

## NOTES TO THE 2004 FINANCIAL STATEMENTS

### 1. Accounting policies

#### a. General

The financial statements are presented in accordance with generally accepted accounting principles adapted for the special activity of a central bank, and in line with the practice in other central banks.

The financial statements are presented in nominal NIS (New Israel Sheqalim). Income and expenses are entered on an accrual basis and are included in the balance-sheet items on which they accrued, except for income from securities in local currency (see note 1d).

#### b. Foreign currency

Assets and liabilities denominated in or indexed to foreign currency are translated into NIS at the representative exchange rates published by the Bank of Israel for the balance-sheet date.

Income and expenses in foreign currency are recorded in the Profit and Loss Account at the representative exchange rates prevailing on the value dates of the transactions.

Unrealized exchange-rate differentials are included separately for each currency in the Revaluation Accounts item in the balance sheet. Realized exchange-rate differentials are transferred to the Profit and Loss Account, and are calculated on the basis of the average cost of the balances of that currency. Realization is calculated monthly for all foreign-currency assets in each currency and for all foreign-currency liabilities in each currency. A balance of loss in the revaluation accounts at the end of the year is transferred to the Profit and Loss Account, and is not offset in the future against unrealized profits. Unrealized losses in one currency are not offset against unrealized profits in other currencies.

Details of the exchange rates are as follows:

	31 December			Change	
	2004	2003	2002	2004	2003
	(NIS)			(percent)	
US\$	4.308	4.379	4.737	(1.6)	(7.6)
Euro	5.877	5.533	4.970	6.2	11.3
Special drawing rights (SDR) <sup>a</sup>	6.668	6.484	6.417	2.8	1.0
First currency basket <sup>b</sup>	5.326	5.131	4.966	3.8	3.3
Currency basket <sup>c</sup>	5.006	4.965	5.047	0.8	(1.6)

<sup>a</sup> Based on a weighted 4-currency basket consisting of US\$, €, ¥, and £.

<sup>b</sup> In effect until July 31, 1986, and consisting of: US\$ 0.3500; £ 0.1295; and € 0.4667.

<sup>c</sup> In effect since May 2, 2000, and consisting of: US\$ 0.6698; £ 0.0453; € 0.2493; and ¥ 7.2411.

**c. Indexation**

Assets and liabilities indexed to the Consumer Price Index (CPI) are shown according to the latest known index on the balance-sheet date, i.e., the November index.

Details of the CPI are as follows:

	2004	31 December		Change	
		2003	2002	2004	2003
		(CPI) <sup>a</sup>		(percent)	
November	100.5	99.6	101.6	0.9	-2.0
December	100.6	99.4	101.3	1.2	-1.9

<sup>a</sup> 2002 average = 100.

**d. Securities***Foreign-currency securities*

Tradable foreign-currency securities are shown at market value on the balance-sheet date.

Unrealized profits arising from the difference between the market value of securities and their adjusted cost are included in the Revaluation Accounts item in the balance sheet. The adjusted cost of securities is their par value plus accrued interest, accrued CPI-indexation differentials, and the balance of the premium or discount that has not yet been amortized. The premium or discount is amortized from the time of the purchase of the security until its maturity. The balance of unrealized losses due to a fall in the market price of securities to below their adjusted cost are transferred at the end of the year to the Profit and Loss Account and are shown under 'Other financial income from (expenses on) securities and derivatives'.

Interest and indexation income on foreign-currency securities are shown under 'Interest income from foreign exchange reserves'. Income from the realization of securities is shown under 'Other financial income from (expenses on) securities and derivatives'.

*Local-currency securities and the matched timing principle*

Tradable local-currency securities are shown at market value on the balance-sheet date. The difference between the market value of securities and their original cost is recorded in the Revaluation Accounts item in the balance sheet.

Income from securities is included in the Profit and Loss Account on a cash basis in line with the matched timing principle according to which accrued profits from government securities not yet received in cash from the government are not included in the Bank's income.

Interest and indexation income on local-currency securities are shown under 'Interest income from the government.'

**e. International financial institutions**

*The International Monetary Fund (IMF)*

The Bank of Israel's participation in the IMF less its liability for participation is shown under assets in the item 'International financial institutions.'

Special drawing rights (SDR) allocated by the IMF are shown under liabilities in the item 'International financial institutions.'

*Other international financial institutions*

The Bank of Israel's participation in other international financial institutions includes initial participation in the capital of the international institutions and additional participation payments for increases in the capital of those institutions. The Bank of Israel's participation in other international financial institutions is shown under 'International financial institutions' according to the cost in the currency in which the participation was paid, translated at the exchange rate on the date the transaction took place. Liabilities to international financial institutions are shown under liabilities in the item 'International financial institutions.'

**f. Buildings and equipment**

Buildings and equipment are shown at cost, less accumulated depreciation. Depreciation is calculated by the straight-line method for the estimated useful life:

Buildings	—	fifty to seventy years;
Vehicles	—	six-and-a-half years;
Computers	—	four years;
Other equipment	—	ten years.

Purchases of fixed property for non-significant amounts are included in the Profit and Loss Account.

**g. Treasury bills**

The balance of Treasury bills in the balance sheet reflects the par value (the redemption price) of Treasury bills held by the public less the balance of the discount that has not yet been amortized. Treasury bills sold by the government to the Bank of Israel but not yet sold to the public are not included in this balance.

The discount is the difference between the par value of the Treasury bills and the proceeds of their sale to the public. The discount is amortized by the straight-line method.

Interest expenses on the balance of Treasury bills held by the public are shown in the Profit and Loss Account in the item 'Interest paid to the banks and the public.'

**h. Employee pensions, severance pay, and vacation pay**

The liability for employee pensions and severance pay is actuarially computed on an accrual basis which reflects the liability for pensions and severance pay payments to

employees accrued to the balance-sheet date. In calculating the liability, the reduced liability as a result of raising the retirement age as part of the changes in pension conditions applying from 2004 onward has not yet been taken into account.

Provision for vacation pay is computed on the basis of vacation days due, accrued to the balance-sheet date.

**i. Revaluation accounts**

There are separate revaluation accounts for each item (currency, security), which are transferred to the Profit and Loss Account when the item is realized in whole or in part.

The balance of the loss in the Revaluation Accounts arising from price differentials in foreign-currency securities and from exchange-rate differentials on balances in foreign currency is transferred to the Profit and Loss Account at the end of the year.

**j. Derivative financial instruments**

The Bank of Israel uses derivative financial instruments in its monetary and foreign exchange activities.

*1. Activity in derivative financial instruments in Israel:*

*a) NIS/US\$ swaps*

NIS/US\$ swaps implemented by the Bank of Israel with domestic banks are shown net, i.e., the balance of dollars to be received from the banks (translated according to the exchange rate on the balance-sheet date) *less* the balance of NIS to be transferred to the banks. The way the balance is shown in the balance sheet depends on whether it is a net debit or net credit balance. A net debit balance is shown under the item 'Other assets' and a net credit balance under 'Other liabilities.'

Interest expenses on these transactions is shown in the Profit and Loss Account under the item 'Interest paid to the banking corporations and the public.'

*b) Purchase and sale options on the US\$/NIS exchange rate*

The Bank of Israel sells NIS/US\$ exchange-rate options to the banks. The balance of options to the date of the financial statement is shown in Note 18, 'Contingent liabilities and special commitments.' Expenses arising from the exercise of options during the period of the statement, and expenses expected from their exercise in accordance with the representative exchange rate of the dollar on the balance-sheet date, *less* income from the premium on the options, are shown in the item 'Other financial income from (expenses on) securities and derivatives.' The income from the premium on options is spread evenly over the duration of the options using the

straight-line method. Advance income on the premium *plus* expenses accrued due to the difference between the exercise rate and the representative dollar exchange rate on the balance-sheet date is included in the 'Other liabilities' item.

*c) Future remittances of Treasury bills*

The balance of the liability on Treasury bills for future remittance up to the date of the financial statement is given at par (redemption price) in Note 18, 'Contingent liabilities and special commitments.'

Receipts on account of future issues of Treasury bills is included in the balance sheet under 'Other liabilities.'

*2. Derivative financial instruments in activities abroad:*

*a) Repurchase agreements (Repo), and Reverse Repurchase Agreements (Reverse Repo)*

The balances of Repo and Reverse Repo agreements are shown in the balance sheet as 'Foreign exchange reserves.' In the Profit and Loss Account the results of the transactions are shown as 'Interest income from foreign exchange reserves.'

*b) Foreign-currency swaps*

The transactions are shown at net value in 'Foreign exchange reserves,' i.e., the balance of future foreign-currency receipts (in one of the currencies) *less* future foreign-currency remittances (in the other currency).

In the Profit and Loss Account the results of these transactions are included in 'Interest income from foreign exchange reserves.'

*c) Futures*

The balance of futures contracts at market prices on the date of the financial statement are given in Note 18, 'Contingent liabilities and special commitments.'

In the Profit and Loss Account the change in the value of the contracts is recorded under 'Other financial income from (expenses on) securities and derivatives.'

**k. Transfer of profits**

In accordance with the Bank of Israel Law, 5714–1954, the Bank must transfer its net profits to the government within sixty days of the end of each business year. Since the Bank has a balance of accrued losses, the losses are added to them. In years when there are profits, these are offset against the losses and are not transferred to the government.

## 2. Foreign exchange reserves

The currency composition of the Bank of Israel's reserves matches their possible uses. These uses, which also provide a basis for the determination of the desired level of the reserves, are defined as reserves that can be sold to the government to service its debts and to finance imports in an emergency, and that can be used to implement the Bank of Israel's policy for stabilizing the financial and foreign-currency markets and for implementing monetary policy. (The yields on the foreign exchange reserves are shown in Table 4 in the Explanatory Remarks to the Financial Statements below.)

	31 December			
	2004	2003	2004	2003
	(NIS million)		(\$ million)	
Tradable securities	99,717	91,839	23,147	20,973
Short-term deposits	11,906	23,197	2,764	5,297
Demand deposits	3,103	1,195	720	273
Derivative financial instruments <sup>a</sup>	2	(3,306)	1	(755)
<b>Total</b>	<b>114,728</b>	<b>112,925</b>	<b>26,632</b>	<b>25,788</b>

<sup>a</sup> Derivative financial instruments are shown net, i.e., future foreign-currency liabilities minus future foreign-currency assets (see note 1.j.2).

## 3. International financial institutions (assets)

	31 December	
	2004	2003
	(NIS million)	
The IMF (see a below)	1,995	2,305
Investment in BIS shares (see b below)	265	265
Other (see c below)	260	250
<b>Total</b>	<b>2,520</b>	<b>2,820</b>

### a. The International Monetary Fund (IMF)

The balance with the IMF (the reserve tranche) constitutes part of the quota allocated to Israel which Israel paid to the Fund in foreign currency.

#### *The quota in the IMF*

Each member country has a quota allowing it to participate in the capital of the Fund. The quota is related to the country's economic situation (national income, exports, balance of payments, level of the reserves) and also determines its voting rights. Part of the quota is deposited in the country's central bank in notes and deposits indexed to Special Drawing Rights, and part (called the reserve tranche) is transferred to the Fund in foreign currency, and can be withdrawn.

Up to 1998 Israel drew its reserve tranche, putting up against this withdrawal a non-interest-bearing deposit in favor of the Fund.

In 1999 the Fund increased members' participation and Israel's quota rose by SDR 262 million. The foreign-currency payment for this increase, SDR 66 million, was deposited in the Fund, and has not been withdrawn.

*The IMF Financial Transactions Plan*

Since 1999 Israel has been part of the Fund's financial transaction plan. The plan is a mechanism through which a member country can exchange SDR or foreign currency against its local currency, and another country is asked to execute a counter-exchange. The sums are determined by the Fund at short advance notice. Up to 2004, Israel's reserve tranche balance grew gradually in light of the Fund's decision that Israel would transfer foreign currency to other countries. From 2004 the Fund began transferring foreign currency to Israel in order to ensure that Israel's average reserve tranche would not be higher than what was decided upon. In 2004 Israel's reserve tranche was reduced by about SDR 56.5 million.

	31 December			
	2004	2003	2004	2003
	(NIS million)		(SDR million)	
International Monetary Fund (IMF) quota	6,195	6,023	928	928
minus liability for the quota <sup>a</sup>	4,200	3,718	630	573
<b>Total<sup>b</sup></b>	<b>1,995</b>	<b>2,305</b>	<b>298</b>	<b>355</b>

<sup>a</sup> The balance of the liability to the IMF is in notes and deposits.  
<sup>b</sup> The surplus of the reserve tranche over the 'basic sum' of SDR 33 million bears interest at a rate set by the IMF from time to time. The annual rate of interest on 31 December 2004, was 1.6 percent (on 31 December 2003, it was 1.6 percent).

**b. Investment in the Bank for International Settlements (BIS) shares**

In 2003 the Bank of Israel purchased 3000 shares in the BIS. The amount shown in the table represents a cash payment of 25 percent of the nominal value of the shares.

**c. Others**

The Bank of Israel participates in the following institutions:

IBRD	–	The International Bank for Reconstruction and Development
IDA	–	The International Development Association
IFC	–	The International Finance Corporation
EBRD	–	The European Bank for Reconstruction and Development
MIGA	–	The Multilateral Investment Guarantee Agency
IDB	–	The Inter-American Development Bank
IIC	–	The Inter-American Investment Corporation

**4. Credit to the government**

Credit to the government consists mainly of long-term advances. These advances were made until 1988.

	31 December	
	2004	2003
	(NIS million)	
Long-term advances <sup>a,c</sup>		
Indexed <sup>b</sup>	3,189	3,643
Unindexed <sup>c</sup>	664	747
Credit for binational funds <sup>d</sup>	142	145
<b>Total</b>	<b>3,995</b>	<b>4,535</b>

<sup>a</sup> The interest and indexation differentials for each year are due for payment on 31 December of that year. The principal is due to be paid in annual payments, the last of which will be in the year 2012.

<sup>b</sup> This credit is indexed to the first currency basket. It bears an interest rate of 8 percent, also indexed to that basket.

<sup>c</sup> This credit bears interest at prime rate plus 2 percentage points. The average rate of interest during 2004 was 7.91 percent (11.4 percent in 2003).

<sup>d</sup> This credit was given to the government for it to invest in the Binational (US—Israel) Industrial Research and Development Fund and the Binational (US—Israel) Science Fund, established in cooperation with the US government. The Funds deposited their money in deposits in the Bank of Israel, and it is shown in the balance sheet under “Other Liabilities” (see Note 13). The credit and the deposits bear interest.

<sup>i</sup>. Correspondence in September 2003 between the Minister of Finance and the Governor of the Bank of Israel included several agreements regarding “Proposals in the Economic Program for 2004 Relating to the bank of Israel.” One of the items in that correspondence was “the repayment of the government’s debt to the Bank of Israel due to be repaid on 31 December 2003,” and it was determined that “the Bank of Israel will grant a loan to the government to finance the balance of the debt, principal and interest due for repayment on 31 December 2003.” The same section also specified the repayment dates of the loan, the requirement for the Bank and the Ministry of Finance to reach an agreement on the interest payable, and that “if the Attorney General is of the opinion that the debt can be cancelled, then it shall be cancelled.”

The amount of the debt, principal and interest, due for repayment on 31 December 2003 was NIS 1,070 million (the total balance of the government debt, principal plus interest, prior to the above repayment was NIS 5,460 million). The debt due to be repaid on 31 December 2003 was duly repaid, as at that time the views of the Attorney General regarding the debt had not been received. Furthermore, as the Bank and the Ministry of Finance had not reached an agreement with regard to the rate of interest on the loan to finance the repayment of that debt, no such loan was granted to the government.

ii. In February 2005 the opinion of the Deputy Attorney General, on behalf of the Attorney General, was received, according to which “there are no legal grounds preventing the Bank of Israel from canceling the government’s debt to the Bank as agreed between the outgoing Governor and the Minister of Finance.” In the summary giving the basis for this opinion it was written that “it appears that from a legal standpoint the Bank of Israel has the authority to cancel a government debt to the Bank that dates back to a time prior to the prohibition on granting loans to the government under section 45 of the Bank of Israel Law.” With regard to the reasonableness of a Bank of Israel decision to cancel a government debt to the Bank, it noted that “if there are macroeconomic reasons supporting such a decision that are consistent with the Bank’s objectives and policies, such a decision would not be unreasonable.” Summarizing the position, it stated that “we stress that our conclusion that there are no legal grounds preventing the Bank of Israel from canceling a government debt to the Bank applies in the light of the special circumstances in this case, which is about a debt created in essence prior to the amendment of section 45 of the Bank of Israel Law, and it does not create a precedent for other issues, including any other government debts to the Bank of Israel.”

iii. In effect, most of the government debt (about two-thirds of the principal) to the Bank of Israel was created after the passing of the amendment to section 45 of the Bank of Israel Law (the section relevant to the question of the possibility of canceling such a debt).

iv. Cancellation of a government debt by the Bank of Israel is a capital transaction whose accounting-economic essence is equivalent to transferring profit from the Bank of Israel to the government, which must be shown in the Bank’s financial statements in accordance with that essence. The Bank of Israel Law does not allow the transfer of profit to the government in the absence of an appropriate balance of profit (on 31 December 2004 the Bank of Israel has a loss balance of NIS 13,852 million).

In the light of the above, the Bank of Israel’s financial statements do not take into account a cancellation of government debt to the bank. The Bank considers that this subject must be examined from all relevant aspects—economic, accounting and legal. A comprehensive study of this issue should be performed after the government has reconsidered the matter, and if necessary after an updated legal view has been obtained relating also to the points made in subsections iii and iv above.

## 5. Loans

	31 December	
	2004	2003
	(NIS million)	
Monetary loans <sup>a</sup>	787	634
Other loans <sup>b</sup>	1,404	2,093
<b>Total</b>	<b>2,191</b>	<b>2,727</b>

<sup>a</sup> The average rate of interest on the monetary loans in 2004 was 3.8 percent (in 2003, 7.1 percent). The average rate of interest on the monetary loans on 31 December 2004 was 3.3 percent (on 31 December 2003 it was 4.8 percent).

<sup>b</sup> Including credit to the Industrial Development Bank of NIS 1,389 million (on 31 December 2003 it was NIS 2,062 million). In August 2002 the Industrial Development Bank encountered liquidity problems and could not meet its liabilities. The Bank of Israel responded to a request from the bank and made available to it a special credit line to enable it to continue operating regularly. The credit line was originally NIS 2,200 million; this was reduced from time to time, and should end in 2006. The Industrial Development Bank pays interest on the utilized part of the credit at the Bank of Israel interest rate. In accordance with the decision of the economic-social cabinet, if at the end of the period there remains a balance of credit from this credit line to be repaid, that balance will become the responsibility of the government. This credit is therefore not expected to result in a loss to the bank of Israel.

## 6. Local-currency securities

This item consists of tradable government securities indexed to the last CPI known on the balance-sheet date. They are shown at market value.

The yield to maturity on the local-currency securities portfolio on 31 December 2004 was 2.6 percent, and the portfolio's average period to maturity was 4.3 years (on 31 December 2003 the yield to maturity was 3.5 percent, and the average period to maturity was 4.7 years).

	31 December	
	2004	2003
	(NIS million)	
<b>Time to redemption from balance-sheet date</b>		
Less than one year	1,428	850
Between one and two years	237	1,420
Between two and three years	405	232
Between three and four years	499	396
Between four and five years	678	482
Between five and seven years	937	1,495
Seven years or longer	579	638
<b>Total</b>	<b>4,763</b>	<b>5,513</b>

## 7. Other assets

This item consists mainly of:

- a. Amounts receivable from the official receiver of the Trade Bank (In Liquidation) Ltd., constituting reimbursement of payments made by the Bank of Israel on the strength of guarantees given, with government authorization, to depositors in the Trade Bank following the discovery in April 2002 of the embezzlement in the bank.

- b. Loans to employees.
- c. Buildings and equipment net of cumulative depreciation (see Note 1.f).

## 8. Banknotes and coins in circulation

	31 December 2004		31 December 2003	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
<b>Banknotes in circulation</b>				
NIS 20	22	436	20	404
NIS 50	44	2,181	43	2,144
NIS 100	105	10,480	96	9,624
NIS 200	33	6,689	30	6,037
<b>Coins in circulation</b>	–	983	–	913
<b>Other</b>	–	9	–	10
<b>Commemorative coins</b>	–	5	–	5
<b>Total</b>		<b>20,783</b>		<b>19,137</b>

## 9. International financial institutions

	31 December	
	2004	2003
	(NIS million)	
Special Drawing Rights allocated <sup>a</sup>	712	692
Liabilities to international financial institutions <sup>b</sup>	64	68
<b>Total</b>	<b>776</b>	<b>760</b>

<sup>a</sup> Special drawing rights (SDR) are money which member countries of the International Monetary Fund (IMF) have undertaken to buy from it. The Fund allocates SDRs to member countries relative to the size of their quotas. To date Israel has been allocated SDR 106.4 million.

<sup>b</sup> Liabilities in bills or deposits to the following institutions: IDB, MIGA, EBRD, IDA, IBRD (see Note 3.c).

## 10. Deposits of the government

Government deposits comprise deposits for financing its budgetary activity and other deposits.

### *Government deposits for financing the budget*

These are defined as deposits that the government may use to finance its budgetary and extra-budgetary activity and, accordingly, to which section 45(b) of the Bank of Israel Law (the “Non-Printing Law”), 5714-1954, applies. Financial movements arising from government budgetary and extra-budgetary activity in Israel and abroad and financial movements with the Bank of Israel are recorded in this item.

### *Other deposits*

Other deposits include a local-currency deposit for stabilizing bond prices, and various foreign-currency deposits. The bond-price stabilization deposit represents the

proceeds from the purchase at source of government securities by the Bank of Israel in order to stabilize prices on the Tel Aviv Stock Exchange (TASE). In accordance with an agreement with the Ministry of Finance, the proceeds are placed in a special deposit on behalf of the government, but may not be used to finance government expenses. At the request of the Ministry of Finance the bond-price stabilization arrangement was discontinued in January 1993, and the deposit is gradually being reduced against the redemption of such bonds purchased in the past. The redemption of these bonds will end in 2009.

	31 December			
	2004	2003	2004	2003
	(NIS million)		(\$ million)	
<b>Deposits for budget financing</b>				
<b>Local currency<sup>a</sup></b>	<b>(7,406)</b>	<b>(12,626)</b>		
<b>Foreign currency</b>				
Borrowing under US government guarantee <sup>b</sup>	12,652	19,799	2,937	4,521
US government economic aid <sup>b</sup>	–	7	–	2
Current deposit	533	813	124	186
<b>Total</b>	<b>13,185</b>	<b>20,619</b>	<b>3,061</b>	<b>4,709</b>
<b>Total deposits for budget financing</b>	<b>5,779</b>	<b>7,993</b>		
<b>Other deposits</b>				
Bond-price stabilization local-currency deposit <sup>a</sup>	90	133		
Other foreign-currency deposits <sup>b</sup>	616	178	143	41
<b>Total other deposits</b>	<b>706</b>	<b>311</b>		
<b>Accrued interest on government deposits</b>	<b>29</b>	<b>14</b>		
<b>Total</b>	<b>6,514</b>	<b>8,318</b>		

<sup>a</sup> Local-currency government deposits bear (when in debt) or pay (when in credit) interest at prime. The average prime rate in 2004 was 5.7 percent (in 2003 it was 8.9 percent).

<sup>b</sup> Government foreign-currency deposits derived from borrowing under US government guarantee or from US government economic aid and some of other deposits earn interest at the rate paid on US Treasury bills with an average of 6 months to maturity. The rate of interest on 31 December 2004 was 2.4 percent (on 31 December 2003 it was 1.0 percent). On foreign-currency debit balances interest is charged at the borrowing rate abroad plus 5 percentage points.

## 11. Treasury bills

The Short-Term Loan Law, 5744–1984, authorizes the government to issue bonds to be sold only to the Bank of Israel; the Bank would sell them to and buy them from the public to regulate the money supply and to carry out its functions. The government must deposit the entire proceeds of sales of these bonds in the Bank of Israel and may not use the proceeds for anything apart from repaying the loan in accordance with this Law or paying the interest on it. The purchase of bonds from the government by the Bank of Israel and the deposit of the proceeds of this sale in the Bank of Israel are not reflected in the Bank's balance sheet.

The balance of Treasury bills shown in the balance sheet reflects the redemption value of bills held by the public *less* the balance of the discount not yet amortized.

In 2003 the method of calculation was adjusted so that the balance of the discount to the beginning of the year reflects the discount on the sale of the Treasury bills by the Bank of Israel to the public, and will be amortized by the straight-line method. This adjustment increased the balance of the discount to the beginning of 2003 by NIS 311 million. (Until 31 December 2002 the discount was calculated according to the discount on the sale of the Treasury bills by the government to the Bank of Israel and was amortized by the effective interest method.)

The following is the composition of the Treasury bill balance:

	31 December	
	2004	2003
	(NIS million)	
Redemption value of Treasury bills sold to the public	73,506	56,084
Less Discount at time of sale to public	3,254	3,470
Proceeds of sale of Treasury bills to the public	70,252	52,614
Plus Reduction in discount for period to balance-sheet date	1,652	1,711
<b>Total balance of Treasury bills</b>	<b>71,904</b>	<b>54,325</b>

## 12. Deposits of banking corporations

### a. Local-currency time deposit

The Bank of Israel receives local-currency time deposits from the banking corporations. The deposits are allocated by auction for periods of a day or a week. The deposits are not considered as liquid assets for the purpose of fulfilling the banking corporations' reserve requirements.

	31 December	
	2004	2003
	(NIS million)	
Daily deposits	8,000	15,257
Weekly deposits	8,000	15,000
<b>Total</b>	<b>16,000</b>	<b>30,257</b>
Accrued interest on deposits	3	17
<b>Total</b>	<b>16,003</b>	<b>30,274</b>

The average rate of interest on time deposits in 2004 was 4.3 percent (in 2003 it was 7.5 percent).

The average rate of interest on the balance of deposits on 31 December 2004 was 3.8 percent (on 31 December 2003 it was 5.3 percent).

### b. Other deposits

The banking corporations' other local-currency deposits in the Bank of Israel serve as liquid assets against residents' local-currency and foreign-currency deposits. The reserve requirement ranges from 0 percent to 6 percent, according to the term of the deposit.

*Foreign-currency demand deposits* serve as liquid assets against nonresidents' foreign-currency deposits.

	31 December 2004			
	2004		2003	
	(NIS million)		(\$ million)	
<b>Local-currency demand deposits</b>	<b>10,426</b>	<b>11,106</b>		
<b>Foreign-currency deposits</b>				
Foreign-currency demand deposits	1,103	868	256	198
Unrestricted deposits	488	1,756	113	401
<b>Total foreign-currency deposits</b>	<b>1,591</b>	<b>2,624</b>	<b>369</b>	<b>599</b>
<b>Total</b>	<b>12,017</b>	<b>13,730</b>		

### 13. Other liabilities

This item consists mainly of:

- Provision for employee pensions and severance and vacation pay;
- Deposits of the US–Israel Binational Industrial Research and Development Foundation and a deposit of the US–Israel Binational Science Foundation;
- Expected expenses against the exercise of options on the dollar/NIS exchange rate *plus* income received in advance;
- The net balance of NIS/US\$ swaps (see Notes 1.j.1.a and 18);
- Various creditors.

### 14. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see also Note 1.b, 1.d, and 1.i):

	31 December	
	2004	2003
	(NIS million)	
Foreign-currency balances	9,390	10,161
Tradable local-currency securities	1,198	1,355
Tradable foreign-currency securities	107	257
<b>Total</b>	<b>10,695</b>	<b>11,773</b>

## 15. Bank of Israel's capital

	31 December 2004	
	2004	2003
	(NIS million)	
Share capital	60	60
General reserve	260	260
<b>Total</b>	<b>320</b>	<b>320</b>

## 16. Losses

In accordance with the Bank of Israel Law, 5714–1954, the Bank must transfer its net profits to the government within sixty days of the end of each business year. Losses incurred by the Bank accrue in this item, and will be offset against future profits.

	31 December	
	2004	2003
	(NIS million)	
Loss brought forward from previous year	(13,055)	(13,361)
(Loss) Profit in current year	(797)	306
<b>Total loss</b>	<b>(13,852)</b>	<b>(13,055)</b>

## 17. Assets and liabilities, by indexation bases

	31 December 2004				31 December 2003			
	In local currency	In foreign currency	Non- financial items	Total	In local currency	In foreign currency	Non- financial items	Total
	(NIS million)				(NIS million)			
<b>Assets</b>								
Foreign exchange reserves	–	114,728	–	<b>114,728</b>	–	112,925	–	<b>112,925</b>
Balance in international financial institutions	–	2,009	511	<b>2,520</b>	–	2,320	500	<b>2,820</b>
Credit to the government <sup>a</sup>	664	3,331	–	<b>3,995</b>	747	3,788	–	<b>4,535</b>
Loans	2,191	–	–	<b>2,191</b>	2,725	2	–	<b>2,727</b>
Local-currency securities <sup>b</sup>	4,763	–	–	<b>4,763</b>	5,513	–	–	<b>5,513</b>
Other assets	407	–	36	<b>443</b>	344	–	29	<b>373</b>
<b>Total assets</b>	<b>8,025</b>	<b>120,068</b>	<b>547</b>	<b>128,640</b>	<b>9,329</b>	<b>119,035</b>	<b>529</b>	<b>128,893</b>
<b>Liabilities</b>								
circulation	20,783	–	–	<b>20,783</b>	19,137	–	–	<b>19,137</b>
International financial institutions	–	776	–	<b>776</b>	–	760	–	<b>760</b>
Deposits of the government	(7,317)	13,831	–	<b>6,514</b>	(12,495)	20,813	–	<b>8,318</b>
Treasury bills	71,904	–	–	<b>71,904</b>	54,325	–	–	<b>54,325</b>
Deposits of banking corporations	26,428	1,592	–	<b>28,020</b>	41,380	2,624	–	<b>44,004</b>
Other liabilities <sup>c,d</sup>	9,323	(5,843)	–	<b>3,480</b>	9,257	(5,946)	–	<b>3,311</b>
Revaluation accounts	10,588	107	–	<b>10,695</b>	11,516	257	–	<b>11,773</b>
Bank of Israel capital	–	–	(13,532)	<b>(13,532)</b>	–	–	(12,735)	<b>(12,735)</b>
<b>Total liabilities</b>	<b>131,709</b>	<b>10,463</b>	<b>(13,532)</b>	<b>128,640</b>	<b>123,120</b>	<b>18,508</b>	<b>(12,735)</b>	<b>128,893</b>
<b>Surplus assets (liabilities)</b>	<b>(123,684)</b>	<b>109,605</b>	<b>14,079</b>	<b>–</b>	<b>(113,791)</b>	<b>100,527</b>	<b>13,264</b>	<b>–</b>

<sup>a</sup> Foreign-currency credit to the government includes long-term advances totalling NIS 3,189 million denominated in NIS and indexed to the exchange rate against the first currency basket (NIS 3,643 million on 31 December 2003).

<sup>b</sup> Local-currency securities indexed to the Consumer Price Index.

<sup>c</sup> Other Foreign-currency liabilities include NIS 28 million deriving from expenses expected on exercising US\$/NIS exchange-rate options (NIS 28 million on 31 December 2003).

<sup>d</sup> NIS/\$ swaps are shown in the balance sheet net, in accordance with the balance (see Note 1.j.1(a)). This net balance was in credit, and is therefore shown in this ('Other liabilities') item. This table shows dollars to be received in the foreign-currency column (NIS 6,031 million on 31 December 2004; NIS 6,131 million on 31 December 2003), and NIS to be paid in the local-currency column (NIS 6,239 million on 31 December 2004; NIS 6,176 million on 31 December 2003), so that the balances of these items may be negative.

**18. Contingent liabilities and special commitments**

	31 December	
	2004	2003
	(NIS million)	
<b>1. Contingent liabilities<sup>a</sup></b>		
Documentary credits and guarantees for government imports and exports		
Documentary credits	26	58
Guarantees	442	181
Other contingent liabilities		
Liabilities to pay international financial institutions on demand	3,593	3,637
<b>2. Special commitments</b>		
Derivative financial instruments in activity in Israel		
Currency swaps with domestic banks		
Future receipts of dollars <sup>b</sup>	6,031	6,131
Future payments of NIS	6,239	6,176
\$/NIS purchase options	844	911
\$/NIS sales options	810	911
Future remittances of Treasury bills (at par)	640	640
Derivative financial instruments in activity abroad		
Currency swaps and forward transactions		
Future receipts of foreign currency	1,873	658
Future payments of foreign currency	2,055	658
Repurchase agreements (Repo) and Reverse Repo (RRepo)		
Repo	–	19,753
Reverse Repo	–	16,448
Futures		
Sales commitments	2,805	3,970*
Purchase commitments	1,607	2,704*
Participation in international financial institutions not yet due for payment	10	34

\* Restated

<sup>a</sup> Several claims were made on the Bank of Israel. The Bank of Israel does not consider it necessary to make a special provision for these claims, as the chances that they will be upheld are slight.<sup>b</sup> The balance of swaps on the balance-sheet date was \$1,400 million (\$1,400 million in 2003).**19. Interest income from the foreign exchange reserves**

	Year to 31 December	
	2004	2003
	(NIS million)	
Tradable securities	2,236	2,445
Short-term deposits	331	217
Demand deposits	13	13
Derivative financial instruments <sup>a</sup>	(20)	(44)
<b>Total</b>	<b>2,560</b>	<b>2,631</b>

<sup>a</sup> Expenses on interest on derivatives is shown net.

## 20. Interest income from loans

	Year to 31 December	
	2004	2003
	(NIS million)	
From monetary loans	30	57
From other loans <sup>a</sup>	73	195
<b>Total</b>	<b>103</b>	<b>252</b>

<sup>a</sup> Mostly deriving from interest on credit advanced to the Industrial Development Bank (see Note 5).

## 21. Interest income from the government

	Year to 31 December	
	2004	2003
	(NIS million)	
Long-term advances		
Indexed	441	472
Unindexed	59	95
From binational funds	65	65
From government deposits	348	959
From local-currency securities	474	537
<b>Total</b>	<b>1,387</b>	<b>2,128</b>

## 22. Other interest income

This item consists of interest income from the IMF.

## 23. Interest paid to the banks and the public

	Year to 31 December	
	2004	2003
	(NIS million)	
<b>In local currency</b>		
On local-currency time deposits	906	2,325
On swaps	192	419
On Treasury bills <sup>a</sup>	3,472	4,151
Other	4	6
Total in local currency	4,574	6,901
<b>In foreign currency</b>		
On banks' deposits	9	18
<b>Total</b>	<b>4,583</b>	<b>6,919</b>

<sup>a</sup> On 2003 including NIS 311 million from an adjustment to the calculation of the balance of the discount for Treasury bills to the beginning of the year. (see note 11).

## 24. Interest paid to the government

	Year to 31 December	
	2004	2003
	(NIS million)	
On local-currency deposits <sup>a</sup>	6	16
On foreign currency deposits	251	219
<b>Total</b>	<b>257</b>	<b>235</b>

<sup>a</sup> On the bond-price stabilization deposit (see Note 10).

## 25. Other interest paid

This item consists mainly of interest paid:

- a. To international financial institutions;
- b. On deposits of the US–Israel Binational Industrial Research and Development (BIRD) Foundation and a deposit of the US–Israel Binational Science Foundation.

## 26. Other financial income from (expenses on) securities and derivatives

	Year to 31 December	
	2004	2003
	(NIS million)	
<b>Foreign-currency securities<sup>a</sup></b>	<b>(273)</b>	<b>629</b>
<b>Derivative financial instruments</b>		
In foreign currency	(183)	(42)
In local currency	12	(28)
<b>Total derivative financial instruments</b>	<b>(171)</b>	<b>(70)</b>
<b>Total</b>	<b>(444)</b>	<b>559</b>

<sup>a</sup> Including income from (expenses on) the realization of securities and from decline in their value at the end of the year.

## 27. Other financial income—miscellaneous

	Year to 31 December	
	2004	2003
	(NIS million)	
In local currency	5	4
In foreign currency	37	20
<b>Total</b>	<b>42</b>	<b>24</b>

## 28. Administrative and general expenses

	Year to 31 December	
	2004	2003
	(NIS million)	
Wages and general expenses <sup>a</sup>	482	511
Provision for employees' entitlements	32	70
<b>Total</b>	<b>514</b>	<b>581</b>

<sup>a</sup> Including pensions.

## 29. Other income

	Year to 31 December	
	2004	2003
	(NIS million)	
Doubtful debts <sup>a</sup>	23	–
Income from dividend	2	–
<b>Total</b>	<b>25</b>	<b>–</b>

<sup>a</sup> Update of the loan-loss provision for the North American Bank.