

Chapter 3

The Public's Financial Asset Portfolio

The value of the public's¹ portfolio of financial assets fell by 5 percent in 2002 and totaled NIS 1,214 billion, after rising in real terms since 1995. Two major developments in the portfolio during the year were the large decrease in share prices in Israel and abroad, which was the main reason for the decline in the portfolio's value, and the move from unindexed shekel assets to CPI-indexed assets or foreign currency assets.²

The positive trends in the composition of the asset portfolio during the last decade came to an end in 2002. The growth in the proportion of unindexed shekel assets that began in 1993 ceased, concurrent with an increase in the proportion of CPI-indexed assets, which had fallen consistently since the mid-1990s. This development reflected the increased uncertainty over the development of inflation in the course of the year. But in the foreign currency component and the share component of the portfolio, the trends characteristic of the previous years became stronger: The proportion of foreign-currency denominated and indexed assets increased, due to the positive accrual of assets of this type and the depreciation of the shekel, and the proportion of shares in Israel and abroad decreased as a result of the large downturn in the equity markets.

The structural development of the asset portfolio was not uniform throughout the year: During the first half of the year, the public increased the proportion of CPI-indexed and foreign currency indexed assets, and reduced the proportion of unindexed assets in the portfolio due to the large depreciation of the shekel and expectations that this depreciation would continue, and as a result of the rise in inflation expectations. During the second half, following the interest rate hikes in June and after the foreign currency market had become more stable

¹ Households and firms; not including the government, the Bank of Israel, the commercial banks and foreign residents. See Box 3.1 for details and definitions.

² The reference here is to assets denominated in foreign currency or indexed to foreign currency.

and inflation expectations had fallen, the public increased the proportion of un-indexed assets without changing the proportions of CPI-indexed and foreign currency assets. The developments in the portfolio during the second half of the year only partly offset the structural changes that occurred in the portfolio during the first half.

1. MAIN DEVELOPMENTS

The public's financial asset portfolio contracted by 5 percent in real terms during 2002 and totaled NIS 1,214 billion at the end of the year (Table 3.1). This followed consistent real increases in the portfolio's value since the mid 1990s. The real decrease in the portfolio's value during 2002 reflected the continued recession in non-financial activity, and matched the decline in private saving.

The real decline in the value of the asset portfolio resulted mainly from the 30 percent decrease in the share component (shares in Israel and abroad), and from the 5 percent real erosion in the unindexed shekel component. These decreases were partly offset by a 20 percent real increase in the value of the foreign currency component and a slight increase in the value of the CPI-indexed component.

The disinflation process and the convergence of inflation towards price stability were the main factors affecting the development of the asset portfolio's composition during recent years. Accordingly, the proportion of unindexed shekel assets in the public's financial asset portfolio increased gradually at the expense of the proportion of CPI-indexed assets. In 2002 however, the rise in inflation expectations and growing uncertainty over inflation heightened the risk involved in investment in unindexed shekel assets. As a result, the portfolio underwent a process of adjustment during the year: The proportion of CPI-indexed assets expanded, while the proportion of unindexed shekel assets contracted. (This development was particularly apparent during the second half of the year, as will be described later.)

The development of the asset portfolio's composition over the years has also been affected by the liberalization of the foreign currency market, which led to a growth in the proportion of foreign currency assets, and by the considerable volatility in share prices in Israel and abroad, which has reduced the proportion of shares in the portfolio. These trends intensified during 2002 as a result of the depreciation of the shekel, currency risks, and the sharp drop in prices in the local and worldwide equity markets.

The developments that altered the portfolio's indexation composition also led to a change in the portfolio's composition by term to maturity. An examination of the portfolio's composition exclusive of the share component (which was affected by price slides) shows that the proportion of short-term assets, which mainly consist of unindexed assets, fell in 2002 concurrent with a rise in the proportion of medium and long-term assets, which mainly consist of CPI-indexed or foreign currency assets. The changes in the proportions of short and long-term assets in the portfolio during 2002 reversed the previous years' structural trends in the portfolio.

Table 3.1
The Public's Financial Asset Portfolio, 1998–2002

	Balance (NIS billion, current prices)					Composition and real change (percent)				
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Total	832.1	1,039.4	1,116.8	1,198.2	1,214.1	4.5	23.3	7.5	5.8	-4.9
Assets by indexation										
Unindexed assets	208.4	258.5	320.0	374.5	379.6	25.0	24.9	28.7	31.3	31.3
CPI-indexed assets	386.2	403.6	406.1	425.9	464.0	46.4	38.8	36.4	35.5	38.2
Foreign-currency-indexed and denominated assets	86.0	103.5	113.8	140.9	180.0	10.3	10.0	10.2	11.8	14.8
Shares in Israel	133.1	221.5	222.9	226.6	171.3	16.0	21.3	20.0	18.9	14.1
Shares abroad	18.5	52.2	54.0	30.3	19.3	2.2	5.0	4.8	2.5	1.6
Assets by term to maturity^a										
Short term	211.8	250.6	289.9	328.1	344.0	30.3	31.5	33.3	33.8	32.9
Medium term	330.3	372.8	396.1	444.4	482.8	47.3	46.8	45.5	45.8	46.1
Long term	156.4	173.0	183.6	198.6	219.9	22.4	21.7	21.1	20.5	21.0
Commercial banks										
Unindexed shekel deposits	150.1	189.5	224.0	256.8	239.5	18.0	18.2	20.1	21.4	19.7
CPI-indexed deposits	19.7	18.4	28.9	28.9	33.2	2.4	1.8	2.6	2.4	2.7
Foreign-currency-indexed and denominated deposits	71.1	81.2	86.7	104.4	127.2	8.5	7.8	7.8	8.7	10.5
CPI-indexed savings schemes	96.7	100.7	91.3	88.7	102.7	11.6	9.7	8.2	7.4	8.5
Foreign-currency-indexed savings schemes	6.2	6.6	7.8	7.4	6.9	0.7	0.6	0.7	0.6	0.6
Unindexed savings schemes	1.4	1.9	2.5	4.1	6.9	0.2	0.2	0.2	0.3	0.6
Assets by institutional composition										
Total institutions ^b	295.5	327.5	345.4	370.0	386.4	35.5	31.5	30.9	30.9	31.8
Provident funds	107.3	116.9	119.8	123.5	119.5	12.9	11.2	10.7	10.3	9.8
Advanced study funds	31.8	37.7	42.0	47.8	46.9	3.8	3.6	3.8	4.0	3.9
Pension funds for established members	95.1	101.6	105.4	109.4	119.7	11.4	9.8	9.4	9.1	9.9
Pension funds for new members	3.4	5.3	7.5	10.7	14.4	0.4	0.5	0.7	0.9	1.2
Life insurance plans: guaranteed yield	38.9	40.2	40.6	41.5	44.6	4.7	3.9	3.6	3.5	3.7
Life insurance plans: profit share	19.0	25.8	30.1	37.1	41.2	2.3	2.5	2.7	3.1	3.4
The public directly	191.5	313.6	330.2	338.0	311.4	23.0	30.2	29.6	28.2	25.6

^a Excluding shares.

^b Engaged in contractual saving.

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

With respect to the composition of the asset portfolio by degree of tradability, the decrease in the tradable portion of the portfolio continued in 2002, reflecting the downsizing of the share component. The growth in the non-tradable portion of the portfolio reflected the increased proportion of CPI and foreign-currency indexed assets.

The development in the asset portfolio's composition during 2002 can be divided into two main periods:

The first half of the year was characterized by a small gap between the local interest rate and the interest rate abroad. This was against the background of the 2 percentage point cut in the Bank of Israel's interest rate at the end of 2001, the lack of fiscal discipline, which was reflected by an upward deviation in the budget deficit and increased government borrowing, and the deterioration in the security situation. These developments led to a large depreciation of the shekel and a rise in depreciation expectations, an upsurge in inflation, and a considerable growth in inflation expectations for all terms. The risk of investing in unindexed assets and the feasibility of investing in CPI-indexed and foreign currency assets thereby increased. Accordingly, the public increased the proportion of CPI-indexed and foreign currency assets in the portfolio, at the expense of unindexed assets. The shekel continued to depreciate due to the growth in demand for foreign-currency indexed or foreign currency denominated assets resulting from depreciation expectations, leading to an increase in the value of these assets.

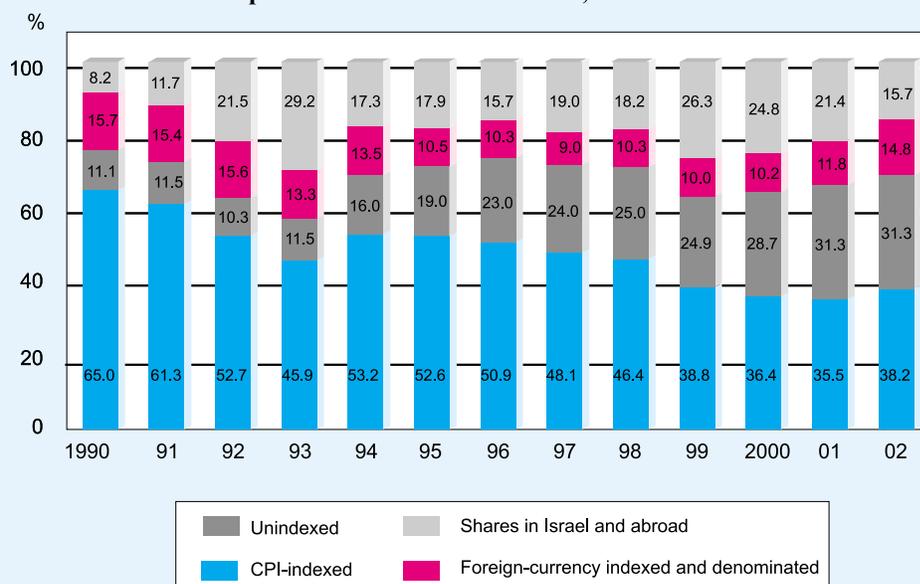
During the second half of the year, following the cumulative 4.5 percentage point interest rate hikes in June and July and the government's decision to cut the budget, the shekel appreciated, the inflation rate slowed, and inflation expectations for short terms fell back down within the targeted range of inflation. This was despite the continued uncertainty in the markets, which was apparent in the first half of the year as well. As a result of these developments, the proportion of unindexed shekel assets increased while the proportion of CPI-indexed and foreign currency assets remained stable. However, these shifts in composition only partly offset the changes that occurred in the first half of the year.

2. THE INDEXATION COMPOSITION OF THE ASSET PORTFOLIO

As stated, the trends characteristic of the asset portfolio during previous years changed in 2002, and were reflected by a move from unindexed shekel assets to CPI-indexed or foreign currency assets.

The upturn in the proportion of the unindexed component of the asset portfolio ceased in 2002 for the first time since 1993. The unindexed component amounted to 31 percent of the total portfolio in 2002 compared with 11 percent at the beginning of the 1990s (Table 3.1 and Figure 3.1). After rising consistently in real terms for a decade, the value of the unindexed component fell by 5 percent in real terms during 2002 and was estimated at NIS 380 billion at the end of the year. The growth in the unindexed component of the portfolio resulted from the disinflation process and the convergence of inflation towards the price stability typical of Western economies. The credibility of monetary policy's ability to attain inflation targets and the fall in inflation expectations reduced the risk inherent in unindexed shekel investment, concurrent with the expectation of a higher yield on these assets as the result of monetary restraint. During 2002 however, as uncertainty over inflation increased and credibility in monetary policy decreased, the unindexed component of the portfolio contracted in real terms. The

Figure 3.1
Indexation Composition of the Asset Portfolio, 1990–2002



SOURCE: Based on data from banks' balance sheets, TASE, the Ministry of Finance, and the Monetary Department, Bank of Israel.

decrease was mainly apparent among short-term deposits and overnight deposits (SROs). The decrease was partly offset by an increase in the public's holdings of Treasury bills, which will still be exempt from tax in 2003. The increased supply of Treasury bills resulted from the removal of the ceiling on Treasury bill issues and the commercial banks' sales of these instruments. Concurrent with the decrease in the proportion of unindexed assets, the proportion of CPI-indexed assets rose in 2002 to 38.2 percent of the total portfolio. This followed a consistent decline from 53 percent in 1994 to 35.5 percent in 2001. The value of the CPI-indexed component grew by 2 percent in real terms in 2002 to an estimated NIS 465 billion. During recent years, due to the fall in the actual and expected inflation, the relative feasibility of investing in CPI-indexed assets, which protect against a rise in the consumer price index, decreased together with their proportion in the asset portfolio. The rise in actual inflation and inflation expectations for all terms during 2002, concurrent with a considerable upward deviation from the long-term inflation target, led to a renewed need for hedging against inflation. As a result, the CPI-indexed component of the public's asset portfolio expanded as stated.

The foreign currency component of the asset portfolio increased by 20 percent in real terms during 2002 to an estimated NIS 180 billion. Since the shekel depreciated in real terms by 0.7 percent and 6.1 percent against the dollar and the currency basket respectively, the increase resulted from a positive accrual of foreign currency assets. The development of the foreign currency component of the asset portfolio during recent

Table 3.2
Distribution of the Public's Asset Portfolio, by Indexation
Composition, 1998–2002

	(current prices)									
	Balance (NIS billion)					Composition (percent)				
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Total	832.7	1,043.6	1,116.8	1,198.2	1,214.1	100.0	100.0	100.0	100.0	100.0
Unindexed assets	208.4	258.4	320.0	374.5	379.6	25.0	24.9	28.7	31.3	31.3
Cash and liquid deposits	45.0	53.7	57.7	68.1	57.5	5.4	5.2	5.2	5.7	4.7
Term deposits	120.5	156.1	190.2	216.8	209.7	14.5	15.0	17.0	18.1	17.3
Treasury bills	16.5	18.0	26.2	26.9	40.1	2.0	1.7	2.3	2.2	3.3
<i>Gilon</i> and <i>Shahar</i> bonds	24.9	28.7	43.5	58.7	65.5	3.0	2.8	3.9	4.9	5.4
Savings schemes	1.4	1.9	2.5	4.1	6.9	0.2	0.2	0.2	0.3	0.6
CPI-indexed assets	386.2	403.6	406.1	425.9	464.0	46.4	38.8	36.4	35.5	38.2
Savings schemes	96.7	100.7	91.3	88.7	102.7	11.6	9.7	8.2	7.4	8.5
CPI-indexed deposits	51.9	50.9	55.4	55.2	59.6	6.2	4.9	5.0	4.6	4.9
Tradable bonds	78.8	80.2	76.4	87.7	89.8	9.5	7.7	6.8	7.3	7.4
Other assets ^a	158.7	171.8	182.9	194.3	211.9	19.1	16.5	16.4	16.2	17.5
Shares	151.6	273.7	276.9	256.9	190.5	18.2	26.3	24.8	21.4	15.7
In Israel	133.1	221.5	222.9	226.6	171.3	16.0	21.3	20.0	18.9	14.1
Abroad	18.5	52.2	54.0	30.3	19.3	2.2	5.0	4.8	2.5	1.6
Foreign-currency-indexed and										
denominated assets	86.0	103.5	113.8	140.9	180.0	10.3	10.0	10.2	11.8	14.8
Assets in Israel	79.3	87.0	89.2	94.6	106.1	9.5	8.4	8.0	7.9	8.7
<i>Pamah</i> restitutions	18.4	16.7	15.3	16.9	20.7	2.2	1.6	1.4	1.4	1.7
Other <i>Pamah</i>	39.4	47.2	52.6	56.5	62.9	4.7	4.5	4.7	4.7	5.2
Foreign-currency-indexed deposits	6.3	4.5	2.8	3.4	4.5	0.8	0.4	0.2	0.3	0.4
Tradable bonds	9.1	12.1	10.8	10.4	11.0	1.1	1.2	1.0	0.9	0.9
Savings schemes	6.2	6.6	7.8	7.4	6.9	0.7	0.6	0.7	0.6	0.6
Assets abroad	7.1	16.5	24.6	46.2	73.9	0.8	1.6	2.2	3.9	6.1
Deposits abroad	7.1	12.9	16.7	28.2	40.8	0.8	1.2	1.5	2.4	3.4
Securities abroad (excl. shares)	0.0	3.7	8.0	18.0	33.1	0.0	0.4	0.7	1.5	2.7

^a Assets held by provident and pension funds and life insurance schemes—mainly earmarked bonds.

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

years was affected by the liberalization of the foreign currency market, which involved a gradual removal of restrictions on investment in foreign currency. This change provided the public with an increased range of investment opportunities, thereby making it possible to reduce exposure to currency risk and the elements of risk unique to the Israeli economy. As a result, the proportion of foreign-currency denominated and foreign-currency indexed assets rose from 10 percent of the portfolio in 1998 to 12 percent in 2001. The foreign currency component continued to expand during 2002 and reached 15 percent of the total portfolio, due to the depreciation of the shekel and the growth in currency risk during the year. Moreover, turnover in exchange rate

derivatives increased considerably during the year (especially in the first half, as detailed in Chapter 4). Had it not been for this development in the derivatives market, which has become an important channel for the management of currency risk, the foreign currency component of the portfolio might have expanded to a greater extent.

The real increase in the foreign currency component mainly derived from a growth in Israeli residents' deposits and investments in foreign securities (excluding shares). These totaled NIS 41 billion and NIS 33 billion respectively at the end of 2002, compared with NIS 28 billion and NIS 18 billion at the end of 2001.

Share prices fell heavily in the local and worldwide equity markets during

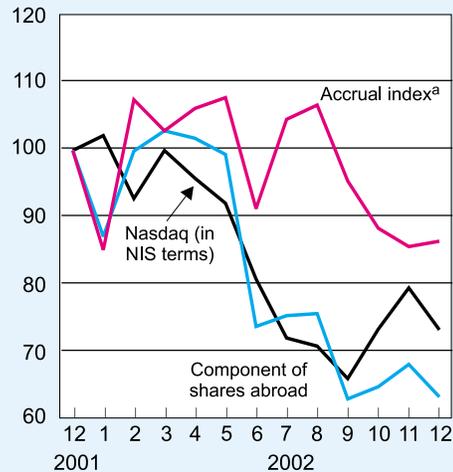
2002. The General Share Index in Israel and the NASDAQ index in the USA fell by 20 percent and 32 percent respectively, decreases that were the dominant factor in the development of the local and foreign share component of the public's asset portfolio.

The 24 percent nominal decrease in the local share component of the asset portfolio derived from the heavy price slide, which reflected *inter alia* the continued slowdown in non-financial activity. As with the local share component, the decrease in the value of the foreign share component resulted from the downturn in worldwide equity markets, which was partly offset by the rise in the shekel-dollar exchange rate and by Israeli residents' reduced holdings of foreign shares during the second half of the year (Figure 3.2).

Since the features of the local and foreign share components of the asset portfolio are similar, we will subsequently relate to them as a single entity — the share component of the portfolio. The share component contracted by 30 percent in real terms to NIS 191 billion in 2002. This component's proportion in the asset portfolio has declined continually during recent years, and amounted to 16 percent at the end of 2002. This was after reaching 26 percent in 1999 as a result of the buoyant levels of trading in the local and worldwide equity markets.

The same trends are apparent from an analysis of the asset portfolio by indexation type excluding the (local and foreign) share component in 2002: an increase in the proportion of foreign currency denominated or indexed assets, at the expense of the proportion of unindexed assets. The CPI-indexed component of the portfolio excluding shares remained stable (Table 3.3).

Figure 3.2
Accrual in Component of Shares
Abroad, Dec. 2001–Dec. 2002



^a The accrual index expresses the change in the public's holdings of this component and is calculated by adjusting for the shares component in the appropriate share index.

Table 3.3
Distribution of Assets, by Indexation Composition (excl. shares abroad), 1998–2002
 (current prices)

	1998	1999	2000	2001	2002
Unindexed assets	30.6	33.8	38.1	39.8	37.1
Cash and liquid deposits	6.6	7.0	6.9	7.2	5.6
Term deposits	17.7	20.4	22.6	23.0	20.5
Treasury bills	2.4	2.3	3.1	2.9	3.9
<i>Gilon</i> and <i>Shahar</i> bonds	3.7	3.8	5.2	6.2	6.4
Savings schemes	0.2	0.3	0.3	0.4	0.6
CPI-indexed assets	56.7	52.7	48.3	45.2	45.3
Savings schemes	14.2	13.2	10.9	9.4	10.0
CPI-indexed deposits	7.6	6.7	6.6	5.9	5.8
Tradable bonds	11.6	10.5	9.1	9.3	8.8
Other assets	23.3	22.4	21.8	20.6	20.7
Foreign-currency-indexed and denominated assets	12.6	13.5	13.6	15.0	17.6
Assets in Israel	11.6	11.4	10.6	10.1	10.4
<i>Pamah</i> restitutions	2.7	2.2	1.8	1.8	2.0
Other <i>Pamah</i>	5.8	6.2	6.3	6.0	6.1
Foreign-currency-indexed deposits	0.9	0.6	0.3	0.4	0.4
Tradable bonds	1.3	1.6	1.3	1.1	1.1
Savings schemes	0.9	0.9	0.9	0.8	0.7
Assets abroad	1.0	2.2	2.9	4.9	7.2
Deposits abroad	1.0	1.7	2.0	3.0	4.0
Securities abroad (excluding shares)	0.0	0.5	0.9	1.9	3.2

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

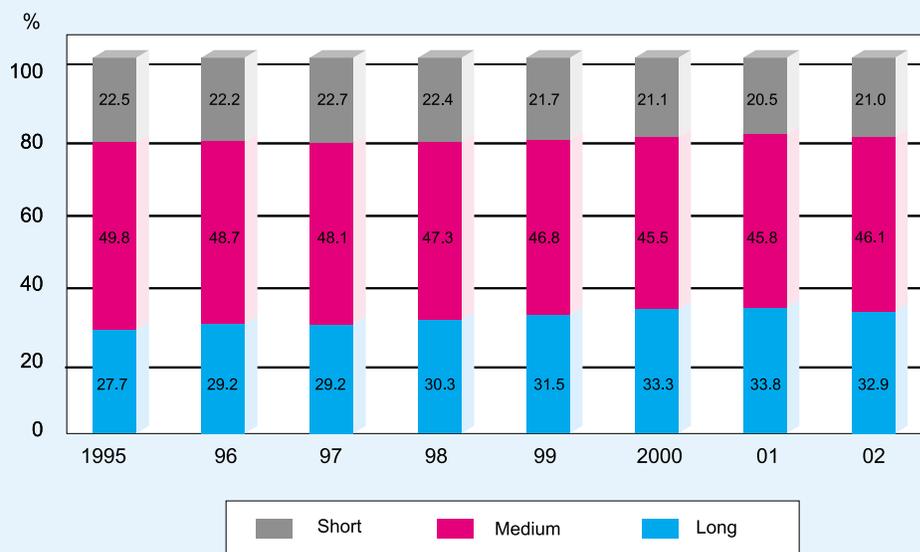
3. DEVELOPMENTS IN MATURITIES

The share component of the public's asset portfolio is highly volatile in line with price developments in the equity market. We will therefore examine the composition of the portfolio by term to maturity exclusive of this component.

The proportion of medium and long-term assets increased at the expense of the proportion of short-term assets, which contracted after expanding during recent years (Table 3.4 and Figure 3.3). The change in trend derived from the fact that most short-term assets are unindexed, while the majority of medium and long-term assets are indexed to the CPI or to foreign currency. The short-term part of the portfolio expanded during previous years due to the increased proportion of unindexed assets that resulted from the disinflation process. This trend was reversed in 2002 due to the rise in the inflation environment.

The proportion of short-term assets—the means of payment (cash and demand deposits), deposits for a term of up to a year and Treasury bills—contracted by 2 percent in real terms to NIS 344 billion. This followed an average real increase of 15 percent

Figure 3.3
Distribution of the Asset Portfolio (Excluding Shares) by
Term to Maturity, 1995–2002



SOURCE: Based on data from banks' balance sheets, TASE, the Ministry of Finance, and the Monetary Department, Bank of Israel.

during the years 1998-2001. The proportion of short-term assets fell to 33 percent of the total portfolio (excluding shares) in 2002, after rising consistently from 28 percent in 1995 to 34 percent in 2001. A particularly large real decrease of 30 percent was recorded in overnight deposits (SROs), from NIS 28 billion in 2001 to NIS 21 billion at the end of 2002. The means of payment and other deposits for a term of up to a year thereby contracted. These decreases were partly offset by a growth in the balance of Treasury bills.

Medium-term assets—bonds, long-term deposits, saving plans, Israelis' investments abroad (excluding shares), advanced study funds and provident funds—expanded by 2 percent in real terms to NIS 483 billion following an average annual real increase of 9 percent since 1998. The proportion of these assets rose to 46.1 percent of the total portfolio (excluding shares) in 2002, compared with 45.8 percent in 2001 and 50 percent in 1995. Israeli residents continued to increase their investments in deposits and securities (excluding shares) abroad during 2002, and an increase was recorded in CPI-indexed saving plans following a real decrease in previous years. A negative accrual of NIS 3 billion was recorded in the provident funds, continuing the trend of withdrawals that began in 1995. A net accrual of a billion shekels was also recorded in the advanced study funds as compared to positive accruals during the last decade.

Long-term assets—pension funds and life insurance plans—increased by 4 percent in real terms to NIS 220 billion, following an average annual real increase of 7 percent during the previous three years. The real increase in 2002 derived from a positive

Table 3.4
Distribution of the Public's Asset Portfolio, by Term to Maturity,^a 1998–2002

	(current prices)									
	Balance (NIS billion)					Composition (percent)				
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Total	698.5	796.4	869.6	971.1	1,046.7	100.0	100.0	100.0	100.0	100.0
Short-term assets	211.8	250.6	289.9	328.1	344.0	30.3	31.5	33.3	33.8	32.9
Liquid shekel assets	40.4	46.9	49.8	58.3	49.4	5.8	5.9	5.7	6.0	4.7
Unindexed deposits	104.6	131.2	159.5	176.6	178.1	15.0	16.5	18.3	18.2	17.0
CPI-indexed deposits	0.6	0.3	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
<i>Pamah</i>	49.5	54.5	58.3	66.1	74.5	7.1	6.8	6.7	6.8	7.1
<i>Patzam</i>	4.6	3.7	2.2	2.4	2.7	0.7	0.5	0.2	0.2	0.3
Treasury bills	12.0	14.0	20.0	24.6	39.2	1.7	1.8	2.3	2.5	3.7
Medium-term and other assets	330.3	372.8	396.1	444.4	482.8	47.3	46.8	45.5	45.8	46.1
Savings schemes	104.3	109.2	101.6	100.1	116.5	14.9	13.7	11.7	10.3	11.1
Unindexed deposits	13.6	21.7	25.3	34.3	25.3	1.9	2.7	2.9	3.5	2.4
CPI-indexed deposits	19.2	18.1	28.8	28.8	33.0	2.7	2.3	3.3	3.0	3.2
Foreign-currency-indexed deposits	1.7	0.8	0.0	0.4	0.1	0.2	0.1	0.0	0.0	0.0
<i>Pamah</i>	8.2	9.3	9.5	7.3	9.1	1.2	1.2	1.1	0.8	0.9
Bonds	38.9	40.8	46.5	59.6	63.7	5.6	5.1	5.4	6.1	6.1
Investment abroad	5.4	14.8	22.5	42.6	68.5	0.8	1.9	2.6	4.4	6.5
Provident funds	107.3	116.8	119.8	123.5	119.5	15.4	14.7	13.8	12.7	11.4
Advanced study funds	31.8	37.7	42.0	47.8	46.9	4.6	4.7	4.8	4.9	4.5
Long-term assets	156.4	173.0	183.6	198.6	219.9	22.4	21.7	21.1	20.5	21.0
Pension funds for established members	95.1	101.6	105.4	109.4	119.7	13.6	12.8	12.1	11.3	11.4
Pension funds for new members	3.4	5.3	7.5	10.7	14.4	0.5	0.7	0.9	1.1	1.4
Life insurance plans										
Guaranteed-yield	38.9	40.2	40.6	41.5	44.6	5.6	5.0	4.7	4.3	4.3
Profit-sharing	18.9	25.8	30.1	37.1	41.2	2.7	3.2	3.5	3.8	3.9

^a Excluding shares in Israel and abroad.

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

accrual of NIS 3 billion in the new pension funds and from a 4 percent real growth in profit-sharing life insurance plans (see Chapter 5 for details). The proportion of long-term assets rose to 21 percent in 2002 after falling during recent years, from 23 percent in 1997 to 20 percent in 2001.

4. TRADABILITY OF THE ASSET PORTFOLIO

The proportion of tradable assets in the asset portfolio fell from 38 percent in 2001 to 35 percent in 2002 (Table 3.5). The decrease in the proportion of tradable assets resulted from the contraction in the share component of the portfolio, which was partly offset by an increase in the proportion of Treasury bills, unindexed bonds and investments in foreign securities. The growth in the proportion of non-tradable assets, from 62 percent

Table 3.5
Tradability of the Asset Portfolio, 1998–2002

	Balance (NIS billion)					Composition (percent)				
	1998	1999	2000	2001	2002	1998	1999	2000	2001	2002
Total	832.4	1,039.4	1,116.8	1,198.2	1,214.1	100.0	100.0	100.0	100.0	100.0
Tradable assets	280.9	416.4	441.7	458.8	430.1	33.7	40.1	39.6	38.3	35.4
Unindexed assets	41.5	46.7	69.7	85.6	105.6	5.0	4.5	6.2	7.1	8.7
Treasury bills	16.5	18.0	26.2	26.9	40.1	2.0	1.7	2.3	2.2	3.3
<i>Gilon</i> and <i>Shahar</i> bonds	24.9	28.7	43.5	58.7	65.5	3.0	2.8	3.9	4.9	5.4
CPI-indexed assets	78.8	80.2	76.4	87.7	89.8	9.5	7.7	6.8	7.3	7.4
Tradable bonds	78.8	80.2	76.4	87.7	89.8	9.5	7.7	6.8	7.3	7.4
Foreign-currency-indexed and denominated assets	9.1	15.7	18.7	28.5	44.1	1.1	1.5	1.7	2.4	3.6
Tradable bonds	9.1	12.1	10.8	10.4	11.0	1.1	1.2	1.0	0.9	0.9
Securities abroad	0.0	3.7	8.0	18.0	33.1	0.0	0.4	0.7	1.5	2.7
Shares in Israel and abroad	151.6	273.7	276.9	256.9	190.5	18.2	26.3	24.8	21.4	15.7
Non-tradable assets	551.5	623.0	675.1	739.5	784.0	66.3	59.9	60.4	61.7	64.6
Unindexed assets	166.9	211.8	250.4	288.9	274.0	20.1	20.4	22.4	24.1	22.6
Cash and liquid deposits	45.0	53.7	57.7	68.1	57.5	5.4	5.2	5.2	5.7	4.7
Term deposits	120.5	156.1	190.2	216.8	209.7	14.5	15.0	17.0	17.1	17.3
Savings schemes	1.4	1.9	2.5	4.1	6.9	0.2	0.2	0.2	0.3	0.6
CPI-indexed assets	307.3	323.4	329.6	338.2	374.2	36.9	31.1	29.5	28.2	30.8
Savings schemes	96.7	100.7	91.3	88.7	102.7	11.6	9.7	8.2	7.4	8.5
CPI-indexed deposits	51.9	50.9	55.4	55.2	59.6	6.2	4.9	5.0	4.6	4.9
Other assets	158.7	171.8	182.9	194.3	211.9	19.1	16.5	16.4	16.2	17.5
Foreign-currency-indexed and denominated assets	77.2	87.8	95.1	112.4	135.8	9.3	8.4	8.5	9.4	11.2
<i>Pamah</i> restitutions	18.4	16.7	15.3	16.9	20.7	2.2	1.6	1.4	1.4	1.7
Other <i>Pamah</i>	39.4	47.2	52.6	56.5	62.9	4.7	4.5	4.7	4.7	5.2
Foreign-currency-indexed deposits	6.3	4.5	2.8	3.4	4.5	0.8	0.4	0.2	0.3	0.4
Savings schemes	6.2	6.6	7.8	7.4	6.9	0.7	0.6	0.7	0.6	0.6
Deposits abroad	7.1	12.9	16.7	28.2	40.8	0.8	1.2	1.5	2.4	3.4

^a Assets held by provident and pension funds and life insurance schemes—mainly earmarked bonds.

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

in 2001 to 65 percent in 2002, mainly reflected an increase in CPI-indexed and foreign currency assets.

The tradability composition of the asset portfolio shows that the decrease in the unindexed component was in the non-tradable part of the portfolio, while the proportion of unindexed assets (Treasury bills and unindexed bonds) in the tradable part of the portfolio increased. The growth in the balance of Treasury bills and their proportion in the portfolio mainly occurred during the last months of the year, and resulted from the substantial growth in the public's demand for Treasury bills. The growth in demand derived from the tax reform, whereby Treasury bills will be exempt from tax in 2003.

The public were able to purchase increased quantities of Treasury bills due to the removal of the ceiling that was previously imposed on their issue and the commercial banks' sales of these instruments.

Box 3.1

The Public's Financial Asset Portfolio

The public's financial asset portfolio includes financial assets owned by the public that are held directly by the public or indirectly via intermediaries. Included under the definition of "the public" are households and firms in the economy exclusive of the government, the Bank of Israel, the commercial banks, the mortgage banks and foreign residents. The asset portfolio reflects the accrual of savings in financial assets, which constitute the public's claims against other entities in Israel and abroad. The portfolio does not include tangible assets held by the public, such as buildings and equipment. We relate to the shares held by the public as a financial asset even though the holding of shares (apart from foreign shares) constitutes the public's claim against entities within it—the firms that issue the shares—and not against an external entity.

There are two reasons for changes in the value of the asset portfolio: One reason is a (positive or negative) accrual of financial assets by the public; and assets may be accrued due to a change in the public's consumption and saving habits, that is, when the public sells financial assets and buys tangible assets, or increases current consumption and *vice versa*. Such a change in the portfolio is possible when other entities, such as the government, foreign residents or the banks, purchase financial assets from the public or sell financial assets to the public. The other reason is a change in the prices of assets in the portfolio. Following a depreciation of the exchange rate for example, the value of foreign-currency indexed investments will increase, as will the total value of the portfolio. The real value of the portfolio is also affected by the development of the consumer price index, since a rise in the index has the effect of eroding of the value of the unindexed assets in the portfolio.

The intermediaries that manage financial assets on behalf of the public are the commercial banks, the mutual funds and institutional investors that engage in contractual saving—the advanced study funds, the provident and severance pay funds, the pension funds and the life insurance companies. These assets include securities (bonds, Treasury bills and shares), saving plans and deposits from the public, as well as investments abroad (deposits or portfolio investments). We will relate to the assets that institutional investors manage on behalf of the public within the framework of contractual saving as a separate investment type. This is because the investment considerations that the public employ when operating with these intermediaries differs from their

considerations with respect to other forms of investment.

The asset portfolio analyzed here constitutes only part of the public's assets, since it does not include tangible assets and due to the lack of suitable available data, does not take into account the liabilities created by leveraged acquisition of part of the assets. The timely availability of data on the financial asset portfolio is its major advantage. Accordingly, even though the analysis is only partial, it is of great importance for monetary policy. The composition of the portfolio is determined mainly on the basis of yield, risk and liquidity considerations, thereby reflecting the public's decisions on the basis of their expectations of developments in the capital and money markets.

We have analyzed the asset portfolio on the basis of three main classifications: asset indexation type, term-to-maturity and asset tradability. Each of these classifications reflects a different aspect of the public's investment decisions.

1. Asset classification by indexation type: The distribution of assets indexed to the CPI or to foreign currency and unindexed shekel assets (Table 3.2). This asset distribution reveals the extent of the public's credibility in the stability of the local currency. Yield and risk considerations are of course taken into account in this respect.

2. Asset classification by term-to-maturity: The term-to-maturity of assets in the portfolio reflects the public's preferences in terms of liquidity. Included in the short-term group are the means of payment, Treasury bills and deposits for a term of up to a year; in the medium term—bonds, deposits for a term of over a year, saving plans, Israeli residents' investments abroad, advance study funds and provident funds;¹ and in the long term—pension funds and life insurance plans (Table 3.4).

3. Asset classification by tradability: The tradable part of the portfolio includes Treasury bills, tradable bonds and shares (Table 3.5). All the remaining assets are non-tradable assets (the means of payment, deposits, saving plans and earmarked market bonds). This distribution of the portfolio is indicative of the depth of the capital market.

The composition of the asset portfolio may vary as the result of changes in the relative prices of the assets in the portfolio's different components, or from a move between different asset types in the portfolio, the sale of unindexed assets and the purchase of CPI-indexed assets, for example. These two phenomena are usually concurrent and interdependent, because changes in asset prices lead to an adjustment in the portfolio and *vice versa*.

¹ The classification of provident funds by term-to-maturity is problematic: Although provident funds usually serve as a 15-year channel of saving, since many of the funds are liquid, for the purpose of our analysis we have classified them as medium-term assets.

