

CHAPTER XV

MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. MAJOR MONETARY DEVELOPMENTS

MONETARY DEVELOPMENTS in 1965 largely reflect the continuation of the slower expansion trend discernible since the beginning of 1964. The average balance of financial assets of the public, consisting of the money supply and less liquid deposits with the banking system, rose by 13 percent in 1965, as compared with 12.6 percent in 1961¹ and an average of 24 percent p.a. during the four-year period 1960-63. In the course of 1965 the money supply went up by IL 191.5 million, or 11.2 percent, compared with 6.1 percent in the previous year and an annual average of some 22 percent in 1960-63. The average level of the money supply was only 9 percent higher in 1965 than in 1964, while in 1964 it had risen by 13 percent and during the 1960-63 period by an average of 20 percent p.a. This increase in the average size of the money supply was the slowest since the establishment of the State, and it only slightly exceeded the growth of the real national product.

The rapid expansion of the money supply and less liquid deposits in 1962-63 far exceeded the increase in the real national product during these two years, and led to the generation of excess liquidity and strong demand pressure in the economy. These were not fully reflected by the rise of the consumer price index and the growth of the adverse balance in Israel's goods and services account during this period, since part of the excess liquidity was absorbed by the share and real estate markets, and also because the Government intervened to check price increases by administrative means. In 1964 a change of trend set in, and it continued through 1965. The share and real estate markets weakened and demand pressure mounted in the commodity and service markets, mainly in 1964. Prices of industrial goods hardly rose owing to the Government's restraining measures, but prices of goods and services not subject to Government control began to move upward. In the latter part of 1964 the efficacy of the price curbs began to wane, and the consumer price index started climbing rapidly, gathering further momentum in the first four months of 1965. At the same time, the import surplus grew appreciably in 1964 and monetary expansion slowed down to a marked extent, while real national

¹ If bank-negotiated bill credits and the Government Short-Term Loan are included with financial assets, the growth came to 13.4 percent in 1965 and 22.2 percent in 1964.

Table XV-1

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1960-65

	IL million							Percent increase or decrease (-) as against previous year						
	1960	1961	1962 ^a	1962 ^b	1963	1964	1965	1960	1961	1962 ^a	1962 ^b	1963	1964	1965
Sources														
Accumulation of foreign currency assets	153.3	134.4	355.8	733.1	227.4 ^c	42.2	219.0	63.7	34.1	67.4	138.8	18.0 ^c	2.8	14.3
Expansion of credit to the public ^d	93.7	95.5	99.9	169.3	155.3	148.2	136.4	21.9	18.3	16.2	27.4	19.7	15.7	12.5
Expansion of credit to the Govt.	-4.1	-48.0	-60.9	-295.4	118.7 ^e	95.4	54.6	-1.1	-13.4	-19.7	-95.4	824.3 ^c	71.7	23.9
Other factors, net	2.2	4.2	-22.9	-35.5	-59.6	-31.8	-16.5	†	†	†	†	†	†	†
Total	245.1	186.1	371.9	571.5	441.8	254.0	393.5	24.4	14.9	25.9	39.8	22.0	10.4	14.6
Components														
Money supply	154.3	88.9	287.5	287.5	352.7	98.1	191.5	21.3	10.1	29.7	29.7	28.1	6.1	11.2
Less—liquid deposits ^f	90.8	97.2	84.4	284.0	89.1	155.9	202.0	32.7	26.4	18.1	60.9	11.9	18.6	20.3
Total	245.1	186.1	371.9	571.5	441.8	254.0	393.5	24.4	14.9	25.9	39.8	22.0	10.4	14.6

^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.

^h Net of deposits earmarked for loans.

product continued to expand. The year reviewed differed somewhat from 1964 in that prices rose more steeply, while the adverse balance in the country's current account showed some improvement after a noticeable deterioration in 1964. While the money supply grew more rapidly during the year reviewed, the average level went up at a lower rate than in 1964.

The rise of prices, which, as stated, began in 1964 and accelerated in the first four months of 1965, subsequently weakened as demand pressure slackened and monetary expansion slowed down. These developments helped to reduce the excess liquidity in the economy, and led to a somewhat tighter money situation, which found expression *inter alia* in the more intensive use of means of payment, as reflected in the increased circulation velocity of the money supply and the rise of the interest rate in the bill brokerage market.

The continued trend toward slower monetary expansion was also reflected by the growth rates of the other financial assets of the public. Less liquid deposits showed a further relatively rapid rise during the year, but these deposits consist mainly of Pazak and Tamam, the accumulation of which reflects the growing demand for foreign currency assets. On the other hand, the outstanding balance of bills traded through the agency of banks went up by IL 161 million, or 26 percent, in 1965, as compared with a rise of IL 179 million (41 percent) in 1964, while the balance of the Government Short-Term Loan¹ actually dropped by IL 75 million, after having risen by some IL 50 million in 1964.

The decline in the country's adverse balance on goods and services account exceeded the relatively small decrease in capital imports during 1965, and was reflected by a more rapid accumulation of foreign currency assets by the banking system—\$ 73 million as against only \$ 14 million in 1964. This increase in foreign currency assets was the main source of monetary expansion. The latter was also fed by the increased volume of credit extended to the Government and to the public, though this factor was less prominent than in 1964. Net credit to the Government was enlarged by IL 55 million in 1965, as against IL 95 million in the previous year, and credit to the public—by IL 136 million, compared with IL 148 million in 1964.

The expansion of bank credit to the public proceeded more slowly than in previous years: whereas in 1963 the increment came to 19.7 percent and in 1964 to 15.7 percent, in 1965 it was only 12.5 percent. Over half the 1965 credit increment was granted outside the ordinary liquidity framework, in the form of credit controlled by the Bank of Israel² or foreign currency credit to local residents. The expansion of ordinary Israeli currency credit was made possible by the growth of the banking institutions' liquid assets.

The increase in liquid assets can be attributed mainly to the accumulation of

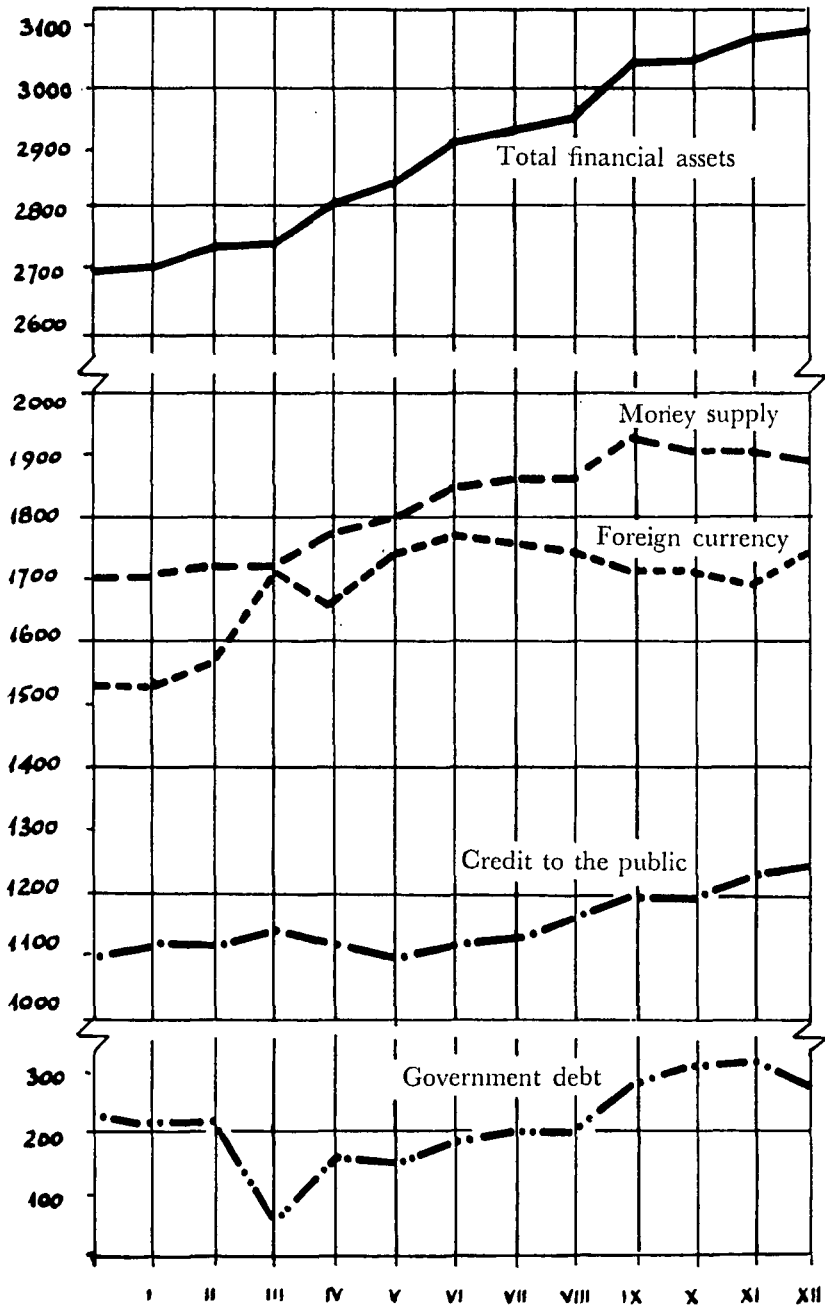
¹ Excluding the special Short-Term Loan under an agreement whereby the banks undertook to supply the Government with a IL 50 million credit. The amount provided in 1965 was IL 23 million.

² Exemptions from the liquidity regulations and rediscounting of bills.

Diagram XV-1

TOTAL FINANCIAL ASSETS, MONEY SUPPLY, AND SOURCES OF INCREASE,
MONTHLY, 1965

IL million



foreign currency by the Bank of Israel, which exceeded the growth of the public's foreign currency deposits. The latter development had exerted a contractionary effect on the volume of liquid assets. The rise in liquid assets enabled the banking institutions to cut down by almost one-third their unauthorized liquidity deficiency, which had reached considerable proportions in 1964, while simultaneously expanding credit to the public—albeit not on a very large scale.

The monetary expansion during the year displayed an irregular pattern. During the first quarter it proceeded much more slowly, in continuation of the trend prevailing in 1964, while during the last quarter the money supply actually contracted. Most of the increase in the money supply, as already mentioned, occurred in the period April–September 1965, when the big rise in the Government's debt to the banking system was the major source of expansion. The increase in credit to the public also contributed to the monetary growth, especially during the second half of the year (in the first half this item showed no rise whatsoever). The accumulation of foreign currency followed the normal seasonal pattern, total foreign currency assets rising until the end of June, and declining from July until the end of the year.

A striking feature of 1965 was the much brisker demand for foreign currency assets, reflected also by the growth of Pazak and Tamam deposits, which went up by IL 170 million as compared with IL 129 million in 1964. On the other hand, the volume of personal restitution payments from Germany contracted from \$ 134 million in 1964 to \$ 114 million. The growth of Pazak and Tamam gained momentum during the second half of the year, simultaneously with the expansion of transactions in debentures linked to the foreign exchange rate and in foreign securities. The price of dollars from Natad accounts¹ likewise rose, as did dollar and gold prices in the black market. The fact that a considerable proportion of current transfers on account of personal restitution payments from West Germany were not converted into Israeli currency exerted a contractionary effect on the money supply and the level of demand in the economy. However, it must be noted that by the end of 1965 the outstanding balance of Pazak and Tamam deposits reached IL 862 million, and that these are relatively very liquid deposits which can be quickly converted into means of payment.

2. THE MONEY SUPPLY

Between the end of 1964 and the end of 1965, the money supply increased by IL 191.5 million, or 11.2 percent, as compared with 6.1 percent during the previous year. The rise in the average level was smaller, amounting to 9 percent in 1965, as against 13 percent in 1964 and an average of 22 percent during the years 1961–63.

¹ This is explained on p. 325.

Table XV-2
ANNUAL INCREASE IN THE MONEY SUPPLY, 1958-65
(IL million)

Year	Balance at end of year	Change in end-year balances		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
1965	657.4	67.1	11.4	647.1	62.6	10.7
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
1965	1,241.5	124.4	11.1	1,186.3	88.1	8.0
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
1965	1,898.9	191.5	11.2	1,833.4	150.7	9.0

The growth of the money supply was concentrated during the six months April-September, when it went up by some IL 211 million. During the first quarter of the year reviewed, the increase was much slower, in line with the pattern of 1964, and totalled only IL 18.2 million. In the last quarter of 1965

Diagram XV-2

THE MONEY SUPPLY, BY MONTHS, 1962-65

IL million

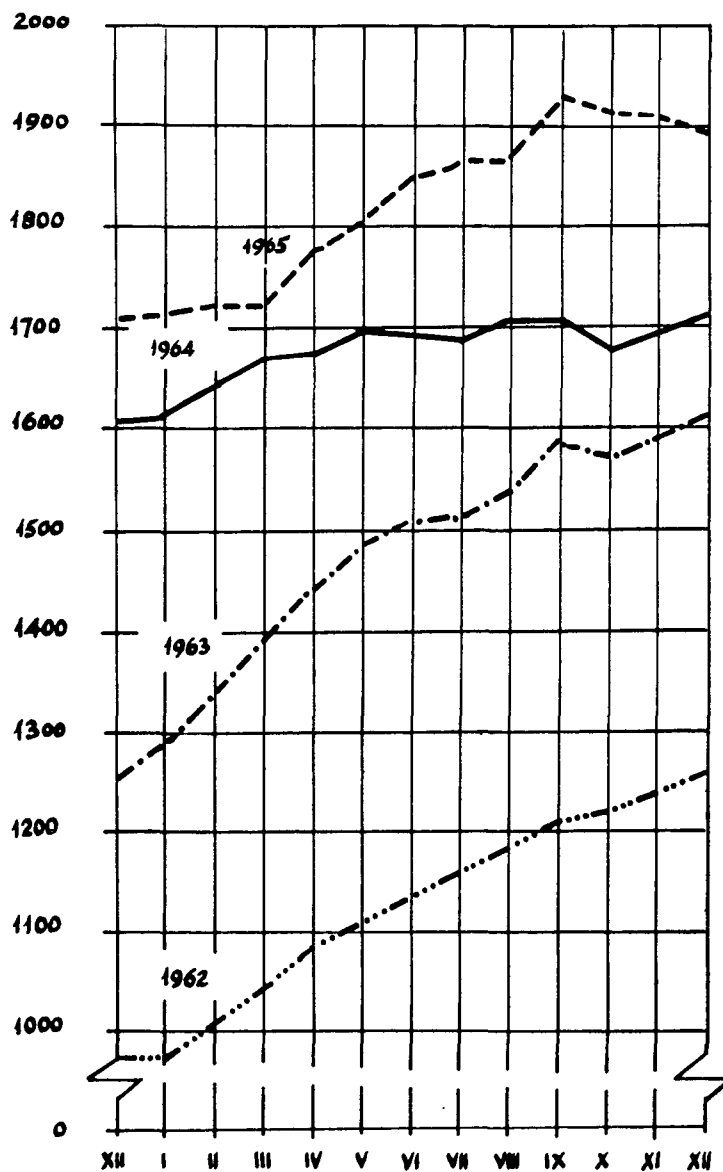


Table XV-3
 THE MONEY SUPPLY, BY MONTHS, 1965
 (IL million)

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.	%
1964 December	590.3	-16.3	-2.7	1,117.1	33.4	3.1	1,707.4	17.1	1.0
1965 January	606.1	15.8	2.7	1,104.6	-12.5	-1.1	1,710.7	3.3	0.2
February	615.4	9.3	1.5	1,110.7	6.1	0.6	1,726.1	15.4	0.9
March	623.3	7.9	1.3	1,102.3	-8.4	-0.8	1,725.6	-0.5	—
April	639.9	13.6	2.2	1,141.9	39.6	3.6	1,778.8	53.2	3.1
May	634.1	-2.8	-0.4	1,169.2	27.3	2.4	1,803.3	24.5	1.4
June	639.5	5.4	0.9	1,217.1	47.9	4.1	1,856.6	53.3	3.0
July	649.5	10.0	1.6	1,218.0	0.9	—	1,867.5	10.9	0.6
August	655.8	6.3	1.0	1,213.7	-4.3	-0.4	1,869.5	2.0	0.1
September	680.3	24.5	3.7	1,256.1	42.4	3.5	1,936.4	66.9	3.6
October	688.9	8.6	1.3	1,225.6	-30.5	-2.4	1,914.5	-21.9	-1.1
November	677.9	-11.0	-1.6	1,235.0	9.4	0.8	1,912.9	-1.6	-0.1
December	657.4	-20.5	-3.0	1,241.5	6.5	0.5	1,898.9	-14.0	-0.7

the money supply contracted by IL 37.5 million. These developments were reflected by a rise of only 9 percent in the average level between 1964 and 1965.

The marked expansion during the period April-September 1965 was due chiefly to a considerable rise in the Government's debt to the banking system during these months, though the debt did not increase very much over the year as a whole. The effect of foreign currency accumulation on the money supply was largely offset by the growth of Pazak and Tamam deposits.

Demand deposits expanded by IL 124 million in 1965—IL 76 million in checking account deposits and IL 48 million in deposits not drawable by check. The weight of the latter within total demand deposits edged up from an average of some 36 percent in 1964 to 37 percent in 1965.¹

Cash in circulation with the public increased by IL 67.1 million during the year reviewed, but its weight within the money supply remained virtually

Table XV-4
CASH AS A PERCENTAGE OF TOTAL
MONEY SUPPLY, 1958-65

Annual average		
1958		38.7
1959		36.8
1960		35.0
1961		35.0
1962		33.7
1963		33.3
1964		34.7
1965		35.3
End of month		
1965	January	35.4
	February	35.7
	March	36.1
	April	35.8
	May	35.2
	June	34.4
	July	34.8
	August	35.1
	September	35.1
	October	36.0
	November	35.4
	December	34.6

¹ Changes in the composition of demand deposits must be regarded as of limited significance, since deposits not drawable by check include certain types of commercial accounts with relatively high turnover velocities.

unchanged at the end of December—34.6 percent. Its average level for the year moved up from 34.7 percent in 1964 to 35.3 percent; this reflects the rise in its relative share during 1964, for in 1965, as stated, there was scarcely any change.

The circulation velocity of the money supply rose by some 9 percent in relation to the national income and by about 4 percent in relation to total available resources, after having gone up at a much slower rate in 1964 and declining in 1963.

Table XV-5
INDICATORS OF THE CIRCULATION VELOCITY OF
THE MONEY SUPPLY, 1955-65

Year	Average annual circulation velocity of money supply in relation to:		Average annual velocity of demand deposits ^a
	National income ^a	Total available resources ^b	
	(1)	(2)	(3)
1960	4.14 ^d	6.23 ^d	16.4
1961	4.13 ^d	6.41 ^d	16.2
1962	4.18 ^d	6.96 ^d	17.9
1963	3.98 ^d	6.13 ^d	18.9
1964	4.11 ^d	6.40 ^d	19.2 ^d
1965	4.48 ^d	6.66 ^d	21.2 ^d

^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 deposits in banks divided by the average annual volume of these deposits. Deposits with cooperative credit societies are not included.

^d Revised data.

The changes in the circulation velocity of the money supply—or, in other words, the changes in the ratio between the money supply and national income, or the economy's total available resources, as the case may be¹—reflect the extent to which the price level adjusted itself as a result of the alterations in the ratio between the growth of the money supply and the growth of the country's real resources. In 1963 the money supply increased faster than the national product, but as there was no corresponding rise in GNP prices, the velocity of the money supply declined. In 1965, on the other hand, the increased velocity of the money

¹ It would have been preferable to calculate the circulation velocity of the money supply in relation to all transactions conducted in the economy. But since this datum was not available, national income and total available resources were used instead.

supply reflects the slower growth of means of payment relative to the real product and the more rapid rise of prices. The rise in the interest rate and the more intensive utilization of means of payment in 1965 mirror the tighter liquidity position of the economy. Further evidence of this development is the fact that the average velocity of demand deposits went up 10 percent despite the slump in the real estate and financial assets markets during the year reviewed.

3. LESS LIQUID DEPOSITS OF THE PUBLIC

Less liquid deposits continued to expand relatively rapidly in 1965, the outstanding balance going up by IL 202 million, or 20.3 percent, compared with a rise of IL 156 million, or 18.6 percent, during 1964.

As in previous years, most of the increase occurred in Pazak and Tamam accounts, which grew by IL 170 million, bringing their weight in total less liquid deposits up to 72 percent. There was also a substantial rise of IL 45.6 million in approved saving scheme deposits, while time deposits in Israeli currency continued downward.

(a) *Pazak and Tamam*

The balance of Pazak accounts rose in 1965 by IL 134.7 million (\$ 45 million), compared with IL 127.5 million (\$ 42.5 million) in 1964. The increase in Tamam totalled IL 35.7 million (\$ 12 million), as against only IL 1.8 million in 1964. The maximum rates of interest payable to owners of these deposits remained unchanged—7 percent per annum on Pazak deposits and 4.5 percent on Tamam deposits.

The big increase in Pazak and Tamam had a contractionary monetary effect, since a considerable proportion of the personal restitution receipts was not converted into local currency but deposited in foreign currency accounts. The growth of such deposits does not enable banking institutions to expand credit, as they must be redeposited *in toto* with the Bank of Israel. Nevertheless, these two types of deposits constitute an addition to financial assets, which undoubtedly affects the behavior of their owners. It should be borne in mind that these deposits, the outstanding balance of which totalled IL 862 million at the end of 1965, are very liquid assets, i.e. they are easily convertible into means of payment, and thus must be taken into account when framing economic policy.

Pazak and Tamam accounts belong in the main to recipients of personal restitution payments from West Germany. The amount of cumulative interest paid by the Bank of Israel and the Treasury on these deposits has been growing steadily, reaching IL 43 million in 1965 as against IL 34 million the year before. If interest receipts are added to the restitution payments, the increase in Pazak and Tamam in 1965 amounted to 45 percent, as compared with 30 percent in the preceding year. This growth is of considerable significance, for

Table XV-6
LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS, 1958-65
 (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	Tamam foreign currency deposits	Other foreign currency deposits ^a	Grand total
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
1965	201.1	31.3	26.7	259.1	611.6	250.6	75.7	1,197.0
1965 January	159.0	43.2	34.3	236.5	489.5	217.6	62.2	1,005.8
February	161.1	42.4	37.1	240.6	497.2	220.7	62.8	1,021.3
March	164.0	39.5	30.1	233.6	504.8	224.3	68.5	1,031.2
April	166.4	37.9	27.8	232.1	516.6	225.4	61.1	1,035.2
May	169.9	38.7	27.8	236.4	524.9	226.4	61.4	1,049.1
June	172.7	37.6	29.0	239.3	535.6	228.0	57.7	1,060.6
July	176.2	35.9	28.2	240.3	545.1	227.9	56.3	1,069.6
August	180.8	36.6	24.1	241.5	552.7	228.2	64.0	1,086.4
September	184.2	34.6	28.1	246.9	566.9	232.8	61.8	1,108.4
October	187.9	33.3	24.6	245.8	582.1	238.3	69.6	1,135.8
November	193.5	32.2	29.8	255.5	597.8	244.2	72.1	1,169.6
December	201.1	31.3	26.7	259.1	611.6	250.6	75.7	1,197.0

^a Revised figures; after deduction of deposits of the public earmarked for loans, most of which belong to provident funds and financial institutions.

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

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

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

the larger the outstanding balance of such accounts, the bigger the absolute amount likely to be converted into Israeli currency.

The expanding volume of Pazak and Tamam deposits constituted part of the general rise in demand for foreign currency assets or assets linked to foreign currency characteristic of 1965. One of the factors accentuating this trend was apparently the stock market slump.

The intensified demand for foreign currency assets also led to a rise in the exchange rate granted to holders of Natad accounts (any Israeli may purchase foreign currency from a Natad account in order to buy foreign securities). Owners of Tamam deposits may offer their foreign currency holdings in the Natad market; the rate of exchange is freely determined by the interplay of supply and demand and hence can equal or exceed the official exchange rate. Expectation of a rise in the exchange rate for Natad dollars thus may have been a contributory motive in the increased accumulation of Tamam deposits. In 1965 the rate for Natad dollars rose from a low of IL 3.12 per dollar during the first half of the year to IL 3.29 per dollar during the second half; the average annual rate was IL 3.21, compared with IL 3.10 in 1964.

The demand for foreign currency assets was reflected not only by the growth of Pazak and Tamam deposits, but also by investment in foreign securities. The outstanding balance of foreign securities¹ went up during the year by IL 90 million, compared with IL 51 million in 1964, to reach IL 241 million. Natad accounts, in which foreign currency is temporarily deposited before and after the execution of foreign security transactions, also expanded in 1965, their average balance totalling IL 12 million as against IL 5 million in 1964.

The increase in Pazak and Tamam deposits was slow at the beginning of 1965, accelerating toward the end of the year. During the first eight months the average monthly increment was IL 9.5 million in Pazak deposits and IL 1.7 million in Tamam, as compared with IL 14.7 million and IL 5.6 million respectively during the last four months. At the end of 1965 the balance of Pazak deposits stood at IL 611.6 million (\$ 204 million), and Tamam at IL 250.6 million (about \$ 84 million).

(b) *Deposits in approved saving schemes*

These deposits expanded in 1965 by IL 45.6 million, compared with IL 31.2 million the previous year. Only two new saving schemes of the type introduced in 1964 were opened during the year reviewed.² Most of the expansion in saving

¹ Foreign securities purchased by Israelis consist largely of debentures issued by the Jewish Agency subsidiary Hollis, which are denominated in foreign currency. The proceeds from such sales are transferred to the Jewish Agency's budget.

² These new schemes permit the saver to choose, upon termination of the period of the deposit, between a high rate of interest (up to 9 percent p.a., net) without linkage of the principal, and a lower rate of interest (up to 4 percent p.a., net) with the principal linked to the consumer price index.

scheme deposits occurred in this type, where some IL 40 million was accumulated in 1965. Deposits in linked saving schemes increased by IL 7.5 million (of which some IL 2.4 million represents linkage increments), whereas non-linked deposits contracted by about IL 12 million, in the main reflecting the shift to schemes with a higher yield. Saving schemes for children and youth expanded by IL 4.9 million, those for secondary education (sponsored by the banks) by IL 3.3 million, and those for the purchase of vehicles by IL 1.3 million. The accumulation in saving schemes proceeded more rapidly during the second half of the year.

The change in the composition of saving scheme deposits made itself felt also in the make-up of the banking institutions' investment portfolios. The banking institutions are required to invest at least 60 percent of their total saving scheme deposits in approved securities, while 25 percent may be used for granting credits subject to Bank of Israel control, and 15 percent may be granted at the institutions' own discretion. Normally, banking institutions invest more than 60 percent of these funds in approved securities, while the quota for controlled credit is not fully utilized. In 1965 the banks' portfolio investments amounted to about 74 percent of the balance of saving scheme deposits, as against 77 percent in 1964. The securities purchased by the banks with these funds possess characteristics similar to those of the saving schemes concerned. Thus, for instance, with the development of saving schemes enabling the saver to choose between a relatively high rate of interest (up to 9 percent) and a lower rate with the principal fully linked to the consumer price index, the banks have shifted some of their investments to Government securities of a similar character. Consequently, their holdings of Government Short-Term Loan certificates declined by some IL 12 million in 1965, whereas their holdings of the Government Development Loan, which also offers an option between a high rate of interest and nonlinkage, increased by IL 19 million.

The IL 201 million balance in saving scheme deposits at the end of 1965 breaks down as follows: new schemes (offering the aforementioned option)—IL 83 million; ordinary nonlinked schemes—IL 46 million; linked schemes—IL 20 million; children's saving schemes—IL 34 million, saving for secondary education—IL 14 million; and saving for vehicle purchases—IL 4 million.

(c) Time deposits

The balance of local currency time deposits declined in 1965, continuing the trend of the last few years. The decrease amounted to IL 12.4 million, following one of IL 10.5 million in 1964, and brought down the balance to only IL 31.3 million. Most of these time deposits are nonlinked and carry a relatively low rate of interest; consequently, they cannot compete with the bill brokerage market, where interest rates are higher, or even with approved saving schemes.

(d) *Deposits against liabilities in Israeli currency*

These deposits contracted by IL 6 million during the year reviewed. This decline is partly explained by the fact that a growing percentage of import transactions are no longer financed by letters of credit involving a down payment of up to 50 percent of the value of the transaction, but payment is made in cash when the documents are presented to the importer. This method obviates the need for depositing an advance. In addition, the exemptions and concessions granted to importers in connection with such deposits apparently were increased.

(e) *Other foreign currency deposits*

There were only small changes in the balance of these deposits during 1965.

4. SOURCES OF THE INCREASE IN FINANCIAL ASSETS

The financial assets of the public, consisting of means of payment and less liquid deposits with the banking system, increased during 1965 by IL 393.5 million, or 14.6 percent, as compared with a rise of IL 254 million, or 10.4 percent, in 1964.

The main factor increasing these assets was the accelerated accumulation of foreign currency assets, which grew by \$ 73 million, as against some \$ 14 million in 1964. Credit to the public and to the Government expanded more slowly than in 1964.

The contribution of the various sources of monetary expansion was not uniform throughout the year reviewed. As in former years, the accumulation of foreign currency assets exerted an expansionary influence during the first half of 1965, but had a contractionary effect in the second half. The Government's debt to the banking system declined considerably during the first quarter, but began to grow rapidly at the beginning of the new fiscal year in April. The expansion of bank credit to the public took place entirely during the last five months of 1965.

(a) *Accumulation of foreign currency assets*

The decline in the adverse balance on Israel's goods and services account in 1965 and the accompanying rise in credits from abroad resulted in a net growth of IL 219 million (\$ 73 million) in the volume of foreign currency assets in the banking system. The gross balance of such assets amounted to IL 2,415.3 million (\$ 805 million) at the end of 1965, of which IL 2,002.4 million was held by the Bank of Israel and the remaining IL 412.9 million by the banking institutions. The banking system's foreign liabilities reached IL 665.4 million (\$ 222 million), after advancing by IL 95 million in the course of

Table XV-7

FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING
SYSTEM, 1958-65

(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
1965	2,415.3	413.7	251.7	1,749.9
1965 January	2,074.3	378.2	164.9	1,531.2
February	2,112.7	384.1	161.4	1,567.2
March	2,272.2	374.0	186.2	1,712.0
April	2,248.5	367.7	217.0	1,663.8
May	2,331.9	368.8	218.7	1,744.4
June	2,350.1	375.8	200.7	1,773.6
July	2,329.3	381.0	184.9	1,763.4
August	2,341.7	392.3	199.8	1,749.6
September	2,299.3	385.0	199.0	1,715.3
October	2,327.4	416.7	197.2	1,713.5
November	2,318.2	401.4	219.1	1,697.7
December	2,415.3	413.7	251.7	1,749.9

^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.

the year. Thus, net foreign exchange reserves totalled some IL 1,750 million, or \$ 583 million, at the end of 1965. The incremental foreign liabilities consisted of IL 35 million in nonresidents' deposits in Israeli banks (Patach), and IL 60 million in other overseas debts (see Table XV-1).¹ The expansion of Patach deposits, which was the main cause of the rise in foreign liabilities in 1961 and 1962, was surpassed in 1965 by other items, chiefly liabilities to foreign

¹ Approximately IL 15 million of the increase in foreign liabilities was due to a change in the method of recording: transactions between foreign banks and local residents, previously listed under contingent accounts as "acceptances", now appear as liabilities on one side of the balance sheet and as foreign currency credit to local residents on the other side.

banks, which grew from \$ 21 million at the end of 1962 to \$ 84 million at the end of 1965, or by 300 percent.

The accumulation of foreign currency assets followed the normal seasonal pattern. During the months January–June there was a rise of \$ 81 million, between July and November a decline of \$ 25.3 million, and in December another rise of \$ 17.4 million (mainly due to a large foreign currency transfer to the Government at the end of the month).

(b) *Credit to the Government*

The Government's debt to the banking system went up in 1965 by IL54.6 million, after having grown by IL 95.4 million in 1964. It should be noted that changes in the Government's debt to the banking system reflect only part of the Government's total influence on the level of demand in the economy. A detailed analysis of the Government's operations by means of the money

Diagram XV-3

FOREIGN EXCHANGE RESERVES, BY MONTHS, 1962-65

\$ million

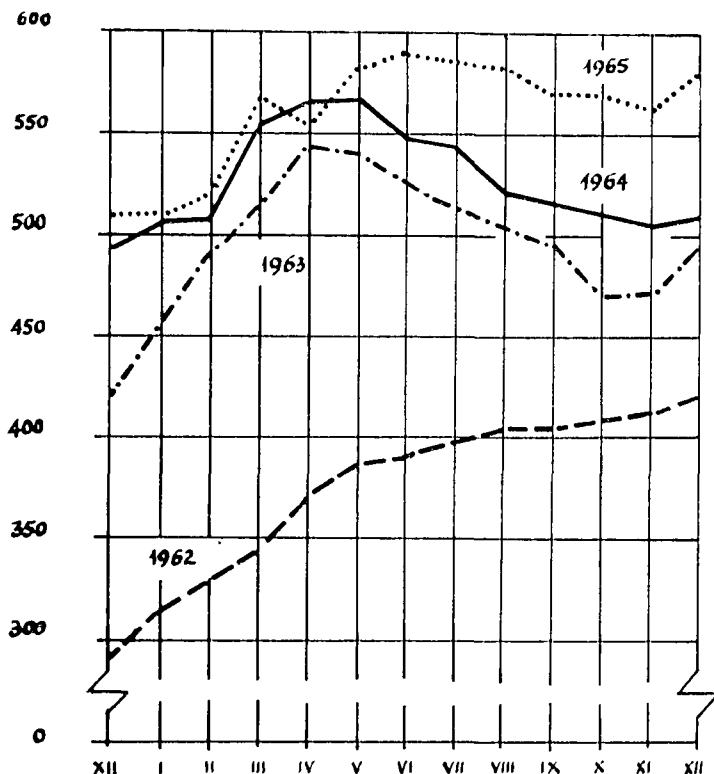


Table XV-8
THE GOVERNMENT'S DEBT TO THE BANKING SYSTEM, 1958-65
 (IL million)

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	22.2	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
1965	-72.8	238.9	22.5	143.6	45.4	105.5	11.4	139.5	283.1
1965 January	-98.1	241.1	21.9	121.1	28.1	84.5	13.7	98.9	220.0
February	-101.0	241.1	26.7	113.4	31.4	86.6	13.0	105.0	218.4
March	-270.4	241.1	26.1	-55.4	33.8	90.7	11.6	112.9	57.5
April	-155.4	239.0	28.5	55.1	33.5	92.3	12.5	113.3	168.4
May	-168.4	239.0	30.8	39.8	31.7	96.7	11.5	116.9	156.7
June	-133.0	239.0	37.9	68.1	33.5	97.9	11.6	119.8	187.9
July	-114.1	239.0	39.5	85.4	32.1	102.0	12.8	121.3	206.7
August	-115.2	238.4	39.9	83.3	36.5	98.7	12.3	122.9	206.2
September	-53.1	238.5	42.8	142.6	50.8	99.4	11.3	138.9	281.5
October	-21.4	239.0	43.3	174.3	50.5	96.6	11.2	135.9	310.2
November	-17.9	238.9	46.9	174.1	51.4	101.2	11.0	141.6	315.7
December	-72.8	238.9	22.5	143.6	45.4	105.5	11.4	139.5	283.1

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

^b Including an increase of IL 1.5 million due to revaluation according to the 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.

flows between it and other sectors (including the rest-of-the-world sector) is given in Chapter VII, "Public Sector Operations", and Chapter XVI, "Flow of Funds".

The changes in the Government's debt followed the seasonal pattern of previous years. During the months January–March (i.e. the latter part of the financial year) the debt decreased by IL 171 million, as compared with a decrease of IL 118 million in the same months of 1964. Nearly all of this decline occurred in March, when the balance was reduced by IL 161 million. This is largely attributable to the fact that the Government postponed the execution of payments to the coming financial year, an operation reflected by developments in April, when the debt shot up by IL 111 million. All told, the increase in the Government's debt during the months April to November 1965 came to IL 258.2 million, as compared with IL 162 million in the corresponding period of the previous year. In December 1965 the Government's debt to the banking system was pared by IL 32.6 million.

The decline in the Government's debt during the first quarter of 1965 had a contractionary monetary effect, and partly offset the expansionary influence of foreign currency accumulation during this period. On the other hand, the increase in the Government's debt between April and November had an expansionary effect, and was the main factor responsible for the growth of the money supply during these months.

The big increase in credit granted to the Government from April to November 1965 was connected with the excess of expenditure over revenue during this period. Another factor was the decline in the outstanding balance of the Government's Short-Term Loan, which had set in toward the end of 1964, and was not taken into account in the Government budget. Instead of the anticipated rise of IL 55 million in budgetary revenue from this source during fiscal 1965/66, there was actually a budgetary expenditure of approximately IL 75 million in 1965.¹ In 1964 revenue from the Short-Term Loan totalled IL 51 million.

The net increase in the Government's debt to the banking system during the year reviewed totalled IL 54.6 million: the net debt to the Bank of Israel rose by IL 14 million and that to the banking institutions by IL 40.6 million. Credit to the Government consisted partly of the purchase of IL 23 million worth of certificates of a special Short-Term Loan series, under an agreement between the Government and the banks for the grant of a IL 50 million credit from funds subject to the ordinary liquidity requirements; the Government received the first IL 9 million of this sum in 1964.

¹ The balance of the ordinary Short-Term Loan contracted during the year by IL 75 million, while the balance of the special Short-Term Loan rose by IL 23 million, so that the overall net decline was IL 52 million.

Table XV-9
CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1958-65^a
(IL million)

End of period	From Bank of Israel	From banking institutions	Total bank credit	From earmarked deposits of the public ^b	Against Government deposits	From earmarked Government deposits	Balance of bill broker- age 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
1965	139.2	1,088.0	1,227.2	455.3	60.5	357.0	773.6
1965 January	122.2	993.3	1,115.5	347.4	49.0	315.6	624.6
February	116.0	985.7	1,101.7	352.0	56.4	312.3	649.7
March	127.9	1,007.6	1,135.5	357.7	60.7	343.2	659.8
April	132.1	977.5	1,109.6	359.4	61.8	344.9	672.4
May	129.6	959.8	1,089.4	371.0	61.2	345.8	689.6
June	131.4	969.3	1,100.7	372.1	63.3	350.9	701.2
July	126.8	986.1	1,112.9	387.8	64.7	353.2	718.8
August	128.0	1,025.3	1,153.3	397.4	60.9	356.6	733.9
September	126.3	1,063.4	1,189.7	395.8	57.7	360.9	731.1
October	125.9	1,059.5	1,185.4	404.9	54.5	360.7	732.0
November	131.1	1,088.6	1,219.7	410.0	60.4	362.9	746.2
December	139.2	1,088.0	1,227.2	455.3	60.5	357.0	773.6

^a Excluding loans to foreign borrowers.

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

^c Bank-negotiated bill credits were not recorded until 1963; the figure for the end of 1962 is an estimate.

^d Including devaluation and linkage increments.

(c) *Bank credit to the public*

1. *The expansion of credit:* Bank credit to the public increased during 1965 by IL 136.4 million, or 12.5 percent; this compares with a rise of IL 148.2 million, or 15.7 percent, in 1964 and an average annual increase of 19 percent during the years 1960–63. The average balance was 10.2 percent higher in 1965 than in 1964. The slower rate of credit expansion in recent years reflects the Bank of Israel's policy of moderating monetary expansion in years when the banks' liquid reserves are swelling rapidly and inflationary pressures are rampant in the economy. One of the factors helping to slow down credit expansion in 1965 was the reduction of the large deficiencies in the banking institutions' liquid cover at the end of 1964, when the fines levied thereon were raised. Despite the high liquidity ratio set, it was possible to expand credit on the above scale during the year reviewed owing to increases in types of credit outside the ordinary liquidity framework, such as controlled credit, rediscounts, and foreign currency credit.¹ These accounted for some 70 percent of the total rise in bank credit granted to the public during 1964 and 1965, as compared with only some 32 percent during the years 1961–63. It should be noted that controlled credit and rediscounts involve lower interest rates than ordinary bank credit, being utilized mainly for financing industrial and agricultural exports, as well as other purposes accorded high economic priority.

Ordinary credit in Israeli currency was expanded by IL 51 million in 1965, as compared with IL 36.4 million the year before. Controlled credit granted by the Bank of Israel within the framework of the 22 percent of deposits exempted from the liquidity requirements increased by IL 37.3 million, as against IL 32.9 million in 1964. As almost the entire quota of the type of controlled credit had been utilized by the beginning of 1965, the quota was raised to 23 percent, and later (for a short time) even to 24 percent. The 22 percent consists of 6 percent intended for export funds, and 16 percent for other purposes. With the raising of the quota to 23 percent, the proportion earmarked for export funds was increased from 6 to 8 percent, while the share of controlled credit for other purposes was reduced from 16 to 15 percent. In order to encourage banking institutions to meet their quota in the export funds, the ordinary liquidity ratio was reduced by an additional 1 percent for all institutions putting up their allotted share.²

Rediscounts at the Bank of Israel went up by only IL 8.1 million, after advancing by IL 30.5 million in 1964. The slow increase in 1965 was mainly due to the relatively small expansion of the Industrial Export Fund following the contraction of outstanding credit to the diamond industry. The entire incre-

¹ Of the total increase in foreign currency credit, IL 15 million was due to a change in the method of recording (see note on p. 328).

² See also section 5, "The Liquidity of Banking Institutions".

Table XV-10
INCREASE IN BANK CREDIT TO THE PUBLIC, 1961-65*
(IL million)

	1961	1962 ^b	1963	1964	1965
Bank of Israel rediscounts	4.4	-1.1	12.3	30.5	8.1
Bank credit					
In local currency					
From the 22% exempt from liquidity require- ments	15.8	24.2	8.5	32.9	37.3
Other credit	61.4	80.1	95.9	36.4 ^c	51.1
Total	77.2	104.3	104.4	69.3 ^c	88.4
In foreign currency	13.9	-3.3	38.6	48.4 ^c	39.9
Total bank credit	91.1	101.0	143.0	117.7	128.3
Total incremental credit from the banking system	95.5	99.9	155.3	148.2	136.4
Credit from and against Government deposits	47.1	97.8	16.4	22.2	35.8
Credit from deposits of the public earmarked for loans	60.1	39.8	37.2	72.3	110.3
Total increase in credit to the public	202.7	237.5	208.9	242.7	282.5

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

^b Excluding linkage and revaluation increments.

^c Revised figures.

ment of credit in the form of rediscounts was channelled to industry, the changes in other economic sectors offsetting one another.

Credit from deposits earmarked for loans was augmented to the considerable extent of IL 110.3 million in 1965, as compared with IL 72.3 million the year before. This type of credit is granted for long terms and usually is linked. The big growth in this item was due to the larger accumulation in provident funds, which account for the predominant share of earmarked deposits, and to a shift from other forms of investment. Credit from Government deposits also increased—by some IL 36 million, about half of which was given for the payment of tax debts. It should be noted that these types of credit do not expand the money supply.

Table XV-11

**OUTSTANDING CREDIT TO THE PUBLIC, BY SOURCE AND DESTINATION,
DECEMBER 31, 1965^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	120.2	100.9	221.1	2.1	223.2
Industry	252.4	391.1	643.5	30.8	674.3
Construction	5.3	77.9	83.2	10.9	94.1
Commerce	20.9	105.2	126.1	5.8	131.9
Public services	5.6	25.8	31.4	0.1	31.5
Local authorities	0.8	127.3	128.1	—	128.1
Credit and financial institutions	6.9	72.4	79.3	0.2	79.5
National Institutions	20.5	11.4	31.9	—	31.9
Business services	20.9	94.3	115.2	3.6	118.8
Private individuals	0.6	145.9	146.5	5.8	152.3
Miscellaneous ^c	3.9	72.6	76.5	0.9	77.4
Total	458.0	1,224.8	1,682.8	60.2	1,743.0
Percentages					
Agriculture	26.2	8.2	13.1	3.5	12.8
Industry	55.1	31.9	38.2	51.2	38.8
Construction	1.2	6.4	4.9	18.1	5.4
Commerce	4.6	8.6	7.5	9.6	7.6
Public services	1.2	2.2	1.9	0.2	1.8
Local authorities	0.1	10.4	7.6	—	7.3
Credit and financial institutions	1.5	5.9	4.7	0.3	4.6
National Institutions	4.5	0.9	1.9	—	1.8
Business services	4.6	7.7	6.8	6.0	6.8
Private individuals	0.1	11.9	8.7	9.6	8.7
Miscellaneous ^c	0.9	5.9	4.5	1.5	4.4
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 available data.

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

^c Including credit to artisans.

The growth of bank credit did not proceed at a uniform pace throughout the year, being concentrated chiefly in the last six months. Between the beginning of January and the end of May, there was even a decline of IL 1.4 million, but at the beginning of June the figure started to move up at a relatively rapid rate. Most of the increment occurred in August, September, and November, when credit was expanded by more than IL 100 million. This trend reflects developments in the banking institutions' liquidity deficiencies, which contracted until June but began to grow from July onward. The expansion of ordinary credit during the second half of 1965 was made possible mainly by the increasing of these deficiencies over this period, since the banking institutions' total liquid assets remained virtually unchanged from the end of May until the end of December, and their own capital likewise increased only slightly. The expansion of credit during the summer months is a seasonal phenomenon, characteristic especially of that granted to agriculture.

Together with the slower expansion of bank credit to the public, there was a decline in the growth of the bill brokerage trade. The outstanding balance of bills sold through the agency of banks rose by IL 160.6 million, or about 26 percent, as compared with a rise of IL 179 million, or 41 percent, in 1964, and totalled IL 773.6 million at the end of the year reviewed. However, in contrast to bank credit, the expansion of the bill brokerage trade was uniform throughout the year (except for a short interval during the holiday period in the autumn), averaging some IL 13.4 million per month. Among the factors braking the growth of bill transactions were the lower rate of monetary expansion, the higher interest charged on bills (chiefly owing to the raising of bank commissions), the slowdown in economic activity, and probably the growing demand for foreign currency assets, which reduced the sources of funds feeding the bill brokerage market. Moreover, some restraining influence was exerted by the Bank of Israel regulation limiting the volume of bank guarantees to three times the institutions' equity capital or 150 percent of their liquid assets, whichever is smaller. The weight of credit formally guaranteed by banks within the total volume of bills transactions continued upward, reaching 79.2 percent at the end of 1965 as compared with 75.8 percent at the end of the previous year.

The export finance funds showed little development during 1965. The Industrial Export Fund increased by only IL 3.3 million, to reach IL 212 million, after having expanded by IL 64 million in 1964. This was due to a decrease of some IL 24 million in the balance of credits for financing diamond exports, while credit granted to other industrial branches was approximately IL 27 million larger during the year reviewed, compared with a rise of IL 12 million in 1964. The smaller amount of financing given the diamond industry reflects, on the one hand, the reduction of stocks as a result of bigger diamond exports and the drop in raw diamond imports as compared with 1964, and on the other, the steps taken to prevent the duplication of credit facilities.

Table XV-12

**OUTSTANDING CREDIT TO THE PUBLIC, BY SECTOR OF DESTINATION,
1958-65^a**

(End of period)

Sector	1958	1959	1960	1961	1962 ^b	1963	1964	1965
IL million								
Agriculture	114.4	129.7	143.4	157.4	176.6	170.2	196.7	223.2
Industry	130.5	163.6	214.4	264.4	392.5	517.5	636.2	674.3
Construction	28.2	36.9	42.6	52.1	62.5	75.0	84.3	94.1
Commerce	54.0	68.1	77.1	82.2	114.1	117.8	121.6	131.9
Public services	21.4	24.4	33.9	31.8	38.5	30.1	19.2	31.5
Local authorities	7.0	7.7	10.3	32.7	58.5	59.4	64.4	128.1
Credit and financial institutions	7.5	13.9	14.3	21.9	27.5	28.7	45.8	79.5
National Institutions	14.8	17.6	29.0	34.7	38.4	26.2	33.6	31.9
Business services	25.9	29.4	36.2	44.7	47.2	57.6	83.4	118.8
Miscellaneous ^c	66.7	78.6	97.0	119.5	152.1	180.3	197.0	229.7
Total	470.4	569.9	698.2	841.4	1,107.9	1,262.8	1,482.2	1,743.0
Percentages								
Agriculture	24.3	22.7	20.5	18.7	15.9	13.5	13.3	12.8
Industry	27.8	28.7	30.7	31.4	35.4	41.0	42.9	38.8
Construction	6.0	6.5	6.1	6.2	5.6	5.9	5.7	5.4
Commerce	11.5	11.9	11.0	9.8	10.3	9.3	8.2	7.6
Public services	4.5	4.4	4.7	3.8	3.5	2.4	1.3	1.8
Local authorities	1.5	1.3	1.5	3.9	5.3	4.7	4.3	7.3
Credit and financial institutions	1.6	2.4	2.0	2.6	2.5	2.3	3.1	4.6
National Institutions	3.1	3.1	4.2	4.1	3.5	2.1	2.3	1.8
Business services	5.5	5.2	5.2	5.3	4.3	4.6	5.6	6.8
Miscellaneous ^c	14.2	13.8	13.9	14.2	13.7	14.2	13.3	13.1
Total	100.0	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, as well as 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 the local authorities.

^c Including credit to private individuals.

The Agricultural Export Fund was enlarged by IL 3 million in 1965, to reach IL 6.9 million; most of the additional credit was for financing the cultivation of export crops, and only a small proportion for financing shipments to foreign markets. The Industrial Working Capital Fund was increased by IL 40 million in 1965, following a special arrangement for the granting of credits for this purpose. By the end of 1965 the outstanding balance of this fund stood at approximately IL 20 million.

2. *The destination of credit:* The data on the sectorial distribution of credit include loans from earmarked deposits of the public, as well as credit against Government deposits, which is mainly granted for the payment of tax debts. The fact that industrial credits were only IL 38 million larger in 1965 is attributable to the decline of IL 30 million in outstanding credit to the diamond branch. Credit to other industries went up IL 68 million, compared with a rise of IL 37 million in 1964. The decrease in respect of the diamond industry brought down the share of the entire industrial sector within total outstanding credit from 42.9 percent at the end of 1964 to 38.8 percent at the end of 1965. The relative share of farm credit continued downward during the year reviewed, standing at 12.8 percent at the end of the year compared with 13.3 percent at the end of 1964. The share of industry and agriculture in incremental credit controlled by the Bank of Israel was larger, the industrial sector (including the diamond branch) receiving 69-percent of the total increase and agriculture some 36 percent.¹

The incremental credit to local authorities in part constitutes new credit from the proceeds of debenture issues floated by bank subsidiaries in accordance with Treasury regulations, but some of it does not represent new credit at all, reflecting merely the transfer to one of the banking institutions for collection of outstanding loans granted to local authorities. The increase in credit to financial institutions mainly reflects the transfer of loans granted by banking institutions to shipping companies through the agency of financial institutions. The additional credit granted to the services sector in 1965 consists largely of credit to the public services. The weight of other sectors within the total volume of credit did not change to any appreciable extent.

5. THE LIQUIDITY OF BANKING INSTITUTIONS

In 1965 there was a rise in the effective liquidity ratio and a consequent drop in the liquidity deficiencies of banking institutions. The effective liquidity ratio rose from 45.4 percent at the end of 1964 to 47.3 percent at the end of 1965. The average monthly liquidity ratio was also higher, reaching 45.9 percent as against 43.2 percent in 1964.

After a decline in 1964 of IL 2 million in the liquid assets of banking insti-

¹ In the other sectors the balance of controlled credit declined.

CHANGES IN THE LIQUID ASSETS OF BANKING INSTITUTIONS,* BY SOURCE, 1959-65
(IL million)

End of period	Credit from the Bank of Israel		Net foreign currency with Bank of Israel	Net balances in transit between banking institutions	Total (1) + (2) + (3) + (4)	Cash held by the public ^c	Net foreign currency balances of banking institutions at Bank of Israel	Liquid assets held against deposits requiring 90% or 100% liquid cover ^d	Total (6) + (7) + (8)	Ordinary liquid assets in Israeli currency (5)-(9)
	To the public, net ^b	To the Govt.								
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
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	1,247.1	1.1	1,284.1	409.4	490.4	26.5	926.3	357.8
1963	79.3	43.5*	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
1965	127.4	143.6	1,910.3	-0.4	2,180.9	657.4	884.7	32.2	1,574.3	606.6
1965 January	115.4	121.1	1,635.8	1.5	1,873.8	606.2	733.5	35.1	1,374.8	499.0
February	109.9	113.4	1,667.3	3.1	1,893.7	615.5	739.7	34.7	1,389.9	503.8
March	103.3	-55.4	1,829.6	2.5	1,880.0	623.4	750.7	28.3	1,402.4	477.6
April	123.8	55.1	1,801.1	2.4	1,982.4	637.0	762.0	26.6	1,425.6	556.8
May	117.7	39.8	1,882.3	0.8	2,040.6	634.2	770.3	29.6	1,434.1	606.5
June	114.9	68.1	1,900.6	0.9	2,084.5	639.7	782.5	30.1	1,452.3	632.2
July	115.7	85.4	1,879.8	-0.5	2,080.4	649.6	791.5	32.3	1,473.4	607.0
August	110.5	83.3	1,889.7	1.5	2,085.0	655.9	805.5	27.3	1,488.7	596.3
September	116.4	142.7	1,867.3	1.8	2,128.2	680.4	819.0	30.3	1,529.7	598.5
October	108.2	174.3	1,841.5	-2.0	2,122.0	689.0	844.1	32.9	1,566.0	556.0
November	122.7	174.1	1,847.6	-2.2	2,142.2	677.9	873.6	33.3	1,584.8	557.4
December	127.4	143.6	1,910.3	-0.4	2,180.9	657.4	884.7	32.2	1,574.3	606.6

* Net of liquid assets held against deposits requiring 90 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 Exclusive of demand deposits held for other banking institutions, which are listed net in column (4).

* Including credit from the Bank of Israel for the advance repayment of foreign liabilities, which actually had no effect on the banking institutions' liquid assets.

tutions and an increase of only IL 25 million in deposits requiring ordinary liquid cover, during the year reviewed both items resumed their rapid growth, the former rising by IL 76.7 million. The arrangement under which these institutions purchased bills from the Bank of Israel with the unutilized portion of the 22 percent quota exempted from the liquidity regulations was terminated in February 1965, and by the end of April the banking institutions returned to the Bank of Israel IL 15.6 million in bills which had fallen due. The total amount of deposits subject to the ordinary liquidity requirements rose during 1965 by IL 116.4 million.

The growth of the banking institutions' liquid assets can be attributed mainly to the swelling of the Bank of Israel's foreign exchange reserves by IL 281.5 million during the year. In addition, there was a small increase of IL 27.7 million in the volume of credit granted by the Bank of Israel to the public and to the Government. Among the factors acting to hold down the increase in liquid assets, the most striking was the growth of the banking institutions' foreign currency deposits with the Bank of Israel (mainly Pazak and Tamam). These grew by IL 170.9 million, while the amount of cash held by the public increased by IL 67 million (see Table XV-13).

Since the average weekly liquidity deficiency went up appreciably in 1964, the Bank of Israel raised the fine levied on such deficiencies in February 1965. The penalties were set at rates ranging from 10 percent on deficits not exceeding 2 percent of the deposits requiring ordinary liquid cover to 20.5 per cent on deficits exceeding 9 percent of such deposits.¹

The formal liquidity ratio, including the 22 percent quota exempted from the ordinary liquidity requirements, stood at 69 percent² at the beginning of 1965. The 22 percent quota, as already pointed out, breaks down as follows: 6 percent for credits granted through the export finance funds, and 16 percent for other types of controlled credit. Since the 6 percent earmarked for the export funds was fully drawn on at the beginning of 1965, the quota was raised to 7 percent in March and to 8 percent in June, while the overall quota was raised to 23 percent in June. At the same time, the formal liquidity ratio was reduced in that month from 69 to 68 percent. These two developments reduced the required liquidity ratio by 2 percent, but only those banking institutions which had paid their entire 8 percent quota into the export fund were entitled to benefit from this. In order to permit the granting of other kinds of controlled credit—e.g. for industrial working capital, citriculture, etc—after the allotted quota had been utilized, it was provisionally raised by 1 percent between October 1965 and February 1966, with the result that during this period the liquidity ratio declined by a further 1

¹ The fine was previously 10 percent regardless of the size of the deficit.

² In other words, the liquidity ratio actually required was 69 percent, minus that part of the 22 percent quota utilized for the granting of controlled credit.

Table XV-14

**THE LIQUIDITY OF BANKING INSTITUTIONS IN LOCAL CURRENCY,^a
1958-65**

(IL million)

End of period	Liquid balances at Bank of Israel	Cash held by banking insti- tutions	Net balances in transit between banking insti- tutions	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) — × 100 (6) (6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1958	175.8	12.6	8.6	19.2	177.8	453.7	39.2
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	38.1
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
1965	610.1	29.1	-0.4	32.2	606.6	1,283.4	47.3
1965 January	500.2	32.4	1.5	35.1	499.0	1,157.1	43.1
February	502.4	33.0	3.1	34.7	503.8	1,162.7	43.3
March	470.1	33.3	2.5	28.3	477.6	1,150.4	41.5
April	548.3	32.7	2.4	26.6	556.8	1,188.1	46.9
May	600.1	35.2	0.8	29.6	606.5	1,216.4	49.9
June	628.1	33.3	0.9	30.1	632.2	1,264.9	50.0
July	607.9	31.9	-0.5	32.3	607.0	1,263.7	48.0
August	586.8	35.3	1.5	27.3	596.3	1,262.7	47.2
September	587.7	39.3	1.8	30.3	598.5	1,301.1	46.0
October	555.0	35.9	-2.0	32.9	556.0	1,267.3	43.9
November	556.5	36.4	-2.2	33.3	557.4	1,275.6	43.7
December	610.1	29.1	-0.4	32.2	606.6	1,283.4	47.3

^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 here cited are taken from 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. Figures for ordinary liquid assets, deposits requiring ordinary liquid cover, 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 banking institutions, which are listed net in column (3).

percent, while the quota of exemptions from the liquidity requirements reached 24 percent.

The recognized deficiency¹ in liquid cover decreased by IL 2.5 million during 1965 as a result of new directives issued by the Bank of Israel designed to reduce this deficit gradually between June 1965 and May 1967 at the rate of $\frac{1}{4}$ percent of the volume of deposits requiring liquid cover per month. As of June 1967, the deficiency will be decreased at a monthly rate of $\frac{1}{2}$ percent of the volume of such deposits, until it is finally eliminated. The recognized deficiency totalled IL 25.7 million at the end of 1965.

Developments in the liquidity of banking institutions were not uniform throughout the year. In the first half of 1965 there was a substantial expansion of liquid assets, and a similar growth of deposits subject to the ordinary liquidity requirements. As a result, the effective liquidity ratio rose during this period, reaching a high of 50 percent at the end of June, while the deficiency virtually disappeared by June 1965. Among the factors responsible for these developments were the accumulation of foreign currency assets, which was concentrated entirely during the first half of the year, and the nonincrease in credit to the public during this period. As of July, the liquidity ratio began to fall and the deficiency rose steadily. This was due to the decline in total liquid assets, in the main owing to the contraction of foreign exchange reserves at the Bank of Israel, and to the expansion of credit to the public. The second half of 1965 witnessed a considerable rise in Bank of Israel credit to the Government, but on the other hand there was a substantial increase in foreign currency deposits with the Bank of Israel, which tended to reduce the liquid assets of the banking institutions. Furthermore, during the second half of 1965 there was a marked growth in credit to the public, which stemmed partly from the reduction of the liquidity deficiency during the first half of the year, and partly from the seasonal expansion of credit during the summer months.

The rise in the effective liquidity ratio in December is an annual occurrence, reflecting the banking institutions' attempt to improve their balance sheets toward the end of the calendar year.

6. DEVELOPMENT OF BANKING INSTITUTIONS

The combined balance sheet of the banking institutions increased by 16.6 percent in 1965, compared with a rise of 17 percent the year before. Excluding contingent accounts, the growth came to 15 percent, as against 14 percent the previous year, the higher rate chiefly reflecting the more rapid accumulation of foreign currency assets. On the other hand, the contingent accounts expanded

¹ For an explanation of the "recognized deficiency", see the Bank of Israel Annual Report for 1961, Chapter XIV, section 1.

Table XV-15

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1964-65

	IL million		Percent		Increase or decrease (-)	
	1964	1965	1964	1965	IL m.	%
Assets						
Cash and balances at						
Bank of Israel	1,348.4	1,608.1	33.7	34.8	259.7	19.3
Loans to the public ^a	986.8	1,097.9	24.6	23.8	111.1	11.2
Loans to the Government	30.9	46.4	0.8	1.0	15.5	50.2
Loans to the public						
From Govt. deposits	381.7	417.4	9.5	9.0	35.7	9.4
From deposits						
earmarked for loans	345.0	455.3	8.6	9.8	110.3	32.0
Foreign currency assets	389.1	412.9	9.7	8.9	23.8	6.1
Securities	223.3	284.3	5.6	6.2	61.0	27.3
Real estate	69.0	78.9	1.7	1.7	9.9	14.3
Net balances with other banking institutions	2.8	3.6	0.1	0.1	0.8	28.6
Other accounts	226.8 ^b	215.5	5.7	4.7	-11.3	-5.0
Total	4,003.8 ^c	4,620.3	100.0	100.0	616.5	15.4
Liabilities						
Demand deposits	1,116.0	1,239.9	27.9	26.8	123.9	11.1
Less liquid deposits ^a	1,014.0	1,213.0	25.2	26.3	199.0	19.6
Foreign liabilities ^c	552.6	653.8	13.8	14.2	101.2	18.3
Government deposits	396.6	429.8	9.9	9.3	33.2	8.4
Deposits earmarked for loans	352.3	464.0	8.8	10.0	111.7	31.7
Equity capital	246.7	282.7	6.2	6.1	36.0	14.6
Debentures	6.2	16.0	0.2	0.3	9.8	158.1
Other accounts	319.4 ^c	321.1	8.0	7.0	1.7	0.5
Total	4,003.8 ^c	4,620.3	100.0	100.0	616.5	15.4
Contingent accounts						
Balances held by and for banking institutions	73.1	87.4			14.3	19.6
Clients' liabilities and guarantees for clients	1,159.0	1,396.5			237.5	20.5
Total	1,232.1 ^c	1,483.9			251.8	20.4
Grand total	5,235.9 ^c	6,104.2			868.3	16.6

^a The figure for 1964 is IL 11.6 million higher than that in Tables XV-6 and XV-9, and that for 1965 is IL 9.9 million higher; since they include Bank of Israel loans to the banking institutions in these amounts. The difference in less liquid deposits is further increased by the amount of loans from various institutions, totalling IL 7.4 million in 1964 and IL 6.0 million in 1965.

^b Revised figures.

^c Including deposits of nonresidents.

at a lower rate than in 1964—by some 20 percent as against 28 percent—owing to the slower growth of the bill brokerage trade.

On the assets side, the outstanding development was the increase in cash and balances at the Bank of Israel, which reached IL 259.7 million as against IL 142.1 million in 1964. This was connected, on the one hand, with the growth of Israeli currency deposits requiring liquid cover and the rise in the effective liquidity ratio, which led to an increase in the banking institutions' deposits at the Bank of Israel, and on the other hand, with the marked expansion of Pazak and Tamam deposits, which under existing regulations must be kept *in toto* at the Bank of Israel. Credit to the public was expanded to a lesser extent than in 1964. The increase of IL 61 million in the securities item resulted partly from the purchase of IL 23 million worth of certificates from the special Short-Term Loan series under the agreement to lend IL 50 million to the Government, and partly from purchases of approved securities out of the incremental funds accumulated in saving schemes.

On the liabilities side, demand deposits resumed their upward trend, advancing by IL 124 million as against IL 33 million in 1964. The rapid accumulation of Pazak and Tamam deposits found expression on the liabilities side in an increase of IL 199 million in the less-liquid deposits item. On the other hand, the growth of equity capital was much slower—IL 36 million compared with IL 59 million in the preceding year. Consequently, there was a slight decline in the weight of equity capital in total liabilities (including contingent accounts)—from 4.7 percent at the end of 1964 to 4.6 percent at the end of 1965.¹

Contingent accounts increased more slowly in 1965—20 percent as against 28 percent in 1964—chiefly because of the slower growth of the bill brokerage trade.² Restrictions on the volume of bank guarantees were effective as regards certain banking institutions, but others were still able to expand the volume of guarantees since they had not yet reached the stipulated “ceiling”.

After a period of five years during which the number of banking institutions in Israel remained unchanged, their ranks were expanded by one in 1965, with the opening of the Agudat Israel Bank. On the other hand, the number of cooperative credit societies declined after three of the cooperatives merged with a fourth and became branches of the latter. The number of branch offices of banking institutions continued to show a slower increase, 22 being added in 1965 as against 27 the year before. About half the new offices were opened in development areas, Arab villages, and small localities. The three

¹ The weight of equity capital in the combined balance sheet of Israel's banking institutions, exclusive of contingent accounts, declined from 6.2 percent at the end of 1964 to 6.1 per cent at the end of 1965.

² The reasons for the slower expansion of the bill brokerage trade are given in section 4(c), “Bank credit to the public”.

big banks opened eight new branches, while nine were opened by other banks. There were five new branch offices of credit cooperatives at the end of 1965, but three of these were previously head offices of cooperatives which had merged.

Table XV-16
BANKING INSTITUTIONS AND THEIR BRANCHES, 1955-65

End of period	1955	1956	1957	1958	1959	1960	1961	1962	1963	1964	1965
The 3 big banks											
Head offices	3	3	3	3	3	3	3	3	3	3	3
Branches	104	114	193	219	244	289	335	351	363	372	380
Total	107	117	196	222	247	292	338	354	366	375	383
Other banks											
Head offices	21	22	22	22	22	23	23	23	23	23	24
Branches	52	61	67	72	83	111	151	168	180	195*	204
Total	73	83	89	94	105	134	174	191	203	218*	228
Credit cooperatives											
Head offices	94	93	59	52	42	29	27	26	25	23	20
Branches	74	79	49	48	54	60	72	72	76	79	84
Total	168	172	108	100	96	89	99	98	101	102	104
All banking institutions											
Head offices	118	118	84	77	67	55	53	52	51	49	47
Branches	230	254	309	339	381	460	558	591	619	646*	668
Total	348	372	393	416	448	515	611	643	670	695*	715

* Revised figures.

The weight of the Big Three in total banking business underwent few changes in 1965. Their share of loans to the public and demand deposits remained unchanged, while their share of less liquid deposits declined from 76.3 to 75.5 percent. On the other hand, their weight in the bill brokerage trade edged up from 43 to 45.5 percent, while the share of other banks declined and that of credit cooperatives rose slightly. The share of the Big Three in the bill brokerage trade remains noticeably lower than in other types of banking activity. This is ascribable to the fact that they entered this business at a relatively late stage, and have not yet reached their permitted quotas in all cases. It should further be noted that they guarantee virtually all the bills sold through their intermediation.

Table XV-17

**CASH AND BALANCES AT THE BANK OF ISRAEL, CREDIT, DEPOSITS,
AND BALANCE OF BILL BROKERAGE TRADE, 1962-65**

(percentages)

End of period	The 3 big banks	Other banks	Credit cooperatives	Total
Cash and balances at the Bank of Israel				
1962	66.1	27.7	6.2	100.0
1963	64.9	29.1	6.0	100.0
1964	66.8	27.1	6.1	100.0
1965	67.8	26.3	5.9	100.0
Loans to the public from banking institutions^a				
1962	68.8	22.9	8.3	100.0
1963	67.3	25.8	6.9	100.0
1964	67.7	26.2	6.1	100.0
1965	67.9	26.8	5.3	100.0
Local currency demand deposits				
1962	64.7	25.1	10.2	100.0
1963	63.2	27.4	9.4	100.0
1964	64.5	25.9	9.6	100.0
1965	64.3	26.1	9.6	100.0
Other deposits^b				
1962	71.3	23.5	5.2	100.0
1963	71.9	23.6	4.5	100.0
1964	76.3	19.5	4.2	100.0
1965	75.5	20.8	3.7	100.0
Bill brokerage				
1962	36.2	54.8	9.0	100.0
1963	38.5	49.0	12.5	100.0
1964	43.0	45.9	11.1	100.0
1965	45.5	42.3	12.2	100.0

^a Including credit to nonresidents.

^b Including deposits of nonresidents (Patach).

7. INCOME AND EXPENSES OF BANKING INSTITUTIONS

Developments in banking institution income and expenses during 1965 differed in several respects from those of the previous year:

(a) Operating income rose at an accelerated rate again, following a marked slowdown in the previous year. On the other hand, there was a somewhat slower rise in operating expenses. As a result, operating profit went up by approximately 25 percent, in contrast to a 9 percent drop in 1964.

(b) There was a very substantial decline in capital gains, especially from the sale of securities. On the other hand, capital losses from this source were

Table XV-18

INCOME AND EXPENSES OF BANKING INSTITUTIONS, 1964-65

	IL million		Percent		Percent increase or decrease (-)	
	1964	1965	1964	1965	From 1963 to 1964	From 1964 to 1965
Operating income						
Interest on loans	137.0	156.8	45.1	43.2	16.2	14.5
Service charges	69.1	93.4	22.8	25.7	18.7	35.2
Interest on deposits with the Bank of Israel and other banks	63.0	76.6	20.8	21.1	16.5	21.6
Other income ^a	34.4	36.4	11.3	10.0	15.1	5.8
Total operating income	303.5	363.2	100.0	100.0	16.7	19.7
Operating expenses						
Wages and fringe benefits	107.6	129.1	39.0	39.3	22.4	20.0
Interest on deposits ^b	118.8	146.0	43.1	44.5	17.9	22.9
Other expenses ^c	49.3	53.3	17.9	16.2	21.1	8.1
Total operating expenses	275.7	328.4	100.0	100.0	20.2	19.1
Profits						
Operating profit	27.8	34.8	65.3	81.5	-9.4	25.2
Capital gains (net)	14.8	7.9	34.7	18.5	-6.3	-46.6
Total profits	42.6	42.7	100.0	100.0	-8.4	0.2
		1961	1962	1963	1964	1965
Operating profit as a percentage of operating income		7.5	8.2	11.8	9.2	9.6
Operating profit as a percentage of equity capital ^d		18.3	20.7	21.3	13.0	13.3
Total profits as a percentage of equity capital ^d		23.0	29.8	32.4	19.7	16.2

^a Including income from securities (other than capital gains) and from foreign currency, trustee, and insurance transactions.

^b Including interest and commission on loans received and on rediscounts, as well as fines for liquidity deficiencies.

^c Including administrative expenses, depreciation, donations, and bad debts.

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

bigger, so that the banking institutions' capital gains were only half as large as in 1964. Total profits remained virtually unchanged—IL 42.7 million as against IL 42.6 million in 1964.

(c) The changing trend in the composition of operating income, which was discernible up to 1963 but not in 1964, reasserted itself in 1965.

Income from interest on loans declined from 45 percent of total operating income to 43 percent. On the other hand, the share of income from service charges went up from 23 to 26 percent. The increase was due partly to the raising of commission rates during 1965, in connection with both bill brokerage and other services.

The two other income items showed less conspicuous changes: the weight of interest on deposits went up slightly, while that of income from foreign currency and securities transactions (exclusive of capital gains) declined.

The changes in the structure of the banking institutions' operating expenses were less striking. The weight of interest payments rose, and there was also some increase in the weight of the wages, salaries, and fringe benefit item. On the other hand, the weight of other administrative expenses declined (there was even an absolute decrease in bad debts). The rise in interest paid on deposits mainly reflected the rapid accumulation in Pazak and Tamam accounts (as against the rise in this expense item there was an increase in income from deposits with the Bank of Israel).

Outlay on wages and fringe benefits went up at a slightly lower rate in 1965, but this reflected the smaller increase of personnel and not a smaller increase in the average wage bill per employee. The average number of persons employed by the banking institutions was 5.5 percent higher in 1965; this compares with a rise of some 9 percent in 1964 and more than 11 percent in 1962 and 1963. Average expenditure per employee rose by 13 percent in 1964 and nearly 14 percent in 1965.

Operating income was larger than in 1964. Operating profit before income tax amounted to 9.6 percent of operating income (as contrasted with 9.2 percent in 1964). Operating profit also increased relative to average equity capital—from 13.0 percent in 1964 to 13.3 percent in 1965. Equity capital expanded much more slowly than in 1963 or 1964, but the growth still averaged 19.8 percent over the year, exceeding the rise in liabilities.

On the other hand, overall profitability declined. Total profits, including capital gains but before deduction of income tax, amounted to 16.2 percent of average equity capital, as against 19.7 percent in 1964. This downtrend is explained by the steep drop in capital gains during 1965. (During the period 1962–64 capital gains accounted for nearly a third of total profits. The share of capital gains within total profits in 1965 fell to a fifth—about the same proportion as in 1960 and 1961.)