

## CHAPTER XV

# MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

### 1. MAIN MONETARY DEVELOPMENTS

THE MODERATION of economic activity, which began to make itself felt in 1965, became more pronounced during the year reviewed, particularly in the second half. The real gross national product did not increase at all, while full employment, which had long characterized the economy, gave way to mounting unemployment. The decline in net capital imports led to some depletion of foreign exchange reserves, after foreign currency accumulation had for many years been the main cause of monetary expansion. In view of these developments, the Bank of Israel followed an expansionary monetary policy—after having long pursued an opposite course—in order to check the growth of unemployment and the further slackening of economic activity. The rate of economic activity was unquestionably affected also by the changed attitude of the public toward the holding of various financial assets instead of real assets.

The money supply expanded by IL 109 million over the course of the year—i.e. by some 5.7 percent as against 11.2 percent in 1965. The average level went up by 7.3 percent, compared with 9 percent in the previous year. Financial assets of the public, which consist of the money supply and less liquid deposits with the banking system, averaged 12.4 percent higher in 1966, as against a rise of some 13 percent in 1965 and 12.6 percent in 1964. If bank-negotiated bill credits and the Government Short-Term Loan are included with financial assets, the growth rate was faster in 1966 than in 1965.<sup>1</sup>

In 1964 and 1965 monetary expansion was less pronounced than in the two preceding years. Nevertheless, the relatively rapid growth of the national product continued during this period, while prices mounted considerably. These developments helped to reduce the excess liquidity which had existed in the economy since the devaluation of 1962, and led to a somewhat tighter money situation in the latter part of 1965. The same trends carried over through the first quarter of 1966: the contraction of the money supply which began in October 1965 continued, while the velocity of demand deposits rose, as did the interest rate in the bill brokerage market. As from April 1966, the liquidity situation improved

<sup>1</sup> 14.3 percent compared with 13.4 percent.

**Table XV-1**  
**INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1963-66**  
 (IL million)

	1963	1964	1965	1966	Percent increase or decrease (-) as against previous year			
					1963	1964	1965	1966
<b>Sources</b>								
Accumulation of foreign currency assets	227.4 <sup>a</sup>	54.2 <sup>b</sup>	219.0	-70.0	18.0	3.6	14.3	-4.0
Expansion of credit to the public <sup>c</sup>	155.3	148.2	136.4	291.4	19.7	15.7	12.5	23.7
Expansion of credit to the Government	118.7 <sup>d</sup>	95.4	54.6	201.0 <sup>e</sup>	824.3	71.7	23.9	71.0
Bank of Israel open-market operations	—	—	—	-15.1	—	—	—	—
Other factors, net	-59.6	-43.8 <sup>b</sup>	-16.5	0.3	†	†	†	†
<b>Total</b>	<b>441.8</b>	<b>254.0</b>	<b>393.5</b>	<b>407.6</b>	<b>22.0</b>	<b>10.4</b>	<b>14.6</b>	<b>13.2</b>
<b>Components</b>								
Money supply	352.7	98.1	191.5	108.9	28.1	6.1	11.2	5.7
Less-liquid deposits <sup>f</sup>	89.1	155.9	202.0	298.7	11.9	18.6	20.3	25.0
<b>Total</b>	<b>441.8</b>	<b>254.0</b>	<b>393.5</b>	<b>407.6</b>	<b>22.0</b>	<b>10.4</b>	<b>14.6</b>	<b>13.2</b>

<sup>a</sup> After the advance repayment of IL 148.7 million in foreign debts.

<sup>b</sup> Revised figure.

<sup>c</sup> Excluding credit from deposits earmarked for loans.

<sup>d</sup> Including credit totalling IL 148.7 million from the Bank of Israel for the advance repayment of Government liabilities abroad.

<sup>e</sup> Including the deposit with the Treasury of IL 19 million proceeds from the sale of a debenture issue by a banking institution; does not include Bank of Israel purchases of bonds on the Stock Exchange.

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

<sup>g</sup> Net of deposits earmarked for loans.

Diagram XV-1  
 FINANCIAL ASSETS, BY COMPONENT, 1966

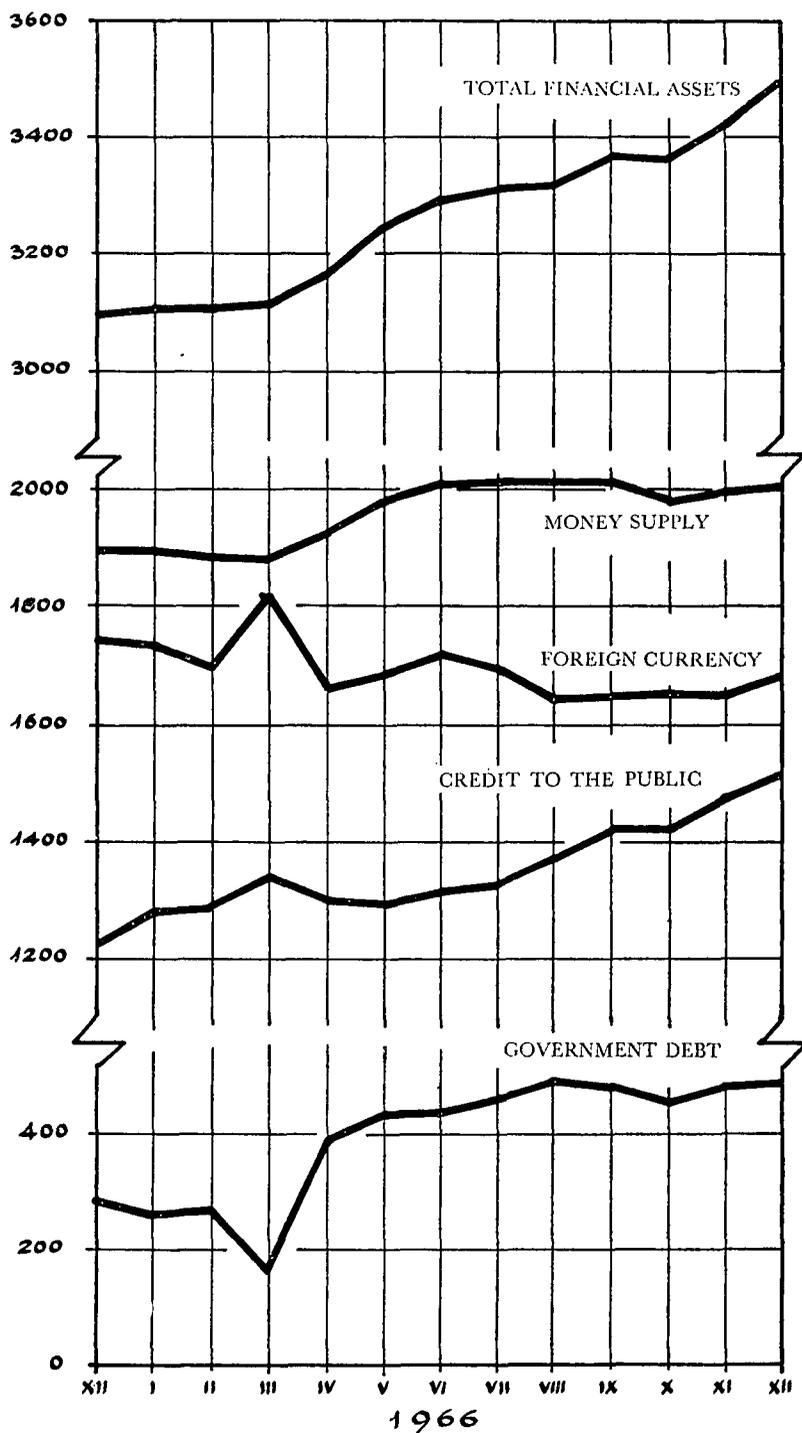
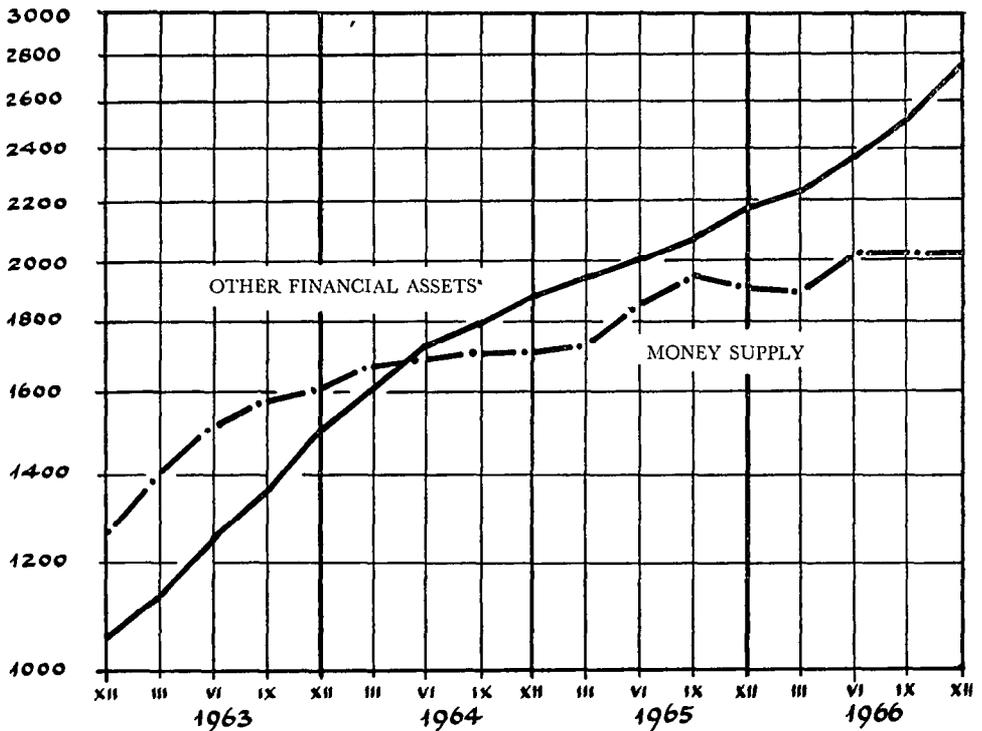


Diagram XV-2

## FINANCIAL ASSETS HELD BY THE PUBLIC, 1963-66



<sup>a</sup> Nonliquid deposits of the public, Short-Term Loan, and bills purchased through banks.

somewhat following the large-scale expansion of credit to the Government and the public, and the money supply began to swell.

While the growth of the money supply in 1966 was relatively slow as compared with the two preceding years, it must be remembered that the real national product failed to advance in 1966, in contrast to a rise of 8 and 10 percent respectively in 1965 and 1964. Moreover, the average percentage rise in financial assets of the public was considerably higher than that in the national product at current prices, whereas in 1965 the opposite was true. The monetary expansion of 1966 was thus reflected more in the "near-money" financial assets than in means of payment, a development that exerted a contractionary effect on the level of aggregate domestic demand.

The marked growth in financial assets of the public (including bill brokerage and the Short-Term Loan) in 1966 largely reflects the reduced demand for real assets. The year witnessed a striking decrease in purchases of dwellings, automobiles, and other durable consumer goods. On the other hand, there was a stronger demand for financial assets, especially those that are not value-linked, bear a high rate of interest, and are highly liquid—such as bills sold through

the agency of banks, the Short-Term Loan, and time deposits. This development was connected on the one hand with the intensification of the economic slowdown and unemployment, factors which caused uncertainty concerning future earnings, and on the other hand with the expectation that prices would firm, which encouraged the holding of nonlinked assets. The growing slump in construction activity led to the weakening of housing prices and expectations of a further decline. This induced some potential buyers to defer purchases of real estate and temporarily acquire nonlinked liquid assets, the real return on which rose as a result of the stabilization of prices during the second half of the year. The appearance of a new asset in the middle of the year—Short-Term Loan certificates for three months—and the substantial increase in the interest rate on time deposits as from September, when the liquidity ratio on these deposits was lowered, tended to augment the demand for such assets. The changed preference of the public for various types of assets, due partly to the depressed state of the economy, further intensified the economic slowdown owing to the growing reluctance on the part of buyers and to shrinking demand for real assets.

The shift from real to financial assets should be reflected by a rise in the share of total income held in the form of financial assets, i.e. by a decrease in the circulation velocity of the money supply. Indicators of the circulation velocity are presented in Table XV-5. They show that the velocity declined only slightly relative to available resources, and even rose slightly relative to the national product. This can be attributed to the introduction of new financial assets constituting near substitutes for means of payment, such as the three-month Short-Term Loan certificates and time deposits for six months or more carrying a relatively high rate of interest. This undoubtedly induced a certain switch from cash and demand deposits to these and other short-term financial assets, and increased the weight of total liquid financial assets relative to the national product or to the economy's available resources at current prices.

In the light of the conditions prevailing in the economy in 1966—the moderation of economic activity on the one hand, and increased supply in the money market on the other—interest rates might have been expected to decline by more than the actual slight, lagged fall toward year's end. Moreover, total credit granted to the public by banking institutions and bank-negotiated bill credits could have been expected to expand more slowly than the very rapid rate that actually occurred.

The decline in capital formation and the stability in output reduced the need for working capital credits, but on the other hand, the much larger wage bill and the cost of financing expanded stocks tended to increase the demand for credit. In addition, the dearer cost of foreign credits, which led to the contraction of short-term credit from abroad, accentuated the demand for domestic credit substituting for part of the foreign sources. However, on balance, the demand for short-term domestic credit in 1966 presumably was no greater

than in previous years, and may even have been smaller. Taking into account the marked expansion of ordinary bank credit to the public, which is relatively cheap, bank-negotiated bill credits might have been expected to expand more slowly and the interest rate to drop sharply, especially in view of the larger supply of funds to this market. However, the total amount of credit provided through the bill brokerage trade rose during the first half of 1966 by IL 247 million, or 32 percent, as compared with a rise of IL 161 million, or 26 percent, the year before. In the latter part of 1966 the interest rate on such transactions, especially in their various indirect forms, did in fact drop slightly following a prolonged rising trend, but a sizable direct decline in the interest rate occurred only at the beginning of 1967. Partial data suggest that the demand of industry and agriculture for bank-negotiated bill credits increased relatively little during the year, but there was a growing demand from certain public bodies and local authorities, which found it difficult to balance their budgets from ordinary income. Moreover, the demand of certain large public companies in the construction sector also helped to absorb the big supply of funds to this market and to prop up the interest rate. The demand for credit by such public bodies is usually less sensitive to changes in the interest rate than that of private concerns.

As regards the Government Short-Term Loan, the bigger offer of certificates as from the middle of 1966 absorbed the funds supplied to this market without depressing the interest rate. The proceeds from the incremental sale of this loan by the Bank of Israel during the period June–October 1966, which totalled IL 85 million, were transferred to the Government for financing its operations, in accordance with the agreement whereby the Short-Term Loan was transferred to the Bank of Israel to serve as an instrument of its open-market operations.<sup>1</sup> Toward the end of 1966 and the beginning of 1967, the Bank of Israel reduced the yield on Short-Term Loan certificates several times, in order to check the growth of the public's holdings. The banking institutions, which had accumulated funds from investors in the bill brokerage trade as a result of the shortage of good notes offered, followed in the central bank's footsteps and cut the interest rate on such transactions at the beginning of 1967.

The sources of monetary expansion were also different in 1966 than in previous years. For many years the accumulation of foreign currency was the leading factor. In 1966 net capital imports were smaller than the balance of payments deficit on current account, so that foreign exchange reserves shrank by \$ 23 million, after having risen by \$ 73 million in 1965. The source of monetary expansion in 1966 was thus the larger volume of bank credit granted to the Government and the public.

The expansion of bank credit to the public was made possible by the activities of the Bank of Israel, since the volume of liquid assets held by banking

<sup>1</sup> See section 4 below.

institutions contracted during the year reviewed. The slower growth of the national product, mounting unemployment, and the decline in foreign exchange reserves induced the Bank of Israel to revise its monetary policy. For many years this policy aimed to limit credit and the liquidity of the economy, since such factors as the rapid foreign currency accumulation and the Government's deficit financing were causing a considerable increase in means of payment and inflationary pressures on the demand side. In 1966 the Bank of Israel for the first time adopted an expansionary monetary policy. However, the steps taken to expand credit and the relatively much larger amount of bank credit granted to the Government did not lead to a rapid growth of the money supply, since foreign currency balances decreased by \$ 23 million (as contrasted with an increase of \$ 73 million in the preceding year), and also because the monetary expansion of 1966 was reflected more in the growth of financial assets than of means of payment, in contrast to the situation in 1965 (see Table XV-1).

All told, the various sources of monetary expansion caused the money supply and less liquid deposits with banking institutions to go up by 13.2 percent in 1966, compared with 14.6 percent the year before.

The Bank of Israel expanded means of payment in two ways—by reducing the liquidity ratio and stepping up its rediscounts. The lowering of the liquidity ratio actually took place mainly during the second half of 1966, when unemployment began to mount and the full extent of the recession became apparent. During those six months the liquidity ratio was pared by some 6 percent: the formal liquidity ratio was reduced by 4 percent—from 69 percent<sup>1</sup> to 65 percent; the quota of controlled credit exempted from the liquidity requirements was increased by 1 percent—from 24 to 25 percent; while the liquidity ratio for time deposits for periods of six months or more was cut to only 10 percent, a step tantamount to reducing the overall liquidity ratio by about 1 percent, taking into account the volume of time deposits at the time. Previously, the same liquid cover had to be maintained against time deposits as for demand deposits. The relatively big expansion of credit from banking institution resources in 1966 was thus made possible, despite the decrease in their liquid assets, by the lowering of the liquidity ratio.

At the same time that it reduced the required liquidity ratio, the Bank of Israel considerably stepped up its rediscounting operations. The figure was IL 122 million larger in 1966, compared with a rise of only IL 8 million in 1965. Altogether, bank credit to the public was up IL 291.4 million, or 23.7 percent, during the year reviewed, as against IL 136.4 million, or 12.5 percent, in the preceding year. Besides the marked growth of bank credit to

<sup>1</sup> The formal liquidity ratio was actually 68 percent, but it applied only to banks that had met their 8 percent quota in the Export Finance Fund. Most of the banks failed to meet their quota, and consequently had to maintain a liquidity ratio of 69 percent.

the public, the year reviewed witnessed a substantial increase of IL 201 million in the Government's net debt to the banking system, which had grown by only some IL 55 million during 1965. Toward the end of 1966 the Bank of Israel slowed down the sale of Short-Term Loan certificates, and began to buy other bonds on the Stock Exchange in order to inject more liquidity into the economy.

## 2. THE MONEY SUPPLY

During the year reviewed the money supply expanded by IL 108.9 million, or 5.7 percent only, as compared with 11.2 percent in 1965. The increase in the average level amounted to 7.3 percent in 1966, in contrast to some 9 percent the year before.

The changes in the money supply during the year reviewed reveal a

**Table XV-2**  
**ANNUAL INCREASE IN THE MONEY SUPPLY, 1963-66**  
 (IL million)

Year	Balance at end of year	Change in end-year balance		Average annual balance	Change in average annual balance	
		IL m.	%		IL m.	%
<b>Cash</b>						
1963	525.0	115.7	28.3	496.0	113.2	29.6
1964	590.3	65.3	22.4	584.5	88.5	17.8
1965	657.4	67.1	11.4	647.1	62.6	10.7
1966	751.1	93.7	14.3	716.7	69.6	10.8
<b>Demand deposits</b>						
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
1966	1,256.7	15.2	1.2	1,250.7	64.4	5.4
<b>Money supply</b>						
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
1966	2,007.8	108.9	5.7	1,967.4	134.0	7.3

Table XV-3

**THE MONEY SUPPLY, BY MONTHS, 1966**  
(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.	%
1965 December	657.4	-20.5	-3.0	1,241.5	6.5	0.5	1,898.9	-14.0	-0.7
1966 January	667.6	10.2	1.6	1,230.2	-11.3	-0.9	1,897.8	-1.1	-0.1
February	671.8	4.2	0.6	1,209.4	-20.8	-1.7	1,881.2	-16.6	-0.9
March	701.8	30.0	4.5	1,184.8	-24.6	-2.0	1,886.6	5.4	0.3
April	704.4	2.6	0.4	1,223.4	38.6	3.3	1,927.8	41.2	2.2
May	700.5	-3.9	-0.6	1,280.0	56.6	4.6	1,980.5	52.7	2.7
June	712.6	12.1	1.7	1,296.5	16.5	1.3	2,009.1	28.6	1.4
July	730.7	18.1	2.5	1,284.9	-11.6	-0.9	2,015.6	6.5	0.3
August	725.2	-5.5	-0.8	1,287.3	2.4	0.2	2,012.5	-3.1	-0.2
September	742.4	17.2	2.4	1,269.7	-17.6	-1.4	2,012.1	-0.4	0.0
October	741.0	-1.4	-0.2	1,238.9	-30.8	-2.4	1,979.9	-32.2	-1.6
November	751.4	10.4	1.4	1,246.3	7.4	0.6	1,997.7	17.8	0.9
December	751.1	-0.3	0.0	1,256.7	10.4	0.8	2,007.8	10.1	0.5

similar pattern as in 1965: a slight increase or fall at the beginning and end of the year, with most of the growth taking place in the second quarter.

During the first quarter of 1966 the money supply contracted by some IL 12 million, continuing a trend that began in October 1965. In the second half of 1966 the level of the money supply remained stable. Most of the expansion, as already mentioned, was concentrated during the months April–June 1966, when means of payment soared by IL 122.5 million. The sole source of growth during these months was the very large increase in credit granted to the Government by the banking system, for both total credit to the public and foreign currency assets declined.

The slow rise of the money supply during the year was reflected chiefly in demand deposits, which advanced by only IL 15.2 million. The deceleration was even more striking in checking account deposits, which actually shrank by IL 5 million in 1966, while deposits not drawable by check expanded by approximately IL 20 million.

Cash in circulation with the public accounted for IL 93.7 million of the total increment to the money supply during 1966—i.e. for the overwhelming proportion. Consequently, the weight of this item within the money supply went up to 37.4 percent at the end of the year, as against 34.6 percent at the end of 1965. On an annual average, the rise was from 35.3 to 36.4 percent. The uptrend in the relative share of cash thus continued for the

**Table XV-4**  
**CASH AS A PERCENTAGE OF TOTAL**  
**MONEY SUPPLY, 1963-66**

<b>Annual average</b>		
	1963	33.3
	1964	34.7
	1965	35.3
	1966	36.4
<b>End of month</b>		
1966	January	35.2
	February	35.7
	March	37.2
	April	36.5
	May	35.4
	June	35.5
	July	36.3
	August	36.0
	September	36.9
	October	37.4
	November	37.6
	December	37.4

Table XV-5

INDICATORS OF THE CIRCULATION VELOCITY OF THE  
MONEY SUPPLY, 1963-66

Year	Average annual circulation velocity of the money supply in relation to:		Average annual velocity of demand deposits <sup>c</sup>
	National income <sup>a</sup>	Total available resources <sup>b</sup>	
	(1)	(2)	(3)
1963	4.13 <sup>d</sup>	6.16 <sup>d</sup>	18.9
1964	4.25 <sup>d</sup>	6.45 <sup>d</sup>	19.2
1965	4.67 <sup>d</sup>	6.78 <sup>d</sup>	21.2
1966	4.71	6.66	21.9

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

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

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

<sup>d</sup> Revised figure.

third consecutive year, following a protracted movement in the opposite direction.

The slowness of the growth of the money supply stands out all the more in view of the fact that the total sources of monetary expansion even increased somewhat—from about IL 394 million in 1965 to some IL 408 million. The reason for the smaller percentage rise of the money supply is to be partly found, therefore, in the substitution of time deposits bearing a relatively high rate of interest for means of payment.

The big increase in cash holdings of the public was partly intended to meet the need for additional funds due to the larger volume of transactions, but it also stemmed to some extent from the economic slowdown. The latter resulted in sellers preferring to receive payment in cash rather than by check, since the number of checks without cover increased appreciably. It should be noted that a switch from demand deposits to cash reduces the amount of money in the economy, as it decreases the liquid assets of the banking institutions.

### 3. LESS LIQUID DEPOSITS OF THE PUBLIC

The upward trend in the volume of less liquid deposits grew stronger in 1966, the outstanding balance advancing by IL 298.7 million, or about 25 percent, as against IL 202 million, or 20.3 percent, in 1965.

As in previous years, most of the increase occurred in Pazak and Tamam

accounts, which were up IL 157 million. Nevertheless, there was also a very rapid expansion of local currency time deposits for periods of six months or more following the reduction of the required liquidity ratio for such deposits and the subsequent rise in the rate of interest paid. Over the year as a whole, time deposits expanded by approximately IL 118 million. Deposits in approved saving schemes went up by some IL 45 million, about the same amount as in 1965.

(a) *Pazak and Tamam deposits*

Pazak balances increased by IL 119.7 (about \$ 40 million) in 1966, as against IL 134.7 million (\$ 45 million) in 1965, while the rise in Tamam deposits totalled IL 37.3 million (about \$ 12 million)—about the same as in 1965.

Personal restitution receipts, which are the main source of Pazak and Tamam deposits, reached \$ 110 million in 1966—this too similar to the 1965 figure. Interest paid on Pazak and Tamam accounts continued upward, reaching approximately \$ 18 million during the year reviewed as against some \$ 14 million in 1965. The growth of Pazak and Tamam balances in 1966 amounted to 41 percent of total restitution receipts plus the interest on the outstanding balance, compared with approximately 45 percent the year before. However, not all of the remaining 59 percent was converted into means of payment. A not insignificant proportion went to buy foreign securities. The balance of such securities owned by Israelis rose by about \$ 25 million during the year, compared with a rise of \$ 30 million in 1965.<sup>1</sup>

The slower growth of Pazak and Tamam balances and foreign security holdings in 1966 constituted part of the general weakening of demand for foreign currency assets and the growing demand for liquid financial assets in Israeli currency. A factor tending to check the expansion of Tamam was the increase in travel abroad during the summer months. The reduced demand for foreign currency assets was also reflected by a drop in the exchange rate offered to owners of Natad accounts. This rate declined from IL 3.23 per dollar at the beginning of 1966 to IL 3.045 in June, but went up to IL 3.19 at the end of the year. The average level was IL 3.16 in 1966, as against IL 3.21 the year before.

The growth of Pazak and Tamam deposits was due to the nonconversion of part of the foreign currency receipts into means of payment. The contractionary effect of the conversion of Israeli pounds for effecting payments abroad exceeded the decline of some IL 70 million in foreign exchange reserves. Pazak and Tamam deposits are redeposited in full with the Bank of Israel and

<sup>1</sup> Part of these securities were acquired by Pazak and Tamam account holders, while the remainder was bought by the general public, which obtained the necessary foreign currency from owners of Tamam deposits through Natad accounts. It is impossible to distinguish between the two types of buyers.

Table XV-6

## LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS, 1963-66

(IL million)

End of period	Saving schemes	Time deposits	Deposits against liabilities	Total less-liquid deposits in Israeli currency <sup>a</sup>	Deposits linked to the exchange rate (Pazak)	Tamam foreign currency deposits	Other foreign currency deposits <sup>a</sup>	Grand total
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
1966	245.9	149.2	21.1	416.2	731.3	287.9	60.3	1,495.7
1966 January	204.1	30.9	30.7	265.7	620.5	254.3	65.9	1,206.4
February	206.9	32.2	27.6	266.7	637.6	258.9	56.1	1,219.3
March	210.1	30.4	23.1	263.6	645.1	264.1	64.6	1,237.4
April	214.0	29.8	21.7	265.5	656.0	268.1	55.1	1,244.7
May	217.7	27.7	24.6	270.0	671.4	270.6	57.9	1,269.9
June	221.4	28.5	24.8	274.7	679.5	272.2	54.8	1,281.2
July	225.0	30.2	23.6	278.8	687.1	271.9	51.8	1,289.6
August	231.3	33.5	22.0	286.8	694.5	271.5	55.4	1,308.2
September	234.6	58.6	19.1	312.3	696.6	274.9	68.8	1,352.6
October	237.4	80.3	19.0	336.7	708.3	280.4	47.7	1,373.1
November	241.9	117.8	14.8	374.5	720.7	284.0	42.5	1,421.7
December	245.9	149.2	21.1	416.2	731.3	287.9	60.3	1,495.7

<sup>a</sup> After deduction of deposits of the public earmarked for loans, most of which belong to social insurance funds and financial institutions.

do not enable banking institutions to expand credit. However, these deposits, the outstanding balance of which exceeded IL 1,000 million at the end of 1966, are very liquid assets which the public can convert into means of payments almost at will.

The rate of expansion of Pazak and Tamam was not uniform throughout the year. Their growth was more rapid at the beginning and the end of the year, but proceeded slowly during the intervening months. Between January and May the average monthly increment of Pazak and Tamam together was approximately IL 16 million, as against only IL 7 million per month during the period June–September. In the last quarter of the year the uptrend gathered momentum, the average monthly increment reaching approximately IL 17 million. The slower growth during the third quarter was apparently due—at least as far as Tamam deposits are concerned—to the use of these funds for foreign travel.

#### (b) *Deposits in approved saving schemes*

These deposits expanded by IL 44.8 million in 1966, compared with IL 45.6 million the year before. Most of the 1966 increment—about IL 38 million—accrued in the optional-type saving schemes.<sup>1</sup> Children's saving schemes increased by IL 5.8 million, and those for secondary education (sponsored by banking institutions) by IL 3.1 million. Linked saving schemes were up by about IL 2 million, but linkage increments came to almost this amount, so that there was virtually no growth in deposits during the year. Unlinked saving schemes continued to lose ground, contracting by IL 5.5 million; the downturn can be attributed to the shift to other saving schemes yielding a higher return. The scheme for the purchase of vehicles showed a growth of IL 0.9 million. The accumulation in saving schemes proceeded at an almost uniform pace throughout the year, with a slight acceleration in the second half.

In 1966 several banking institutions introduced a new type of saving scheme (the "conversion scheme"), in which the public may deposit Absorption Loan and compulsory saving certificates.<sup>2</sup> These are debited at their full value (inclusive of linkage increments up to the date of the deposit), on condition that a further amount of not less than 90 percent of the value of the certificates is also invested in the scheme. The saver receives the same terms as those offered by the optional-type schemes. During the year reviewed about IL 1 million was deposited in the "conversion schemes", while several more banking institutions introduced optional-type schemes.

<sup>1</sup> These schemes permit the saver to choose, upon termination of the period of the deposit, between a high interest rate (up to 9 percent net per annum) without linkage of the principal, and a lower interest rate (up to 4 percent net per annum) with the principal linked to the consumer price index.

<sup>2</sup> In 1966 savers were permitted to deposit in these schemes Absorption Loan certificates of 1961 and 1962 as well as compulsory saving certificates of 1962.

The expansion of saving schemes found expression in the banking institutions' investment portfolios, which came to approximately 75 percent of the balance of saving scheme deposits at the end of 1966—about the same figure as in 1965. Holdings of Short-Term Loan certificates continued to move downward, while investment in the Government Development Loan, which also offers an option between a high rate of interest and nonlinkage, increased. This shift was intended to ensure the holding, as cover against the optional-type saving schemes, of securities of a similar character.

The IL 246 million balance in saving scheme deposits at the end of 1966 breaks down as follows: optional-type schemes—IL 121 million; nonlinked schemes—IL 40 million; children's saving schemes—IL 40 million; linked schemes—IL 23 million; saving for secondary education—IL 17 million; and saving for vehicle purchases—IL 5 million.

(c) *Time deposits*

The protracted decline in time deposits, which had lasted some five years, came to an end in 1966, and in the last four months of the year they even began to expand rapidly. Among the steps taken by the Bank of Israel to increase the economy's liquidity in the second half of 1966 was the lowering of the liquidity ratio on certain types of time deposits as from September. The ratio was reduced to only 10 percent for deposits for a period of six months or more. This enabled banking institutions to expand credit to the public and to raise the interest on time deposits, making them more attractive as compared with other financial assets. The interest paid on these deposits after the reduction of the liquidity ratio ranged, as a rule, from 8 to 11 percent gross per annum, as compared with some 5 percent before. From the beginning of September until the end of 1966, time deposits expanded by nearly IL 116 million. This accelerated growth is explained by the fact that many banking institutions which had granted the maximum permitted amount of financial guarantees proposed to new investors to open time deposits for six months or more on terms similar to those granted on bill brokerage. In addition, there was apparently a certain switch from demand to time deposits, owing to the big differential in interest paid on the two types of accounts.

Over the year as a whole, time deposits were augmented by IL 118 million, after having contracted by IL 12.4 million in 1965. During the period 1961–65 time deposits had declined by IL 67 million.

(d) *Deposits against liabilities in Israeli currency*

These deposits contracted by IL 5.6 million, continuing the downtrend of the previous year when a growing proportion of import transactions were paid for in cash upon presentation of the documents to the importer, instead of being financed by letters of credit involving a down payment when ordering

the goods. The requirement to deposit an advance of up to 50 percent of the value of the transaction was abolished altogether in November 1966. This concession was in line with the policy followed for some time of easing importers' deposit requirements.

#### 4. SOURCES OF MONETARY EXPANSION

The financial assets of the public, consisting of the money supply and less liquid deposits with the banking system, increased in 1966 by IL 407.6 million, or 13.2 percent, as compared with a rise of IL 393.5 million, or 14.6 percent, in 1965.

After a long period of steady expansion, Israel's foreign currency assets declined in 1966 for the first time. The growth of such assets was one of the major causes of monetary expansion in previous years. The decrease in foreign currency balances in 1966 had a contractionary monetary effect, the monetary expansion being entirely attributable to the big increase in bank credit to the Government and the public.

As in previous years, the contribution of the individual factors to monetary expansion was not uniform throughout the year. Foreign exchange reserves went up in March, but contracted in most other months. Credit to the Government declined during the first quarter of 1966, expanded rapidly between April and August, and more or less levelled off during the last four months.

Bank credit to the public expanded throughout most of 1966 (with the exception of April and May), with the growth rate accelerating in the second half of the year. The increase in bank credit to the public was particularly striking in comparison with previous years.

##### (a) *Accumulation of foreign currency assets*

The decrease in capital imports during the year reviewed exceeded the decrease in the adverse balance on Israel's goods and services account. Altogether, Israel's capital imports in 1966, inclusive of short-term credit from abroad, was slightly smaller than the current balance of payments deficit, and consequently there was a net decline of \$ 23 million in foreign currency assets in the banking system. The gross balance of such assets amounted to IL 2,411.7 million (\$ 804 million) at the end of 1966, as against IL 2,415.3 million (\$ 805 million) at the end of 1965. The Bank of Israel held \$ 647.3 million, and the banking institutions \$ 156.6 million. The banking system's foreign liabilities reached IL 719.8 million (\$ 240 million), an increase of \$ 22 million over the year. Thus net foreign exchange reserves totalled some IL 1,691.9 million (\$ 564 million) at the end of 1966. The increase in foreign liabilities was the resultant of a decline of about \$ 1.3 million in nonresidents' deposits (Patach) and a rise of nearly \$ 23 million in foreign obligations. The weight

of foreign residents' deposits within total foreign liabilities has been falling in recent years, while the weight of other liabilities—chiefly loans from foreign banks—has been rising. During the four years 1963–66, foreign residents' deposits expanded by some \$ 34 million, whereas other foreign liabilities increased by \$ 86 million. In 1966 the interest rate in the world capital market went up appreciably. The interest paid on Patach deposits was also raised twice during the year, but not to the same extent as the interest rate abroad. This was presumably the main reason for the contraction of these deposits during 1966.

(b) *Credit to the Government*

The Government's net debt to the banking system soared by IL 201 million in 1966, compared with IL 54.6 million the year before. Approximately IL 19 million of the additional credit granted to the Government arose from the deposit with the Treasury of debenture proceeds mobilized by one of the banking institutions; these funds were included in the Government

Table XV-7

FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM, 1963-66

(IL million)

End of period	Total assets	Less:		Net assets (1)-(2)-(3)
		Nonresidents' deposits	Other foreign liabilities <sup>a</sup>	
	(1)	(2)	(3)	(4)
1963	1,955.7	332.0	135.0	1,488.7
1964	2,101.2	366.6 <sup>b</sup>	191.7	1,542.9 <sup>b</sup>
1965	2,415.3	401.7 <sup>b</sup>	251.7	1,761.9 <sup>b</sup>
1966	2,411.7	397.9	321.9	1,691.9
1966 January	2,398.7	401.3	247.3	1,750.1
February	2,357.9	414.6	223.1	1,720.2
March	2,456.4	392.9	228.4	1,835.1
April	2,322.6	396.3	251.5	1,674.8
May	2,372.2	396.1	273.3	1,702.8
June	2,419.5	406.2	270.8	1,742.5
July	2,380.9	408.1	262.6	1,710.2
August	2,322.9	398.5	272.7	1,651.7
September	2,328.1	397.9	273.9	1,656.3
October	2,319.6	385.8	273.9	1,659.9
November	2,300.8	392.7	254.7	1,653.4
December	2,411.7	397.9	321.9	1,691.9

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

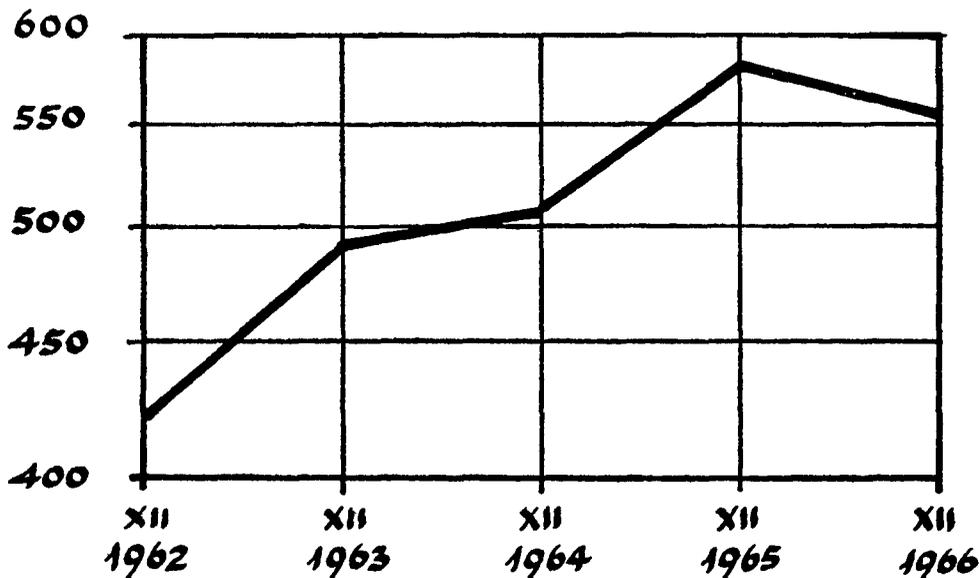
<sup>b</sup> Revised figure.

Diagram XV-3

## FOREIGN CURRENCY ASSETS OF THE BANKING SYSTEM, 1962-66

(\$ million)

(End of year)



budget.<sup>1</sup> The conspicuous rise in the Government's debt during the year reviewed was connected with the economic slowdown, which considerably reduced the Government's tax revenue.

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 fiscal year 1965/66), the figure declined by some IL 122 million, compared with IL 171 million during the corresponding months of 1965. As in 1965, most of the decrease occurred in March; this is largely ascribable to the fact that the Government deferred the execution of payments to the following financial year, an operation reflected in the IL 228 million rise in the debt in April. During the months May-August the debt went up, but it remained relatively stable the rest of the year. Altogether, the increase between April and December 1966 reached some IL 323 million, compared with approximately IL 226 million during the corresponding period of the previous year. The growth of the Government's debt during the months April-August was of a seasonal nature, being due to the lag of revenue behind expenditure in the first half of the fiscal year.

<sup>1</sup> This was not ordinary bank credit to the Government and did not increase the money supply. The banking institution served only as the Government agent for mobilizing funds from the public.

Table XV-8

**THE GOVERNMENT'S DEBT TO THE BANKING SYSTEM, 1963-66**  
(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	
1963	-155.9	221.6	22.2	43.5	44.6 <sup>a</sup>	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
1966	92.4	184.7	19.9	257.2	74.8	160.6	8.5	226.9 <sup>b</sup>	484.1 <sup>b</sup>
1966 January	-96.0	239.0	22.4	120.6	42.0	105.9	10.5	137.4	258.0
February	-75.8	239.0	26.5	136.7	38.0	105.9	9.8	134.1	270.8
March	-200.4	239.0	17.9	20.7	45.7	101.4	6.5	140.6	161.3
April	42.0	239.0	30.5	250.5	47.3	101.0	9.8	138.5	389.0
May	89.0	239.0	31.6	296.4	47.2	97.7	10.0	134.9	431.3
June	89.3	225.7	43.1	271.9	62.0	112.4	10.9	163.5	435.4
July	103.0	218.3	44.7	276.6	73.3	119.2	10.4	182.1	458.7
August	128.9	224.6	44.9	308.6	76.1	113.8	12.2	177.7	486.3
September	117.6	211.0	47.9	280.7	80.6	125.2	12.6	193.2	473.9
October	102.4	215.9	54.8	263.5	80.5	117.2	12.6	185.1	448.6
November	147.7	210.3	55.9	302.1	65.4	123.0	12.3	176.1	478.2
December	92.4	184.7 <sup>c</sup>	19.9	257.2	74.8	160.6	8.5	226.9	484.1

<sup>a</sup> Including IL 21.5 million worth of Government bills purchased from the Bank of Israel in 1963.

<sup>b</sup> Including IL 19 million in debenture proceeds of a banking institution deposited with the Treasury; excluding Bank of Israel purchases of Government bonds on the Stock Exchange.

<sup>c</sup> Excluding the change in the "absorption and security advance" item, which reflects sales of the Short-Term Loan to the public by the Bank of Israel.

The decline in the debt during the first quarter of 1966 had a contractionary monetary effect, and partly offset the expansionary influence during this period of foreign currency accumulation and the growth of credit to the public. The rise in the debt during the months April-August was the main source of monetary expansion during that period.

*(c) Open-market operations of the Bank of Israel*

During the year reviewed the Bank of Israel took over the Government Short-Term Loan, using it as an additional instrument of monetary policy. The outstanding balance of this loan had been declining for some time—between November 1964 and the beginning of June 1966 it fell by some IL 145 million to only IL 155 million. In June 1966 the Bank of Israel reached an agreement with the Government under which the loan was transferred to the Bank, which undertook to transfer to the Government all receipts from the sale of loan certificates until the outstanding balance reached IL 240 million (i.e. until net sales after the date of transfer totalled some IL 85 million). Net proceeds in excess of this figure were to belong to the Bank of Israel. In order to check the prolonged decline in the outstanding balance of the loan and to boost sales, a new series was issued for a three-month period, while the rate of interest paid on the certificates and commissions to agents selling the loan were raised. Moreover, the agents (for the most part banking institutions) were permitted to purchase treasury bills from the Bank of Israel in the ratio of IL 1 for every IL 3 in net sales of the Short-Term Loan. The return on treasury bills, which are one of the banking institutions' liquid assets, was fixed at 9.5 percent p.a. compared with the maximum interest of 7.5 percent obtainable by banks on one-year deposits with the Bank of Israel. This step helped stimulate sales of the Short-Term Loan.

The strong demand for short-term financial assets yielding a high return, together with the above-mentioned measures of the Bank of Israel, caused sales of the loan to spurt. After some five months—i.e. by the end of October 1966—the outstanding balance of the loan reached IL 240 million, and accordingly IL 85 million in net proceeds were transferred to the Treasury for financing its activities. These funds, which were not included in the Government's revenue estimates, reduced the budgetary deficit for the financial year 1966/67.

Sales of Short-Term Loan certificates continued in November and December, mopping up purchasing power. Under the conditions prevailing in the economy, however, it seemed desirable to increase rather than decrease the liquidity of the public. Consequently, the Bank of Israel reduced the liquidity ratio, stepped up its rediscounting operations, and even bought other securities on the stock exchange during this period. The purpose of continuing the sale of

the Short-Term Loan was to bolster the position of this security in the money market, so that it could again serve as a major instrument of monetary policy without requiring a renewed build-up. Nevertheless, several steps were taken to check the volume of sales: at the end of November the interest rates paid on the certificates were slightly lowered,<sup>1</sup> while the ratio between agents' sales and purchases of treasury bills was changed from 1:3 to 1:5. Moreover, the size of the series issued weekly was reduced, and the smaller series were allocated to the agents. In December the interest rates were again cut, as demand continued to be strong. Altogether, the outstanding balance of the Short-Term Loan rose by IL 30 million during the last two months of 1966, but the Bank of Israel neutralized the effect of about half these sales by purchasing other bonds to the tune of some IL 15 million on the Tel Aviv Stock Exchange. In January 1967 the Bank's stock exchange purchases exceeded net sales of loan certificates. Interest rates were reduced further in February 1967—for the third time in three months—and the public's holdings of the loan tapered off. The volume of funds pumped into the money market through the Bank's stock exchange purchases was maintained, but the restricted size of this market perforce limits the scale of the Bank's operations and keeps them from driving up prices to any appreciable extent or causing any dislocations.

(d) *Bank credit to the public*

1. *Expansion of credit*

Bank credit to the public was expanded in 1966 by IL 291.4 million, or 23.7 percent. This was a much faster growth rate than in previous years—in 1965 the figure was 12.5 percent and in 1964, 15.7 percent. The average balance was 18.8 percent larger in 1966 than the year before, in contrast to a rise of 10.2 percent in 1965. This rapid rise is especially significant in view of the fact that the real national product did not increase at all in 1966; in fact, it was even double the percentage growth of the national product at current prices.

In former years the decelerated increase of credit reflected the Bank of Israel's policy of braking the rate of monetary expansion during a period of rapid economic growth and strong inflationary pressures. But in 1966, a year of economic recession, unemployment, and slow monetary expansion, the Bank of Israel considerably reduced the required liquidity ratio, permitting the banks to expand credit to the public. At the same time, it stepped up its rediscounting operations to an appreciable extent. The cutting of the liquidity ratio was for the most part reflected in the expansion of credit, since the banks

<sup>1</sup> For details on the interest rates and changes occurring therein during 1966, see Chapter XXI, "Activities of the Bank of Israel", section 7(a).

utilized only part of the reserves created thereby for covering their liquidity deficiencies, and that only in the last quarter of the year.

The IL 291.4 million increase in credit to the public consisted predominantly of IL 143.2 million in ordinary bank credit and IL 122.2 million in rediscounts at the Bank of Israel. Controlled credit within the framework of exemptions from the liquidity regulations was expanded by IL 34.6 million, while foreign currency credits contracted by IL 8.6 million. The large increase in ordinary bank credit to the public, despite the smaller volume of liquid assets, was made possible by the reduction of the required liquidity ratio.

After the quota of controlled credit within the framework of liquidity exemptions had been almost completely utilized, the Bank of Israel raised the quota by 0.5 percent in June 1966 and by a further 0.5 percent in November, bringing it up to 25 percent. Moreover, the Bank of Israel enabled banking institutions to grant seasonal loans to agriculture in excess of the controlled credit quota, by allowing them special rediscounting facilities for this purpose.

Rediscounts at the Bank of Israel and controlled credit together again accounted for over half the incremental bank credit granted to the public. Such credit is mainly intended to finance industrial and agricultural exports, as well as other purposes accorded high economic priority. The Industrial Export Fund, in which banking institutions participate together with the Bank of Israel and the Government, was expanded from IL 211 million at the end of 1965 to IL 272 million at the end of 1966, and the Agricultural Export Fund from IL 6.9 million to IL 14.3 million.

In order to encourage banking institutions to participate in export funds, it was decided that a bank that had not fully exploited its 7 percent quota (from deposits subject to the ordinary liquidity requirements) for granting loans to exporters must deposit the unexploited balance with the Bank of Israel at a relatively low interest rate, and cannot use these funds to grant other controlled credit within the framework of the 25 percent exempted from the liquidity regulations. This decision was implemented in stages, the credit quota fixed rising from 4 percent at the end of April to 7 percent in October 1966.

The bill brokerage trade expanded rapidly during the year. The outstanding balance of bills sold through the agency of banks rose by IL 247.4 million, or about 32 percent, as compared with approximately IL 161 million, or 26 percent, in 1965. The larger supply of funds in this market had a similar effect as the increase in Short-Term Loan purchases and time deposits, in that it was reflected in the public's preference for liquid assets bearing a relatively high rate of interest over purchases of real assets such as housing, motor cars, and other durable consumer goods.

Owing to the soaring of prices in recent years, the real rate of interest in the economy was relatively low and sometimes even negative. As the maximum legal interest rate has been limited by the Interest Law, excess demand was generated

Table XV-9

## CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1963-66\*

(IL million)

End of period	From Bank of Israel	From banking institutions	Total bank credit	From ear-marked deposits of the public <sup>b</sup>	Against Govt. deposits	From ear-marked Govt. deposits	Balance of bill brokerage trade
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
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	450.3 <sup>c</sup>	60.5	357.0	773.6
1966	261.4	1,257.2	1,518.6	562.2	66.4	395.6	1,021.0
1966 January	151.5	1,130.6	1,282.1	454.9	60.4	358.9	811.1
February	156.9	1,129.7	1,286.6	462.2	64.3	358.7	831.1
March	160.5	1,175.2	1,335.7	476.6	71.7	361.0	835.0
April	154.7	1,139.6	1,294.3	483.9	68.3	360.7	840.7
May	161.1	1,127.0	1,288.1	486.7	66.3	363.6	877.4
June	168.2	1,146.8	1,315.0	497.0	71.0	363.9	907.3
July	177.2	1,151.5	1,328.7	507.4	68.4	375.5	925.9
August	186.3	1,183.8	1,370.1	522.8	65.4	375.1	948.1
September	210.2	1,206.7	1,416.9	524.0	62.4	376.0	957.1
October	223.5	1,196.9	1,420.4	529.1	63.0	377.5	983.3
November	247.4	1,225.0	1,472.4	535.5	64.3	384.4	994.4
December	261.4	1,257.2	1,518.6	562.2	66.4	395.6	1,021.0

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

<sup>b</sup> Mainly credit from deposits of social insurance funds and financial institutions.

<sup>c</sup> Revised figure.

for credit at the legal rate, and this led to the creation of a gray market for credit, one outgrowth of which was the bill brokerage trade. The interest paid by the borrower for such credit far exceeds the legal rate, but only part of it accrues to the lender, the balance constituting commission to the banking institution for its brokerage and guarantee of the bill. The bank guarantee provides security for the investor, and transactions through a bank are more convenient. These and other factors caused such trade to soar from a total balance of some IL 263 million at the end of 1962 to over IL 1,000 million at the end of 1966.

The interest on bank-negotiated bill credits rose gradually during this period. In order to carry on such trade, the banks raise funds from investors at the interest rate current in the market and transfer the funds to borrowers. The borrower pays interest plus a commission to the bank for its services and guarantee, which varies according to the quality of the security provided and the situation in the money market. Thus the additional interest paid by the

**Table XV-10**  
**INCREASE IN BANK CREDIT TO THE PUBLIC, 1963-66\***  
 (IL million)

	1963	1964	1965	1966
Bank of Israel rediscounts	12.3	30.5	8.1	122.2
Bank credit				
In local currency				
Within the framework of liquidity exemptions	8.5	32.9	37.3	34.6
Other credit	95.9	36.4	51.1	143.2
Total	104.4	69.3	88.4	177.8
In foreign currency	38.6	48.4	39.9	-8.6
Total bank credit	143.0	117.7	128.3	169.2
Total incremental credit from the banking system	155.3	148.2	136.4	291.4
Credit from and against Government deposits	16.4	22.2	35.8	44.5
Credit from deposits of the public earmarked for loans	37.2	72.3	105.3 <sup>b</sup>	111.9
Total increase in credit to the public	208.9	242.7	277.5 <sup>b</sup>	447.8

<sup>a</sup> The effect of bills sold by the Bank of Israel to banking institutions during the years 1963 to 1965 has been discounted in this table.

<sup>b</sup> Revised figure.

borrowers was not passed on to the lenders in full, but went to increase the banks' commission. These commissions soon became an important source of income for the banks, which began to encourage this type of transaction owing to its relatively high profitability. In the second half of 1966 the prolonged upward trend in interest rates came to a halt following the much larger supply of funds to this market. The banks now experienced difficulty in finding good borrowers for all the amounts offered, and started to lend to borrowers putting up inferior collateral at the same rate of interest, this being tantamount to the lowering of the interest rate. Various other indirect forms of reducing interest charges also began to appear at this time.

In the course of the year not a few banks reached the permitted ceiling of financial guarantees, and they began to divert investors to other short-term financial assets, such as the Short-Term Loan or time deposits for periods of six months or more.<sup>1</sup> Nevertheless, the proportion of bill brokerage conducted on

<sup>1</sup> See the discussion on time deposits on p. 377.

a guaranteed basis continued upward, reaching 86 percent of all such credit at the end of 1966 as against 79.2 percent at the end of the previous year.

It should be noted that the entire net increase in the bill brokerage trade between the end of 1963 (when the submission of reports to the Bank of Israel became mandatory) and the end of 1966 occurred in bills carrying a bank guarantee. The outstanding balance of bills traded on a nonguaranteed basis remained virtually unchanged during this period, a slight decline in 1966 bringing the level down to that of 1963. Part of the bills traded without a bank guarantee carry the guarantee of a banking institution subsidiary company. It should be recalled that bills are also traded outside the banking system, but apparently not on a large scale.

## 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, most of which is granted for the payment of tax debts. The rapid expansion of credit to the construction sector in 1966 was particularly striking. This sector was especially hard hit by the recession and required considerable credit to finance a large stock of building plots and unsold dwellings. Credit to local authorities and to public and other services also expanded appreciably. The share of industry in the outstanding balance of credit rose again in 1966, reaching 39.5 percent as compared with 38.8 percent the year before. Industrial credits were up 25.7 percent during the year reviewed—a rapid increase in the light of the fact that real industrial output advanced only some 2 percent during the year. The proportion of farm credits continued downward—from 12.9 percent of the total at the end of 1965 to 11.7 percent. However, agriculture too received credit far in excess of the growth of its real product, the increase in the former being 11.5 percent, compared with a decline of about 1 percent in real product. Industry and agriculture thus accounted for about 51 percent of all credit in 1966, but their share of credit controlled by the Bank of Israel was larger—84 percent. Almost all incremental controlled credit went to industry. Such credit is given at a relatively low rate of interest for financing exports and other purposes accorded high economic priority.

The substantially larger volume of credit to industry, made possible by the credit expansion policy of the Bank of Israel in 1966, enabled industrialists to reduce their demand for expensive bank-negotiated bill credit. Partial data indicate that the increase in the latter type of credit to industry was relatively small during the year reviewed.

Partial data on the sectorial distribution of bank-negotiated bill credit show the share of agriculture and industry at the end of 1966 to be far smaller than their share of bank credit, while that of the construction sector was considerably larger.

Table XV-11

**OUTSTANDING CREDIT TO THE PUBLIC, BY SOURCE AND DESTINATION,  
DECEMBER 31, 1966<sup>a</sup>**

Destination	Controlled by the Bank of Israel <sup>b</sup>	Un- controlled credit	Total (1) + (2)	Credit against Govt. deposits	Total (3) + (4)
	(1)	(2)	(3)	(4)	(5)
<b>IL million</b>					
Agriculture	130.0	117.4	247.4	3.0	250.4
Industry	357.7	457.7	815.4	33.0	848.4
Construction	2.0	131.6	133.6	10.5	144.1
Commerce	8.4	116.6	125.0	7.1	132.1
Public services	29.5	34.3	63.8	0.6	64.4
Local authorities	0.4	177.2	177.6	0.4	178.0
Credit and financial institutions	6.7	83.8	90.5	0.1	90.6
National Institutions	16.9	17.9	34.8	—	34.8
Business services	24.3	120.6	144.9	3.7	148.6
Private individuals	—	179.9	179.9	6.3	186.2
Miscellaneous <sup>c</sup>	4.1	63.7	67.8	1.8	69.6
<b>Total</b>	<b>580.0</b>	<b>1,500.7</b>	<b>2,080.7</b>	<b>66.5</b>	<b>2,147.2</b>
<b>Percentages</b>					
Agriculture	22.4	7.8	11.9	4.5	11.7
Industry	61.7	30.5	39.2	49.6	39.5
Construction	0.3	8.8	6.4	15.8	6.7
Commerce	1.4	7.8	6.0	10.7	6.2
Public services	5.1	2.3	3.1	0.9	3.0
Local authorities	0.1	11.8	8.5	0.6	8.3
Credit and financial institutions	1.2	5.6	4.3	0.1	4.2
National Institutions	2.9	1.2	1.7	—	1.6
Business services	4.2	8.6	7.0	5.6	6.9
Private individuals	—	12.0	8.6	9.5	8.7
Miscellaneous <sup>c</sup>	0.7	4.2	3.3	2.7	3.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

<sup>a</sup> Including credit from earmarked deposits of the public, which cannot be classified by sector of destination on the basis of available data.

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

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

Table XV-12

**OUTSTANDING CREDIT TO THE PUBLIC, BY SECTOR OF DESTINATION,  
1963-66<sup>a</sup>**

	1963	1964	1965	1966
<b>IL million</b>				
Agriculture	170.2	196.7	224.6 <sup>b</sup>	250.4
Industry	517.5	636.4 <sup>b</sup>	674.8 <sup>b</sup>	848.4
Construction	75.0	84.3	94.1	144.1
Commerce	101.7 <sup>b</sup>	105.0 <sup>b</sup>	113.8 <sup>b</sup>	132.1
Public services	46.2 <sup>b</sup>	35.6 <sup>b</sup>	47.7 <sup>b</sup>	64.4
Local authorities	59.4	64.4	128.1	178.0
Credit and financial institutions	28.7	45.8	79.5	90.6
National Institutions	26.2	33.6	31.9	34.8
Business services	57.6	83.4	118.8	148.6
Miscellaneous <sup>c</sup>	180.3	197.0	224.7 <sup>b</sup>	255.8
	1,262.8	1,482.2	1,738.0 <sup>b</sup>	2,147.2
<b>Percentages</b>				
Agriculture	13.5	13.3	12.9 <sup>b</sup>	11.7
Industry	41.0	42.9	38.8	39.5
Construction	5.9	5.7	5.4	6.7
Commerce	8.0 <sup>b</sup>	7.1 <sup>b</sup>	6.6 <sup>b</sup>	6.2
Public services	3.7 <sup>b</sup>	2.4 <sup>b</sup>	2.8 <sup>b</sup>	3.0
Local authorities	4.7	4.3	7.3	8.3
Credit and financial institutions	2.3	3.1	4.6	4.2
National Institutions	2.1	2.3	1.8	1.6
Business services	4.6	5.6	6.8	6.9
Miscellaneous <sup>c</sup>	14.2	13.3	13.0 <sup>b</sup>	11.9
	100.0	100.0	100.0	100.0

<sup>a</sup> Including credit against Government deposits for payment of tax debts, as well as credit from deposits of the public earmarked for loans.

<sup>b</sup> Revised figure.

<sup>c</sup> Including credit to private individuals.

## 5. THE LIQUIDITY OF BANKING INSTITUTIONS

Ordinary liquid assets of the banking institutions totalled IL 565.9 million at the end of 1966, as against IL 606.6 million the year before. Deposits requiring ordinary liquid cover amounted to IL 1,289.1 million, compared with IL 1,283.4 million at the end of 1965<sup>1</sup> This decrease in liquid assets and slight rise in

<sup>1</sup> The data for the end of 1965 are not strictly comparable with those for the end of 1966, as time deposits for six months or more and the assets held against them (at the rate of 10 percent) are excluded from the figures as from September 1966.

**Table XV-13**  
**CHANGES IN THE LIQUID ASSETS OF BANKING INSTITUTIONS,\* BY SOURCE, 1963-66**  
(IL million)

End of period	Credit from the Bank of Israel <sup>b</sup>	Net foreign currency at Bank of Israel	Net balances in transit between banking institutions	Total (1) + (2) + (3)	Less:				
					Cash held by the public <sup>c</sup>	Net foreign currency balances of banking institutions at Bank of Israel	Liquid assets held against deposits requiring 90% or 100% liquid cover <sup>d</sup>	Total (5) + (6) + (7)	Ordinary liquid assets in Israeli currency (4)-(8)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1963	122.8	1,543.5	0.3	1,666.6	525.1	575.0	34.5	1,134.6	532.0
1964	243.3	1,628.8	1.6	1,873.7	590.4	713.8	39.5	1,343.8	529.9
1965	271.0	1,910.3	-0.4	2,180.9	657.4	884.7	32.2	1,574.3	606.6
1966	547.7	1,848.7	5.9	2,402.3	751.2	1,047.2	38.0	1,836.4	565.9
1966 January	254.1	1,913.3	0.3	2,167.7	667.7	900.7	33.1	1,601.5	566.2
February	283.8	1,869.0	1.9	2,154.7	672.0	923.7	27.8	1,623.5	531.2
March	149.0	1,979.9	0.6	2,129.5	701.9	934.9	23.3	1,660.1	469.4
April	383.8	1,825.7	-1.7	2,207.8	704.5	949.7	26.0	1,680.2	527.6
May	442.4	1,877.3	-0.5	2,319.2	700.6	970.8	26.0	1,697.4	621.8
June	438.8 <sup>e</sup>	1,917.3	2.1	2,358.2	712.7	977.9	25.6	1,716.2	642.0
July	458.0	1,885.4	3.3	2,346.7	730.8	986.6	30.0	1,747.4	599.3
August	497.7	1,836.3	-0.8	2,333.2	725.3	996.7	25.3	1,747.3	585.9
September	504.7	1,822.2	-6.0	2,320.9	742.5	998.2	34.2	1,774.9	546.0
October	496.9	1,824.5	6.4	2,327.8	741.1	1,017.9	28.8	1,787.8	540.0
November	555.4	1,796.4	10.7	2,362.5	751.5	1,028.4	25.4	1,805.3	557.3
December	547.7	1,848.7	5.9	2,402.3	751.2	1,047.2	38.0	1,836.4	565.9

\* Net of liquid assets held against deposits requiring 90 or 100 percent liquid cover.

<sup>b</sup> Including credit to the Government, credit to the public (less deposits of financial institutions but including deposits of investment banks with the Bank of Israel), and Bank of Israel open-market operations.

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

<sup>d</sup> Excluding demand deposits held for other banking institutions, which are listed in column (3).

<sup>e</sup> Excluding, as from June 1966, the change in the value of treasury bills held by the Bank of Israel.

deposits subject to the ordinary liquidity requirements brought down the effective liquidity ratio from 47.3 percent at the end of 1965 to 43.9 percent at the end of 1966.

Despite the smaller volume of liquid assets, the banks expanded credit substantially during the year reviewed thanks to the reduction of the required liquidity ratio by the Bank of Israel. In the first quarter of the year liquid assets contracted appreciably, while credit to the public was stepped up. As a result, the unauthorized deficiency of liquid assets increased to record dimensions. As from April, the banking institutions' liquidity situation began to show signs of improvement, and the expansion of Bank of Israel credit to the Government and the public started to make itself felt: the banking institutions' liquid assets increased, and the unauthorized deficit began to shrink. In the second half of 1966 the Bank of Israel cut the required liquidity ratio considerably, enabling the banks to expand credit to the public while reducing their liquidity deficiencies.

The liquidity ratio was reduced by 1 percent on each of the following dates: July 1, August 1, November 10, and December 15. The total decrease during the year was thus 4 per cent—from 69 percent at the end of June to 65 percent in the middle of December.<sup>1</sup> Moreover, the quota of controlled credit exempt from the liquidity requirements was raised in June from 24 to 24.5 percent, and in November from 24.5 to 25 percent. Beginning in September, the liquidity ratio on time deposits for periods of six months or more was pared to only 10 percent, whereas previously they had been subject to the ordinary liquidity requirements. This decrease in the liquidity ratio on time deposits was tantamount to reducing the overall ordinary liquidity requirements by 1 percent, taking into consideration the volume of such deposits at the beginning of September. However, if there was a switch from demand to time deposits, the marked differential in the liquidity rates now required for these two types of deposits enabled the banks to expand credit still further. The total reduction in the overall liquidity ratio during the second half of 1966 came to about 6 percent, and it resulted in the creation of surplus reserves in a number of banks and the narrowing of the large liquidity deficiencies of others. The total additional credit made possible by the reduction of the liquidity ratio was approximately IL 120 million.

In order to encourage sales of the Short-Term Loan, the banks were permitted, as from June, to purchase Treasury bills from the Bank of Israel at the ratio of IL 1 worth of treasury bills for every IL 3 in net sales of the Short-Term Loan. The ratio was altered at the end of November to 1:5. At the end of 1966 the banking institutions held IL 52.4 million worth of treasury bills among their liquid assets.

The decrease in the amount of liquid assets held by the banking institutions

<sup>1</sup> See the note on p. 369.

Table XV-14

THE LIQUIDITY OF BANKING INSTITUTIONS IN LOCAL CURRENCY, 1963-66<sup>a</sup>

(IL million)

End of period	Liquid balances at Bank of Israel	Treasury bills with banking institutions	Cash held by banks	Net balances in transit between banking institutions	Less: Liquid assets held against deposits requiring 90% or 100% cover <sup>b</sup>	Total ordinary liquid assets (1) + (2) + (3) + (4) - (5)	Deposits requiring ordinary liquid cover	Liquidity ratio (6) / (7) × 100 (8)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
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
1966	516.8	52.4	28.8	5.9	38.0	565.9	1,289.1	43.9
1966 January	561.7	—	37.3	0.3	33.1	566.2	1,273.0	44.5
February	520.0	—	37.1	1.9	27.8	531.2	1,251.9	42.4
March	454.7	—	37.4	0.6	23.3	469.4	1,226.4	38.3
April	520.2	—	35.1	-1.7	26.0	527.6	1,264.7	41.7
May	610.5	—	37.8	-0.5	26.0	621.8	1,322.2	47.0
June	616.0	12.5	37.0	2.1	25.6	642.0	1,342.9	47.8
July	568.4	19.7	37.9	3.3	30.0	599.3	1,330.1	45.1
August	562.2	13.3	36.5	-0.8	25.3	585.9	1,337.2	43.8
September	526.8	25.5	33.9	6.0	34.2 <sup>c</sup>	546.0 <sup>d</sup>	1,296.5 <sup>d</sup>	42.1 <sup>d</sup>
October	507.7	18.5	36.2	6.4	28.8	540.0	1,263.2	42.7
November	510.1	29.1	32.7	10.7	25.4	557.2	1,273.9	43.7
December	516.8	52.4	28.8	5.9	38.0	565.9	1,289.1	43.9

<sup>a</sup> 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 or 100 percent liquid cover and of the liquid assets held against them.

<sup>b</sup> Excluding demand deposits held for other banking institutions, which are listed net in column (4).

<sup>c</sup> Liquid assets held against deposits requiring 10 percent liquid cover are included as from September.

<sup>d</sup> As from September, the liquidity ratio excludes time deposits for periods of six months or more—which require 10 percent liquid cover—and the liquid assets held against these deposits.

Diagram XV-4

FACTORS AFFECTING THE LIQUIDITY OF BANKING INSTITUTIONS, 1963-66



\* Foreign currency held at the Bank of Israel, less foreign currency deposits of the banking institutions with the Bank of Israel.

during 1966 was the outcome of several conflicting trends. Among the factors tending to bring down the figure was the decline of IL 62 million in foreign currency assets at the Bank of Israel, the increase of IL 163 million in the banking institutions' foreign currency deposits with the Bank of Israel (mainly Pazak and Tamam), and the rise of some IL 94 million in the amount of cash held by the public. On the other hand, Bank of Israel credit to the Government and the public went up by a substantial IL 277 million, and this acted to increase the amount of liquid assets in banking institutions. Thus, on balance, the institutions' liquid asset holdings declined only slightly.

At the end of June 1966 the method of reporting the liquidity situation was changed, and instead of submitting weekly reports, the banking institutions now had to report daily. This eliminated the incentive to increase liquidity on the day of the report (Wednesday). Together with this, the banks were permitted to cover a liquidity deficiency incurred during a certain week by increasing their liquid assets within the next two weeks.

The changes in the effective liquidity ratio during 1966 followed a similar pattern as in previous years. The absorption of funds by the Government toward the end of the financial year caused the liquidity situation to worsen until the end of March. Deposits contracted but liquid assets decreased even more, so that the effective liquidity ratio moved down from 47.3 percent at the end of December 1965 to 38.3 percent at the end of March 1966. The second quarter of the year reviewed saw an improvement in the liquidity situation, chiefly owing to the larger volume of credit granted to the Government and the public by the Bank of Israel. The liquidity ratio rose rapidly, reaching 47.8 percent at the end of June. In the second half of the year the ratio again fell, but it went up slightly toward year's end. The decline in the bank's liquidity during this six-month period was due to the reduction of the required liquidity ratio by the Bank of Israel and to the ensuing expansion of credit.

Changes in the unauthorized deficit of liquid assets during the year reviewed paralleled those in the liquidity ratio. During the first quarter the deficiency increased rapidly, reaching the record sum of some IL 100 million in March. In the second quarter it declined sharply, standing at the end of June at IL 20 million—approximately the level of December 1965. During the second half of 1966 the deficit continued to shrink following the reduction of the required liquidity ratio, and at the end of the year it came to only IL 4.4 million.

The recognized deficiency in liquid cover decreased by about IL 3 million during the year reviewed as a result of Bank of Israel directives to reduce it gradually as from June 1966.<sup>1</sup>

<sup>1</sup> See the Bank of Israel Annual Report for 1965, p. 342.

## 6. THE DEVELOPMENT OF BANKING INSTITUTIONS

The combined balance sheet of Israel's banking institutions was 15.6 percent larger in 1966, compared with a rise of 16.6 percent the year before. Excluding contingent accounts, the rise was also slower than in 1965—14.4 as against 15.4 percent.

On the assets side, the more sluggish growth of the "Cash and balances with the Bank of Israel" item (inclusive of Treasury bills) stood out. The rise here was IL 117.4 million in 1966, as contrasted with IL 259.7 million the year before. This deceleration partly reflects the decrease in the banking institutions' liquid assets during the year reviewed, and partly the slower expansion of Pazak and Tamam deposits, which must be held in full at the Bank of Israel. Credit to the public expanded faster than in 1965—by 18 percent as against 11 percent—a development made possible by the reduction of the required liquidity ratio.

On the liabilities side, there was a conspicuous deceleration in the growth of demand deposits—IL 16 million only compared with IL 124 million in 1965. On the other hand, less liquid deposits expanded rapidly—by some IL 322 million as against IL 199 million in 1965. This increment was due not only to the growth of Pazak and Tamam deposits, but also to the expansion of time deposits following the reduction of the required liquidity ratio on deposits for periods of six months or more.

The growth of equity capital continued to slow down even more in 1966, the increase being IL 21 million as against IL 36 million in 1965. As a result, the weight of this item in the combined balance sheet (including contingent accounts) edged down from 4.6 percent at the end of 1965<sup>1</sup> to 4.3 percent. The larger figure for debentures reflects the issue of debentures by one of the banking institutions (the proceeds from this issue were deposited with the Treasury).

The increase in contingent accounts can be ascribed almost entirely to the marked expansion of the bill brokerage trade in 1966. The rate of increase in contingent accounts was slightly lower than in 1965—19 as against 20 percent—while the bill brokerage trade expanded more rapidly than in 1965. This is explained by the fact that many banking institutions almost fully exploited the volume of financial guarantees permitted them in 1966, and they preferred guaranteeing bill brokerage transactions over other types of financial transactions.

The number of commercial banks operating in 1966 remained unchanged, while the number of cooperative credit societies declined by two. One credit cooperative merged with a commercial bank, while a second merged with another credit cooperative; both became branches of the absorbing institutions.

<sup>1</sup> The weight of equity capital in the balance sheet, exclusive of contingent accounts, declined from 6.1 percent at the end of 1965 to 5.7 percent at the end of 1966.

Table XV-15

## ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1965-66

	IL million		Percent		Increase or decrease (-)	
	1965	1966	1965	1966	IL m.	%
<b>Assets</b>						
Cash, Treasury bills, and balances with Bank of Israel	1,608.1	1,725.5	34.8	32.7	117.4	7.3
Loans to the public <sup>a</sup>	1,097.9	1,296.0	23.8	24.5	198.1	18.0
Loans to the Government	46.4	77.8	1.0	1.5	31.4	67.7
Loans to the public						
From Govt. deposits	417.4	462.0	9.0	8.7	44.6	10.7
From earmarked deposits	455.3	598.2	9.8	11.3	142.9	31.4
Foreign currency assets	412.9	469.9	8.9	8.9	57.0	13.8
Securities	284.3	318.7	6.2	6.0	34.4	12.1
Real estate	78.9	84.5	1.7	1.7	5.6	7.1
Net balances with other banking institutions	3.6	-9.7	0.1	-0.2	-13.3	-369.4
Other accounts	215.5	260.7	4.7	4.9	45.2	21.0
<b>Total</b>	<b>4,620.3</b>	<b>5,283.6</b>	<b>100.0</b>	<b>100.0</b>	<b>663.3</b>	<b>14.4</b>
<b>Liabilities</b>						
Demand deposits	1,239.9	1,255.8	26.8	23.8	15.9	1.3
Less liquid deposits <sup>a</sup>	1,201.0 <sup>b</sup>	1,522.5	26.0 <sup>b</sup>	28.8	321.5	26.8
Foreign liabilities <sup>c</sup>	653.8	715.2	14.2	13.5	61.4	9.4
Government deposits	429.8	473.4	9.3	9.0	43.6	10.1
Deposits earmarked for loans	464.0	606.4	10.0	11.5	142.4	30.7
Equity capital	282.7	303.6	6.1	5.7	20.9	7.4
Debentures	28.0 <sup>b</sup>	46.8	0.6 <sup>b</sup>	0.9	18.8	67.1
Other accounts	321.1	359.9	7.0	6.8	38.8	12.1
<b>Total</b>	<b>4,620.3</b>	<b>5,283.6</b>	<b>100.0</b>	<b>100.0</b>	<b>663.3</b>	<b>14.4</b>
<b>Contingent accounts</b>						
Balances held by and for banking institutions	87.4	99.3			11.9	13.6
Clients' liabilities and guarantees for clients	1,396.5	1,671.7			275.2	19.7
<b>Total</b>	<b>1,483.9</b>	<b>1,771.0</b>			<b>287.1</b>	<b>19.3</b>
<b>Grand total</b>	<b>6,104.2</b>	<b>7,054.6</b>			<b>950.4</b>	<b>15.6</b>

<sup>a</sup> The figures for 1965 and 1966 are respectively IL 9.9 million and IL 38.8 million larger than the corresponding figures in Tables XV-6 and XV-9, as they include Bank of Israel loans to banks in these amounts. The difference in less liquid deposits is further increased by IL 6 million in loans from various institutions in 1965.

<sup>b</sup> Revised figure.

<sup>c</sup> Including deposits of nonresidents.

Table XV-16

## BANKING INSTITUTIONS AND THEIR BRANCHES, 1963-66

End of period	1963	1964	1965	1966
<b>The 3 big banks</b>				
Head offices	3	3	3	3
Branches	363	372	380	397
Total	366	375	383	400
<b>Other banks</b>				
Head offices	23	23	24	24
Branches	180	195	204	211
Total	203	218	228	235
<b>Credit cooperatives</b>				
Head offices	25	23	20	18
Branches	76	79	84	82
Total	101	102	104	100
<b>All banking institutions</b>				
Head offices	51	49	47	45
Branches	619	646	668	690
Total	670	695	715	735

The number of new branch offices of banking institutions opened in 1966 was the same as in the previous year—22. Two of them were the aforementioned credit cooperatives which had merged with other institutions.

The new branches break down as follows: the Big Three opened nine, other banks seven, and credit cooperatives four. The new branches were established mainly in development areas and small towns. In addition, one credit cooperative with seven branches merged with one of the three big banks, becoming branches of the latter, while a second credit cooperative merged with another cooperative, becoming its branch. As a result of all these changes, the Big Three acquired 17 new branches and other banks seven, while the number of cooperative credit branches decreased by two.

The weight of the Big Three in total banking business went up in 1966. The most rapid increase was in the bill brokerage trade, where their share advanced from 45.5 to 49.7 percent. One of the factors in the increased weight of the Big Three was the absorption by one of them of a large credit cooperative. This merger was reflected by a rise in the weight of the Big Three and a decline in that of credit cooperatives. The share of banking business transacted by other banks remained virtually unchanged. Their weight went up in cash and balances with the Bank of Israel, loans to the public, and less liquid de-

posits, but decreased in demand deposits and bill brokerage. The smaller share of other banks in the bill brokerage trade and their larger share of less liquid deposits is attributed to the fact that many of the banks reached the maximum volume of permitted financial guarantees. Consequently, the growth of bill brokerage transactions subsided, while the same banks began to expand time deposits at a relatively rapid rate. In 1966 time deposits served as a close substitute for bill brokerage.

Table XV-17

CASH AND BALANCES AT THE BANK OF ISRAEL, CREDIT, DEPOSITS,  
AND BALANCE OF BILL BROKERAGE TRADE, 1963-66

(percentages)

End of period	The 3 big banks	Other banks	Credit cooperatives	Total
Cash and balances with				
Bank of Israel				
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
1966	70.4	27.2	2.4	100.0
Loans to the public by				
banking institutions <sup>a</sup>				
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
1966	68.9	27.3	3.8	100.0
Demand deposits in Israeli				
currency				
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
1966	66.0	24.7	9.3	100.0
Other deposits <sup>b</sup>				
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
1966	76.1	21.8	2.1	100.0
Bill brokerage				
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
1966	49.7	39.5	10.8	100.0

<sup>a</sup> Including credit to nonresidents.

<sup>b</sup> Including deposits of nonresidents (Patach).

## 7. INCOME AND EXPENSES OF BANKING INSTITUTIONS

Operating income of the banking institutions increased rapidly as compared with 1965, but operating expenses rose even more. As a result, operating profits fell by a substantial 25 percent, after expanding by approximately the same rate in the previous year.

The contraction of capital gains was more marked than in 1965. Profits from the sale of securities fell off sharply, while capital losses arising from the revaluation of security holdings were greater than in 1965. Consequently, the banking institutions wound up the year with a net capital loss of nearly IL 500,000.

Total profits came to about IL 25.7 million, compared with IL 42.7 million in 1965—a decrease of approximately 40 percent.

It should be noted that the appreciable drop in profits during 1966 was largely due to very large losses incurred by a small number of banking institutions. The profit figure for other institutions declined only slightly. The rapid growth of operating income (26.4 percent) reflects the substantial expansion of credit to the public during the year reviewed, the larger average commission charged on bill brokerage transactions and services supplied by the banks, and the higher interest rate paid on deposits with the Bank of Israel. In addition, income from the institutions' deposits with other banks went up following the expansion of such deposits during the year.

Operating expenses were up by about 32 percent, after having increased by approximately 19 percent the year before. Most of this considerable rise was accounted for by two items: interest on short-term deposits and bad debts. After the lowering of the liquidity ratio on time deposits for periods of six months or more at the beginning of September 1966, the banking institutions began to pay much higher interest on such deposits, in some cases as much as on bill brokerage transactions. As a result, the outstanding balance of these deposits soared during the months September–December. The incremental interest paid on time deposits constituted some two-thirds of the total increase in the “interest on deposits” item. Moreover, bad debts and provision for bad debts were considerably larger than in 1965 (when the figure actually contracted). The growth of this item chiefly reflects the losses incurred by certain banking institutions, but there was also a substantial increase in the amount provided for bad debts by most institutions owing to the special conditions prevailing in the economy.

Outlay on wages and fringe benefits rose at approximately the same rate as in 1965, despite a small percentage increase in the average number of employees. After having expanded for several years, the total staff declined in 1966 by about 140. However, because of the increase during 1965, the average annual figure was still 1.4 percent larger than in the preceding year, as compared with a rise of 5.5 percent in 1965 and some 9 percent in 1964.

Table XV-18

## INCOME AND EXPENSES OF BANKING INSTITUTIONS, 1965-66

	IL million		Percent		Percent increase or decrease (-)	
	1965	1966	1965	1966	From 1964 to 1965	From 1965 to 1966
<b>Operating income</b>						
Interest on loans	156.8	195.5	43.2	42.6	14.5	24.7
Service charges	93.4	120.8	25.7	26.3	35.2	29.3
Interest on deposits with the Bank of Israel and other banks	76.6	100.2	21.1	21.8	21.6	30.8
Other income <sup>a</sup>	36.4	42.5	10.0	9.3	5.8	16.8
<b>Total</b>	<b>363.2</b>	<b>459.0</b>	<b>100.0</b>	<b>100.0</b>	<b>19.7</b>	<b>26.4</b>
<b>Operating expenses</b>						
Wages and fringe benefits	129.1	153.6	39.3	35.5	20.0	19.0
Interest on deposits <sup>b</sup>	146.0	201.0	44.5	46.4	22.9	37.7
Other expenses <sup>c</sup>	53.3	78.2	16.2	18.1	8.1	46.7
<b>Total</b>	<b>328.4</b>	<b>432.8</b>	<b>100.0</b>	<b>100.0</b>	<b>19.1</b>	<b>31.8</b>
<b>Profits</b>						
Operating profit	34.8	26.2	81.5	101.9	25.2	-24.7
Capital gains (net)	7.9	-0.5	18.5	-1.9	-46.6	-106.3
<b>Total</b>	<b>42.7</b>	<b>25.7</b>	<b>100.0</b>	<b>100.0</b>	<b>0.2</b>	<b>-39.8</b>
	1961	1962	1963	1964	1965	1966
Operating profit as a percentage of operating income	7.5	8.2	11.8	9.2	9.6	5.7
Operating profit as a percentage of equity capital <sup>d</sup>	18.3	20.7	21.3	13.0	13.3	8.6
Total profits as a percentage of equity capital <sup>d</sup>	23.0	29.8	32.4	19.7	16.2	8.5

<sup>a</sup> Including income from securities (other than capital gains) and from foreign currency, trustee, and insurance transactions.

<sup>b</sup> Including interest and commission on loans received and on rediscounts, as well as fines for liquidity deficiencies.

<sup>c</sup> Including administrative expenses, depreciation, donations, and bad debts.

<sup>d</sup> Does not pertain to foreign banks, as they do not have local equity capital.

Average expenditure per employee increased by 17.4 percent in 1966, as against nearly 14 percent the year before.

The operational profitability of banking institutions declined during the year reviewed. Operating profit before tax amounted to only some 5.7 percent of operating income, as contrasted with 9.6 percent in 1965. Operating profit in relation to average equity capital came to 8.6 percent, as against 13.3 percent the year before. This decline occurred despite the slower expansion of equity capital during 1966.

The overall profitability of banking institutions, which is measured by the ratio between total before-tax profits (net of capital losses) and average equity capital, likewise fell off appreciably—from 16.2 percent in 1965 to 8.5 percent.