Chapter 3
The Public's Financial Asset Portfolio

The value of the public's[1] portfolio of financial assets rose by 6 percent in nominal terms during 2001 to a total of NIS 1,187 billion. This followed an increase of 7.2 percent in 2000 and a large rise of 25.3 percent in 1999.

The weighting of unindexed assets in the asset portfolio continued to grow during 2001, a trend that began as far back as 1992. This was against the background of the disinflation process of the past decade, and low inflation that converged to price stability after 1998. As a result, the weighting of unindexed assets in the asset portfolio amounted to 31 percent at the end of 2001, compared with 25 percent in 1998 and only 10 percent in 1992. In contrast to this trend, CPI-indexed assets accounted for 36 percent of the portfolio in 2001 compared with 47 percent in 1998 and nearly two thirds of the portfolio in 1992. A particularly large increase was recorded during the last two years in the weighting of unindexed bonds due to the substantial accrual in the shekel mutual funds.

The development of the Bank of Israel's interest rate during 2000 and 2001, and the public's expectations regarding its further development were among the reasons for the changes in the internal composition of each channel of investment. These changes led *inter alia* to a growth in the weighting of tradable assets, including certain of these assets that bear interest.

The weighting of foreign currency denominated and foreign currency indexed assets (excluding shares abroad) rose from 10 percent in 1998 and 11 percent in 2000, to 12 percent in 2001 due to the relative stability of the foreign currency market and the considerable decrease in interest rates abroad during 2001.

The weighting of shares (including shares abroad) in the asset portfolio fell from 26 percent in 1999, which was a buoyant year in the equity market, to only 21 percent in 2001. This resulted from the crises in the high-tech industries and in other industries in Israel and abroad, which led to a large drop in share prices.

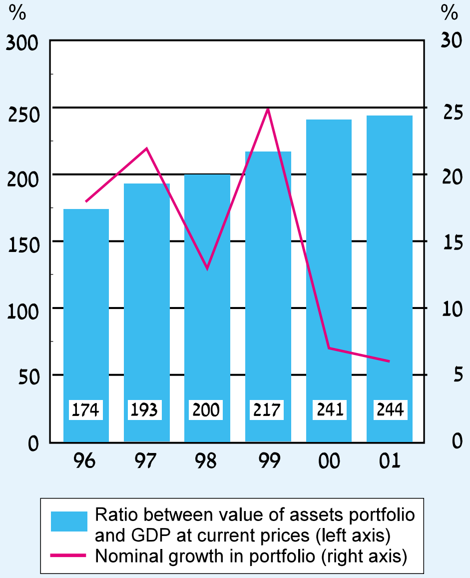
[1] Households and firms; not including the Government, the Bank of Israel, the commercial banks and foreign residents.

1. MAIN DEVELOPMENTS

The rate of growth in the public's portfolio of financial assets moderated due to the slowdown in non-financial activity, the slump in the equity market and the low inflation recorded during 2000 and 2001. The value of the portfolio was estimated at NIS 1,187 billion at the end of 2001 compared with NIS 1,119 billion in December 2000, a 6 percent rise in nominal terms. This was after the value of the portfolio rose by 7 percent in nominal terms during 2000, and by an average of 20 percent a year during the years 1996 to 1999. While the annual rate of increase in the asset portfolio slowed appreciably during the years 2000 and 2001, the value of the portfolio relative to gross domestic product increased. The ratio between the average nominal value of the portfolio and annual GDP at current prices was 240 percent during these years, compared with 217 percent in 1999 and 200 percent and less previously (Figure 3.1). In 1999, most of the increase in this ratio derived from the growth in the share component of the asset portfolio resulting from the growth in new issues during that year and the rise in share prices on the Tel Aviv Stock Exchange and in foreign stock markets. During 2000 and 2001, however, most of the growth in the ratio between the value of the asset portfolio and GDP derived from the increased value of unindexed assets in it.

During 2001 and the last decade as a whole, the asset portfolio developed against the background of a range of changes in the economy, primarily the disinflation process and the reforms in the foreign currency market. As a result, the development of the components of the portfolio during the last three years reflect low inflation expectations and financial stability in the markets due to the policy measures that were adopted. As an example, the weighting of unindexed assets in the portfolio rose during the last decade from 10 percent in 1992 to a third of a portfolio in 2001. The gap between the yields expected on investment in shekels and the alternative investments in the portfolio increased as inflation expectations decreased and with them the interest rate – principally for the short term. It therefore became more worthwhile to invest in unindexed holdings.

Figure 3.1
Nominal Increase in Value of Asset Portfolio and Development Relative to GDP, 1996–2001



Note: The ratio between the value of the portfolio and GDP was obtained by dividing the annual average value of the financial assets by the nominal value of the gross domestic

Table 3.1
The Financial Asset Portfolio of the Public, 1998–2001

	Balance (NIS billion)				Composition (percent)				Nominal rise (percent)		
	1998	1999	2000	2001	1998	1999	2000	2001	1999	2000	2001
Assets by indexation											
Total	832.7	1,043.6	1,118.7	1,187.1	100	100	100	100	25.3	7.2	6.1
Excl. shares in Israel	699.7	822.1	895.8	961.0							
Unindexed assets	208.4	258.4	320.0	370.3	25.0	24.8	28.6	31.2	24.0	23.9	15.7
CPI-indexed assets	386.8	404.4	401.9	428.9	46.5	38.8	35.9	36.1	4.6	–0.6	6.7
Foreign-currency-indexed and denominated assets	86.0	107.1	120.4	139.1	10.3	10.3	10.8	11.7	24.5	12.5	15.5
Shares in Israel	133.1	221.5	222.9	226.1	16.0	21.2	19.9	19.0	66.5	0.6	1.4
Shares abroad	18.5	52.2	53.4	22.7	2.2	5.0	4.8	1.9	182.3	2.2	–57.6
Assets by term to maturity											
Short term	211.8	250.6	289.9	324.2	25.4	24.0	25.9	27.3	18.3	15.7	11.8
Medium term	464.5	620.0	646.4	664.6	55.8	59.4	57.8	56.0	33.5	4.3	2.8
Long term	156.4	173.0	183.6	198.3	18.8	16.6	16.4	16.7	10.6	6.2	8.0
	344.6	401.5	442.5	491.9	41.4	38.5	39.6	41.4	16.5	10.2	11.2
Commercial banks											
Unindexed shekel deposits	150.1	189.5	224.0	255.0	18.0	18.2	20.0	21.5	26.2	18.2	13.9
CPI-indexed deposits	19.2	18.1	24.4	28.3	2.3	1.7	2.2	2.4	–5.5	34.7	16.2
Foreign-currency-indexed and denominated deposits	71.1	84.7	92.7	109.4	8.5	8.1	8.3	9.2	19.2	9.4	18.1
CPI-indexed saving schemes	96.7	100.7	91.2	88.4	11.6	9.6	8.2	7.4	4.1	–9.4	–3.1
Foreign-currency-indexed saving schemes	6.2	6.6	7.8	7.4	0.7	0.6	0.7	0.6	7.3	17.7	–5.4
Unindexed saving schemes	1.4	1.9	2.5	3.4	0.2	0.2	0.2	0.3	36.2	30.7	34.7
Assets by institutional composition											
Total institutions	296.0	323.6	345.8	369.2	35.5	31.0	30.9	31.1	9.3	6.9	6.8
Provident funds	107.8	116.2	120.0	123.3	12.9	11.1	10.7	10.4	7.8	3.3	2.7
Advanced study funds	31.9	37.2	42.2	47.6	3.8	3.6	3.8	4.0	16.6	13.3	12.8
Pension funds for established members	95.1	99.7	105.4	110.6	11.4	9.6	9.4	9.3	4.8	5.7	4.9
Pension funds for new members	3.4	5.3	7.5	10.5	0.4	0.5	0.7	0.9	55.9	41.7	40.3
Life insurance plans-guaranteed yield	38.8	40.1	40.6	42.0	4.7	3.8	3.6	3.5	3.4	1.3	3.4
Life insurance plans-profit share	19.0	25.1	30.1	35.2	2.3	2.4	2.7	3.0	32.1	19.8	17.2
The public directly	**192.1**	**318.5**	**330.4**	**326.0**	**23.1**	**30.5**	**29.5**	**27.5**	**65.8**	**3.7**	**–1.3**

SOURCE: Based on banks' financial statements, and TASE, Ministry of Finance, and Controller of Foreign Exchange data.

The public's investments in CPI-indexed assets (which as is known provide for protection against inflation) declined due to the fall in inflation expectations, and their weighting fell from two thirds of the portfolio at the beginning of the decade to 36 percent at the end of 2001. This trend was mainly reflected by a decrease in saving

Table 3.2
Distributionof the Public's Asset Portfolio by Indexation Composition, 1998–2001

	Balance (NIS billion)				Composition (percent)			
	1998	1999	2000	2001	1998	1999	2000	2001
Total	832.7	1,043.6	1,118.6	1,187.1		25.3	7.2	6.1
Unindexed assets	**208.4**	**258.4**	**320.0**	**370.3**	**25.0**	**24.8**	**28.6**	**31.2**
Cash and liquid deposits	45.0	53.7	57.7	63.8	5.4	5.1	5.2	5.4
Term deposits	120.5	156.1	190.2	216.5	14.5	15.0	17.0	18.2
Saving schemes	1.41	1.9	2.5	4.4	0.2	0.2	0.2	0.4
Treasury bills	16.5	18.0	26.2	26.5	2.0	1.7	2.3	2.2
Gilon and Shahar bonds	24.9	28.7	43.5	59.1	3.0	2.7	3.9	5.0
CPI-indexed Assets	**386.8**	**404.4**	**401.9**	**428.9**	**46.5**	**38.8**	**35.9**	**36.1**
Saving schemes	104.3	109.2	101.5	100.5	12.5	10.5	9.1	8.4
CPI-indexed deposits	51.9	50.9	55.4	55.6	6.2	4.9	5.0	4.7
Tradable bonds	7.8	80.3	76.4	87.5	9.5	7.7	6.8	7.4
Other assets	151.8	164.0	168.6	185.7	18.2	15.7	15.1	15.6
Shares in Israel	**133.1**	**221.5**	**222.9**	**226.1**	**16.0**	**21.2**	**19.9**	**19.0**
Foreign currency and foreign currency indexed assets (incl. shares abroad)	**104.5**	**159.2**	**173.8**	**161.8**	**12.5**	**15.3**	**15.5**	**13.6**
Total (excl. shares abroad)	86.3	107.0	120.4	139.1	10.4	10.3	10.8	11.7
Deposits abroad	7.1	16.4	22.6	33.3	0.8	1.6	2.0	2.8
Pamah restitutions	18.4	16.7	15.3	17.2	2.2	1.6	1.4	1.5
Other Pamah	39.4	47.2	52.5	56.1	4.7	4.5	4.7	4.7
Foreign currency indexed deposits	6.3	4.5	2.8	3.4	0.8	0.4	0.2	0.3
Saving schemes	6.2	6.6	7.8	7.4	0.7	0.6	0.7	0.6
Securities abroad (excl. shares)	0	3.6	8.6	11.4	0.0	0.3	0.8	1.0
Tradable bonds	9.1	12.1	10.8	10.5	1.1	1.2	1.0	0.9
Shares abroad	18.1	52.3	53.4	22.7	2.2	5.0	4.8	1.9

SOURCE: Based on banks' financial statements, and TASE, Ministry of Finance, and Controller of Foreign Exchange data.

via institutional investors,[2] most of whose holdings are invested in CPI-indexed assets, and by withdrawals from CPI-indexed saving plans and deposits concurrent with a large accrual in the shekel mutual funds and in unindexed deposits.

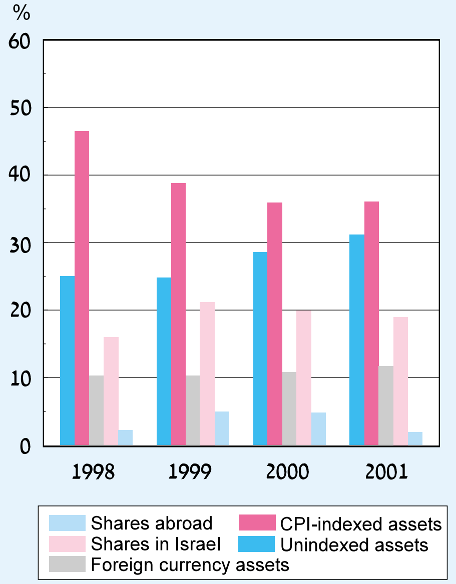
The changes in the composition of the asset portfolio are contributing to their gradual convergence to the composition typical of Western economies that have unrestricted capital movements and low inflation. In these economies, most of the portfolio is denominated in local currency and the portfolio largely consists of tradable assets, including shares.

[2] The institutional investors are the provident and severance pay funds, the advanced study funds, the pension funds and the insurance companies.

2. THE INDEXATION COMPOSITION OF THE ASSET PORTFOLIO

The weighting of unindexed assets in the asset portfolio amounted to 31 percent at the end of 2001. CPI-indexed assets accounted for 36 percent of the asset portfolio, and foreign currency denominated and foreign currency indexed assets (including shares abroad) accounted for 14 percent of the portfolio. The weighting of shares in Israel was estimated at 19 percent of the portfolio in 2001, and the weighting of shares abroad at 2 percent of the asset portfolio (Figure 3.2). The share component of the public's asset portfolio is highly volatile, and can even change from month to month. For the purpose of the analysis, therefore, the distribution of the assets will be presented without the share component in Israel. Shares abroad, which are also highly volatile but have a low weighting in the portfolio, will be presented as part of the foreign currency indexed and foreign currency denominated assets. This is because investment in them is made in foreign currency and is one of the main investment channels for Israeli residents abroad.

Figure 3.2
Indexation Composition
of the Asset Portfolio, 1998–2001



The weighting of unindexed assets in the asset portfolio exclusive of shares in Israel amounted to 38 percent at the end of 2001. CPI-indexed assets accounted for 45 percent of the portfolio, and foreign currency denominated and foreign currency indexed assets accounted for 17 percent of the portfolio (Table 3.3).

a. Impact of the disinflation process and monetary policy

Against the background of the continued process of disinflation and the convergence of inflation to price stability, the weighting of unindexed assets in the portfolio excluding shares in Israel rose in 2001 as well and amounted to 38 percent, compared with 36 percent in 2000, 31 percent in 1999 and 30 percent in 1998. However, the weighting of CPI-indexed assets in the asset portfolio excluding shares in Israel fell to 44.6 percent at the end of 2001, compared with 44.9 percent at the end of 2000, 49 percent at the end of 1999 and 55 percent at the end of 1998.

The value of the public's unindexed assets rose by 16 percent in nominal terms during 2001, following an increase of 24 percent in 2000 and a similar increase in

Table 3.3
Distribution of Assets by Indexation Composition (excl. shares abroad), 1998–2001

(distribution, percent)

	1998	1999	2000	2001
Total	699.6	822.1	895.8	961.0
Unindexed assets	**29.8**	**31.4**	**35.7**	**38.5**
Cash and liquid deposits	6.4	6.5	6.4	6.6
Term deposits	17.2	19.0	21.2	22.5
Saving schemes	0.2	0.2	0.3	0.5
Treasury bills	2.4	2.2	2.9	2.8
Gilon and Shahar bonds	3.6	3.5	4.9	6.1
CPI-indexed assets	**55.3**	**49.2**	**44.9**	**44.6**
Saving schemes	14.9	13.3	11.3	10.4
CPI-indexed deposits	7.4	6.2	6.2	5.8
Tradable bonds	11.3	9.8	8.5	9.1
Other assets	21.7	19.9	18.8	19.3
Shares in Israel, foreign currency and foreign currency indexed assets (incl. shares abroad)	**14.9**	**19.4**	**19.4**	**16.8**
Total (excl. shares abroad)	12.3	13.0	13.4	14.5
Deposits abroad	1.0	2.0	2.5	3.5
Pamah restitutions	2.6	2.0	1.7	1.8
Other Pamah	5.6	5.7	5.9	5.8
Foreign currency indexed deposits	0.9	0.5	0.3	0.4
Saving schemes	0.9	0.8	0.9	0.8
Securities abroad (excl. shares)	0.0	0.4	1.0	1.2
Tradable bonds	1.3	1.5	1.2	1.1
Shares abroad	**2.6**	**6.4**	**6.0**	**2.4**

SOURCE: Based on banks' financial statements, and TASE, Ministry of Finance, and Controller of Foreign Exchange data.

1999. At the end of 2001, 58 percent of unindexed assets consisted of deposits, and 23 percent consisted of unindexed bonds.

The weighting of marketable unindexed assets (unindexed bonds) rose slightly, from 22 percent of total unindexed assets at the end of 2000 to 23 percent at the end of 2001.

The feasibility of investment in unindexed assets and especially in unindexed bank deposits increased, especially after the decline in inflation expectations to low single-digit rates in the last three years. As a result of the impact on inflation expectations of the worldwide financial shock at the end of 1998, the Bank of Israel raised the interest rate. However, the central bank refrained from intervening directly in the foreign currency market, and thereby enabled the market mechanisms to stabilize the dollar exchange rate and inflation expectations. Due to the relatively high exchange rate and the large drop in inflation expectations at the beginning of 1999, after the shock, investment in bank deposits yielded a high and risk-free real return. Since these deposits are also exempt from tax, they became the preferred form of investment in the asset portfolio.

The investment feasibility of interest-bearing tradable assets such as unindexed bonds was maintained during 2001, due to the continued expectations of low and stable inflation and a further reduction in the Bank of Israel's interest rate. Accordingly and as a result of the Government's desire to promote the development of the bond market, a considerable part of its borrowing in this market was by means of unindexed bonds concurrent with an extension of their term-to-maturity, which contributed to the tradability of the unindexed bond market. Against this background, the public invested in unindexed tradable assets, principally via the shekel mutual funds. In December 2001, 4 percent of the asset portfolio excluding shares in Israel consisted of unindexed assets that were purchased via the mutual funds.

Investment in CPI-indexed assets, which provide protection against a rise in the price index, can only be made via three main channels – banking channels, direct investment in the bond market, and deposits with institutional investors. In view of the low level of inflation expectations, the need for hedging against inflation has declined, and the public has sought alternatives to investment in CPI-indexed assets. This has been reflected by the continued decline in the CPI-indexed share in the portfolio. The slight decline in the CPI-indexed component of the portfolio excluding shares in Israel during 2001 mainly reflected the decrease in the non-tradable part of CPI-indexed investments, while the weight of CPI-indexed bonds increased. Investment in CPI-indexed saving plans fell from 11 percent in 2000 to 10 percent at the end of 2001. Within the tradable part, the weight of CPI-indexed bonds rose from 8.5 percent at the end of 2000 to 9.1 percent at the end of 2001. The balance of CPI-indexed bonds increased by 14 percent in nominal terms during 2001 after falling by 5 percent in 2000. The increase largely resulted from the continued decline in the expected real interest rate, a development that increases the capital gains for investors in these bonds. During 2001, the public continued to reduce their savings via the provident funds, most of which are CPI-indexed. This trend, which has continued since the end of 1993, moderated the positive trend in the tradable CPI-indexed market.

b. The impact of the reform in the foreign currency market on the indexation composition of the asset portfolio

The foreign currency components in the public's asset portfolio (including shares abroad) fell from 19 percent of the portfolio excluding shares in Israel in 1999 and 2000, to 17 percent in 2001. This resulted from the decrease in the shares abroad component, which reached 2 percent at the end of 2001 compared with 6 percent of the portfolio in 1999 and 2000, since the weights of the other foreign currency denominated and foreign currency indexed assets rose from 13 percent of the asset portfolio, excluding shares in Israel, in 1999 and 2000, to 15 percent in 2001. This increase mainly reflects the growth in the weights of Israeli residents' investment in deposits abroad, from 3 percent in 2000 to 4 percent at the end of 2001.

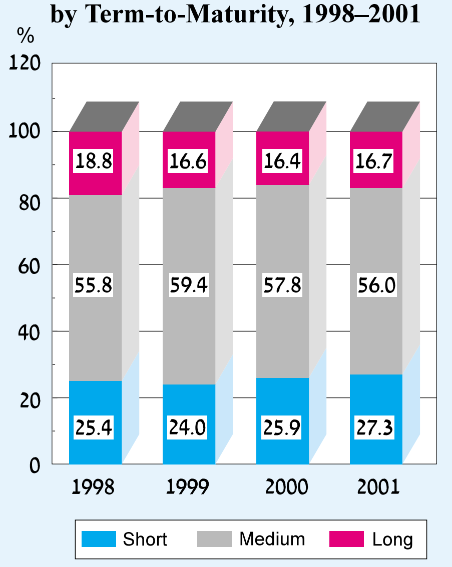
Following the liberalization of the capital markets and the reduced restrictions on investment by individuals and financial intermediaries, Israeli residents' investments in assets abroad and in equity markets abroad have expanded during recent years. This development has made it possible to disperse the public's investment portfolio and to increase its profitability, although this involves exposure to financial risks. In 2001, a combination of two factors—stability in the foreign currency market and the fall in interest rates abroad—reduced the feasibility of investment in foreign currency denominated and foreign currency indexed assets. From the aspect of the long-term trend, the development of the market for derivatives on the exchange rate may have reduced the need to purchase foreign currency (denominated and indexed) assets for the purpose of hedging against exchange rate adjustments, with the result that their weighting in the portfolio did not increase. The background for the development of the market for derivatives on the exchange rate was the Bank of Israel's non-intervention in the foreign currency market, even at the time of the impact of the worldwide financial shock at the end of 1998. This led to increased awareness of foreign currency risks, resulting in demand for financial hedging instruments and the emergence of trading in options for the purchase of dollars for various periods.

c. Impact of the development of the equity market

Due to the relationship between the equity market in the United States and the local market, and especially in view of the development of the high-tech industries in Israel and the growth in Israeli companies' issues abroad, the weight of shares in the asset portfolio fell during 2001. Only in December, following the one-time reduction in the Bank of Israel's interest rate, did the weight of shares increase and approach its level at the end of 2000.

The weight of shares in Israel fell during 2001 until November, to 18 percent, and rose to 19 percent in December. This followed an increase from 16 to 21 percent during the buoyant period in the equity market during 1999. The value of shares in Israel fell by a moderate 1 percent in asset portfolio terms in 2001 compared with 2000. The growth in the weight of shares during December reflected the increase in the relative feasibility of investment in shares following the Bank of Israel's 2 percentage point cut in the interest rate, and this was reflected by the price rises in the market. The downtrend in the share component until December reflected the impact

Figure 3.3
Distribution of the Asset Portfolio by Term-to-Maturity, 1998–2001



of the fall in prices in the equity market, the slowdown in non-financial activity worldwide and in Israel, and the absence of issues in 2001. The crisis in the high-tech shares, which began in March 2000, spread to all sectors as the public attempted to leave the stock markets in Israel and abroad. This development and with it the recession in economic activity in Israel and worldwide, reduced the expectations of a rapid recovery in the equity market, halting companies' issues in Israel and adversely affecting the primary market for shares.

3. DEVELOPMENTS BY TERMS-TO-MATURITY

Table 3.4
Distribution of the Public's Asset Portfolio by Term-to-Maturity, 1998–2001

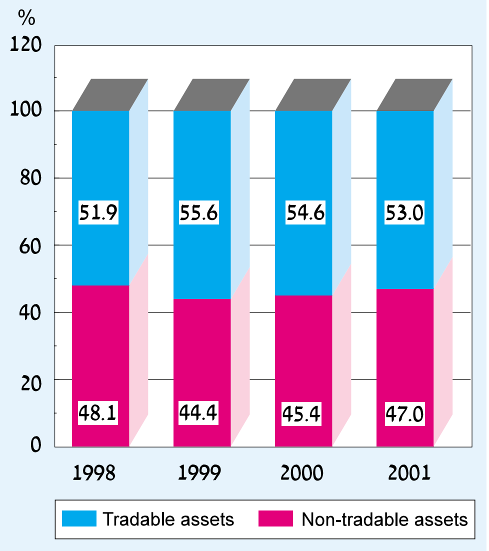
	Balance (NIS billion)				Composition (percent)			
	1998	1999	2000	2001	1998	1999	2000	2001
Total	832.7	1.043.6	1,118.6	1,187.1	100.0	100.0	100.0	100.0
Short term	**211.8**	**250.6**	**289.9**	**324.2**	**25.4**	**24.0**	**25.9**	**27.3**
Liquid shekel assets	40.4	46.9	49.8	57.1	4.9	4.5	4.4	4.8
Unindexed deposits	104.6	131.2	159.5	176.3	12.6	12.6	14.3	14.9
CPI-indexed deposits	0.6	0.3	0.1	0.1	0.1	0.0	0.0	0.0
Pamah	49.6	54.5	58.3	66.0	6.0	5.2	5.2	5.6
Patzam	4.7	3.7	2.2	2.4	0.6	0.4	0.2	0.2
Treasury bills	12.0	14.0	20.0	22.2	1.4	1.3	1.8	1.9
Medium-term and other assets	**464.5**	**620.0**	**645.1**	**664.6**	**55.8**	**59.4**	**57.7**	**56.0**
Saving schemes	104.3	109.2	101.5	100.5	12.5	10.5	9.1	8.4
Unindexed deposits	13.6	21.7	25.3	34.7	1.6	2.1	2.3	2.9
CPI-indexed deposits	19.2	18.1	24.4	28.3	2.3	1.7	2.2	2.4
Pamah	8.2	9.3	9.5	7.3	1.0	0.9	0.9	0.6
Foreign-currency linked deposits	1.7	0.8	0.0	0.4	0.2	0.1	0.0	0.0
Shares	115.1	194.3	193.2	196.5	13.8	18.6	17.3	16.6
Bonds	38.9	40.9	46.5	61.1	4.7	3.9	4.2	5.1
Investment abroad	23.9	70.5	82.5	65.3	2.9	6.8	7.4	5.5
Provident funds	107.8	117.4	120.0	123.3	13.0	11.2	10.7	10.4
Advanced study funds	31.9	37.8	42.2	47.6	3.8	3.6	3.8	4.0
Long-term	**156.4**	**173.0**	**183.6**	**198.3**	**18.8**	**16.6**	**16.4**	**16.7**
Pension funds for established members	95.1	101.7	105.4	110.6	11.4	9.7	9.4	9.3
Pension funds for new members	3.4	5.3	7.5	10.5	0.4	0.5	0.7	0.9
Life insurance plans:								
Guaranteed-yield	38.9	40.2	40	42.0	4.7	3.9	3.6	3.5
Profit-sharing	19.0	25.8	30.1	35.2	2.3	2.5	2.7	3.0

SOURCE: Based on banks' financial statements, and TASE, Ministry of Finance, and Controller of Foreign Exchange data.

The shares of short[3] and long-term[4] assets in the asset portfolio increased during 2001, and the shares of medium-term assets[5] decreased (Figure 3.3). The decrease in medium-term assets mainly derived from the public's reduced investment in shares in Israel and abroad, the continued redemptions from the provident funds, and the withdrawal of money from CPI-indexed and dollar-indexed saving plans. Investment in short-term assets rose to 27 percent of the portfolio in 2001, compared with 26 percent of the portfolio at the end of 2000 and 24 percent at the end of 1999. Unindexed assets, including unindexed deposits, accounted for most of the increase in short-term assets. The weighting of the public's medium-term assets fell from 58 percent of the portfolio in 2000 to 56 percent in 2001 – most of the decrease was recorded in investments in assets abroad, saving plans and shares – while investments in longer-term shekel deposits and bonds increased. The weight of long-term assets rose to a moderate extent in 2001, from 16.4 to 16.7 percent of the portfolio to a growth in the value of the assets of the new pension funds and the profit-sharing life insurance plans (Table 3.4).

During the last three years, the public showed a tendency to extend the period of investment in tradable and non-tradable unindexed assets, a development that is indicative of credibility in the continuation of price stability and stabilizing interest rate policy. The level of tradability in the shekel bond market increased concurrent with the extension of the terms-to-maturity of the bonds supporting a growth in investment in them. It should be noted however, that medium and long-term unindexed investments in 2001 were sensitive to major changes in fiscal and monetary policy and to the terror attack in the USA.

Figure 3.4
Distribution of the Asset Portfolio by Tradability, 1998–2001



4. TRADABILITY OF THE ASSET PORTFOLIO

The weighting of tradable assets in the asset portfolio fell during 2001 compared with 2000 and amounted to 53 percent, compared with 55 percent of the portfolio in 2000 and 56 percent in 1999 (Figure 3.4).

[3] Unindexed shekel deposits, CPI-indexed deposits for a term of up to a year to maturity, demand deposits, cash and Treasury bills.

[4] Pension funds and life insurance plans.

[5] Bonds, shares, saving plans, long-term deposits, advanced study funds, provident funds, and Israeli residents' investments abroad.

Table 3.5
Tradability of the Asset Portfolio, 1998–2001

	Balance (NIS billion)				Composition (percent)			
	1998	1999	2000	2001	1998	1999	2000	2001
Total	832.7	1,043.6	1,118.6	1,187.1	100.0	100.0	100.0	100.0
Non-tradable assets	**400.4**	**463.2**	**508.3**	**557.7**	**48.1**	**44.4**	**45.4**	**47.0**
Unindexed assets	166.9	211.8	250.4	284.7	20.0	20.3	22.4	24.0
Cash and liquid deposits	45.0	53.7	57.7	63.8	5.4	5.1	5.2	5.4
Saving schemes	1.4	1.9	2.5	4.4	0.2	0.2	0.2	0.4
CPI-indexed assets	156.2	160.1	156.9	155.7	18.8	15.3	14.0	13.1
Saving schemes	104.3	109.2	101.5	100.1	12.5	10.5	9.1	8.4
CPI-indexed deposits	51.9	50.9	55.4	55.6	6.2	4.9	5.0	4.7
Foreign-currency and foreign currency indexed assets	77.3	91.3	101.1	117.3	9.3	8.7	9.0	9.9
Pamah restitutions	18.4	16.7	15.3	17.2	2.2	1.6	1.4	1.5
Other Pamah	39.4	47.2	52.5	56.1	4.7	4.5	4.7	4.7
Foreign-currency indexed deposits	6.3	4.5	2.8	3.4	0.8	0.4	0.2	0.3
Saving schemes	6.2	6.6	7.8	7.4	0.7	0.6	0.7	0.6
Deposits abroad	7.1	16.4	22.6	33.3	0.8	1.6	2.0	2.8
Tradable assets	**432.3**	**580.4**	**610.3**	**629.4**	**51.9**	**55.6**	**54.6**	**53.0**
Unindexed assets	41.5	46.6	69.6	85.6	5.0	4.5	6.2	7.2
Treasury bills	16.5	18.0	26.2	26.5	2.0	1.7	2.3	2.2
Gilon and Shahar bonds	24.9	28.7	43.5	59.1	3.0	2.7	3.9	5.0
CPI-indexed assets	230.6	244.3	245.0	273.2	27.7	23.4	21.9	23.0
Tradable bonds	78.8	80.3	76.4	87.5	9.5	7.7	6.8	7.4
Other assets	151.8	164.0	168.6	185.7	18.2	15.7	15.1	15.6
Foreign-currency and foreign currency indexed assets	27.2	68.0	72.8	44.5	3.3	6.5	6.5	3.7
Tradable bonds	9.1	12.1	10.8	10.5	1.1	1.2	1.0	0.9
Securities abroad	0.0	3.6	8.6	11.4	0.0	0.3	0.8	1.0
Shares abroad	18.1	52.3	53.4	22.7	2.2	5.0	4.8	1.9
Shares in Israel	133.1	221.5	222.9	226.1	16.0	21.2	19.9	19.0

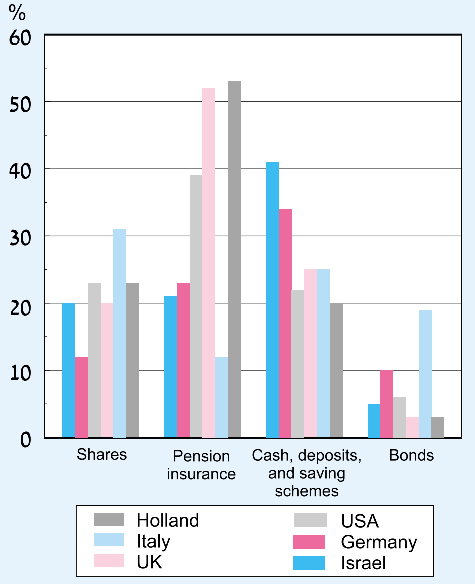
SOURCE: Based on banks' financial statements, and TASE, Ministry of Finance, and Controller of Foreign Exchange data.

This development mainly reflects the decline in the component of shares in Israel, which was partly offset by an increase in the weights of unindexed and CPI-indexed bonds (Table 3.5). The increased weights of non-tradable assets largely resulted from the growth in shekel deposits. The share of tradable assets in the portfolio was affected *inter alia* by the issue of earmarked bonds to institutional investors and by the lack of alternatives to banking intermediation. The further development of the capital market, such as the more active participation of institutional investors, could contribute to an increase in the tradable assets' share. A reform in the pension industry and the expected removal of the treasury bill ceiling will therefore have the effect of increasing the weight of tradable assets in the portfolio.

5. INTERNATIONAL COMPARISON

As a result of the lower rates of inflation during recent years and the element of progress that was made in reforming the capital market at the beginning of the decade, the composition of assets in Israel has become closer to that in developed countries with low inflation—a portfolio largely consisting of unindexed assets and shares. The weighting of CPI-indexed assets in the public's asset portfolio in Israel has decreased during recent years, and the unindexed component has increased among all terms. The weighting of tradable assets such as bonds and shares has also increased, although banking intermediation is still the main channel in the public's investments. In order to examine the distribution of the asset portfolio in Israel relative to other countries, the main components in the asset portfolios of certain countries in the European Union and the USA are presented below (Figure 3.5). While this comparison can provide only a general indication because of the many institutional differences and certain differences in the definitions of data, several important facts can be learned from it.

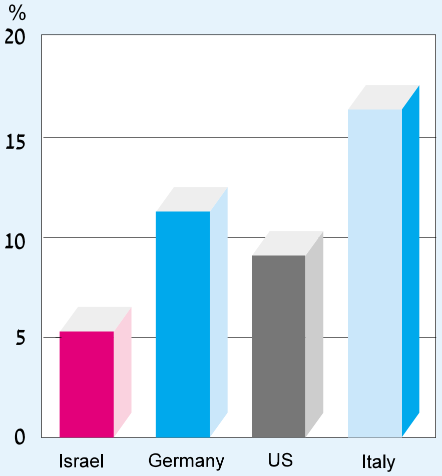
Figure 3.5
Composition of Wordwide Financial Asset Portfolios, 1998–2001



SOURCE: Deutsche Bundesbank Financial Accounts 1999-2000, Flow of Funds Accounts (USA) September 2001, Annual Report of the Bank of Italy 2000, Dutch National Accounts 1998, Bank of England Quarterly Bulletin: Spring 2001.

The international comparison shows that in Israel, the weights of assets in which investment is made via the banking system (deposits and saving plans) are among the highest in the sample, at 41 percent of the portfolio, of which 60 percent are unindexed assets. The removal of the restriction on the issue of Treasury bills will assist in the development of the money market and will lead to increased competition in the area of financial intermediation, thereby contributing to a reduction in the weight of bank intermediation in the public's investments. The share component in the public's asset portfolio is nearly identical to that of the UK, Holland and the USA. This component has the highest level of risk in the portfolio, due to the volatility of share prices. It should be noted that the public's total investments abroad in shares and bonds is greater than shown in Figure 3.5. This is because pension funds abroad disperse their assets among government and corporate bonds, shares and foreign investments, in contrast to the investments of institutional

Figure 3.6
Proportion of Mutual Funds to Total Financial Assets



SOURCE: Deutsche Bundesbank Financial Accounts 1999-2000, Flow of Funds Accounts (USA) September 2001, Annual Report of the Bank of Italy 2000, Dutch National Accounts 1998, Bank of England Quarterly.

investors in Israel, which are mainly comprised of government bonds and ear-marked bonds. Direct investment in government bonds in all the countries in the sample except for Italy accounts for less than 10 percent of the total portfolio. The pension insurance component in Israel—the pension funds and the life insurance plan—is smaller than in the USA, the UK, Holland and Germany, and larger than in Italy. Most countries in the sample provide tax concessions on long-term saving and in Holland pension saving is compulsory for all citizens. It should be noted that the budgetary pension component, which is characteristic of the public sector in Israel, is not included in the asset portfolio data. As a result, the figure on pension insurance in Israel as it is presented in the diagram is downward biased.

The public's investment in the mutual funds in Israel has developed greatly during recent years. But relative to other countries, this channel of investment is still under-developed, as is apparent from Figure 3.6.