probably to keener competition for the public's deposits as well. The increase in the amount of fines paid for liquidity deficiencies is also reflected in this item.

Operating income advanced by approximately IL 43 million in 1964, and operating expenses by IL 46 million. Operating profit declined, therefore, by IL 3 million, or over 9 percent. Capital gains also fell off somewhat, a development to be expected in view of the depressed state of the securities market. Total profits came to IL 42.6 million, about IL 4 million less than in the previous year.

The banking institutions continued to expand their equity capital in 1964, the total reaching IL 222 million as against IL 142 million in 1963. The moderate decline in profits therefore resulted in a considerable reduction of profitability as compared with the two preceding years, which were exceptionally good in this respect.

Table XV-18

INCOME AND EXPENSES OF BANKING INSTITUTIONS, 1963-64

	IL million		Percent		Percent increase or decrease (-)	
	1963 ^a	1964	1963	1964	From 1962 to 1963	From 1963 to 1964
Operating income						
Interest and commission on loans and bills discounted	117.9	137.0	45.3	45.1	15.5	16.2
Service charges	58.2	69.1	22.4	22.8	39.6	18.7
Interest on deposits with the Bank of Israel and other banks	54.1	63.0	20.8	20.8	33.6	16.5
Other income ^b	29.9	34.4	11.5	11.3	24.6	15.1
Total operating income	260.1	303.5	100.0	100.0	24.9	16.7
Operating expenses						
Wages, salaries, and fringe benefits	87.9	107.6	38.3	39.0	25.2	22.4
Interest paid on deposits ^c	100.8	118.8	43.9	43.1	15.0	17.9
Other expenses	40.7	49.3	17.8	17.9	23.0	21.1
Total operating expenses	229.4	275.7	100.0	100.0	20.1	20.2
Profits (before income tax)						
Operating profit	30.7	27.8	66.0	65.3	79.5	-9.4
Capital gains (net)	15.8	14.8	34.0	34.7	113.5	-6.3
Total profits	46.5	42.6	100.0	100.0	89.0	-8.4
	1961	1962	1963	1964		
Operating profit as a percentage of operating income	7.5	8.2	11.8	9.2		
Operating profit as a percentage of equity capital ^d	18.3	20.7	21.3	13.0		
Total profits as a percentage of equity capital^d	23.0	29.8	32.4	19.6		

^a According to a new classification.

^b Including income from securities and from foreign currency, trustee, and insurance transactions.

^c Including interest on loans and rediscounts and fines for liquidity deficiencies.

^d Does not pertain to foreign banks, as they do not have local equity capital.