

## CHAPTER XIV

# MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

### 1. MAIN MONETARY DEVELOPMENTS

MONETARY EXPANSION slowed down considerably in 1969, this being accompanied by a structural change—a shift from unlinked financial assets to linked assets.

The money supply grew by IL 72 million, or about 2.5 percent, compared with a rise of 14.2 percent in 1968.<sup>1</sup> Other financial assets held by the public increased by IL 991 million, or 21.8 percent, as against IL 998 million, or 28 percent, in 1968.

Total monetary expansion—i.e. the growth of the money supply and other financial assets—came to 14.3 percent, compared with 22.3 percent the year before (see Table XIV-1).

The slow expansion of the money supply in 1969—the slowest, in fact, which the Israeli economy has ever experienced—was reflected by a decline in the weight of the money supply within total monetary expansion from 26.5 percent in 1968 to 6.7 percent. As to the structural changes in financial asset holdings of the public, there was a decrease in the weight of the money supply and in that of other unlinked financial assets, such as time deposits, the Short-Term Loan, and bills sold through banks (the bill brokerage trade); these grew by only 6 percent all told. On the other hand, there was a switch to index-linked assets, such as approved saving schemes (which increased by 27.5 percent) and foreign currency deposits (Pazak and Tamam), which swelled by 47.3 percent.

The tightness in the money market, which began to be felt in the last quarter of 1968, carried over through 1969; it was reflected by a rise in free-market interest rates, the incurring of large liquidity deficiencies by banking institutions, and the growth of the bill brokerage trade, and helped to check the expansion of aggregate demand.

It was the shortage of liquid assets, which prevented banking institutions from fully satisfying the relatively heavy demand for credit by the various sectors

<sup>1</sup> The money supply data cited in this chapter do not include the change in IL currency holdings in the administered areas. Data on the flow of currency between Israel and these areas are unreliable, but its dimensions were not such as to affect the analysis presented here. According to balance of payments estimates, it appears that in 1968 and 1969 there was a flow of currency from these areas to Israel in the order of some tens of millions of Israeli pounds.

of the economy, that checked the rate of monetary expansion in 1969. The chief cause of the liquidity scarcity was the external drain resulting from the sharp fall in the country's net foreign currency assets. This factor, together with the contractionary effect of the growth of foreign currency deposits (mainly Pazak and Tamam) of Israeli residents, completely offset the expansionary influence of the deficit financing of the Government budget and the increase in Bank of Israel rediscounts and loans to the public. As a result, the liquid asset holdings of banking institutions shrank by IL 61 million during the year (see Figure XIV-1).

**Table XIV-1**  
**INCREASE IN FINANCIAL ASSETS OF THE PUBLIC,**  
**BY SOURCE AND COMPONENT, 1967-69**  
 (IL million)

	1967 <sup>a</sup>	1968	1969	Percent annual increase or decrease (-)		
				1967	1968	1969
<b>Sources</b>						
Foreign currency assets						
With the Bank of Israel	596.5	-164.9	-1,083.6	32.3	-6.7	-47.5
With banking institutions	72.1	-8.5	4.9	46.0	-9.9	5.3
Total	<b>668.6</b>	<b>-173.4</b>	<b>-1,078.7</b>	<b>39.5</b>	<b>-7.3</b>	<b>-49.3</b>
Credit from the Bank of Israel						
Net credit to the Government	189.3	900.9	1,167.2	72.3	267.9	94.4
Credit and advances <sup>b</sup>	<i>702.4</i>	<i>366.8</i>	<i>1,186.4</i>	..	..	..
Less: Govt. and National						
Institution deposits	<i>513.1</i>	<i>-534.1</i>	<i>19.2</i>	..	..	..
Rediscounts and loans	147.2	41.5	371.6	56.3	10.1	82.6
Open-market operations	-108.2	-130.1	23.8	716.6	105.5	9.4
Total (net)	<b>228.3</b>	<b>812.3</b>	<b>1,562.6</b>	<b>44.9</b>	<b>130.7</b>	<b>109.0</b>
Credit from banking institutions						
To the Government	157.8	73.2	235.5	114.9	24.8	63.9
To the public	370.8	547.6	184.8	29.7	33.8	8.5
Total	<b>528.6</b>	<b>620.8</b>	<b>420.3</b>	<b>38.1</b>	<b>32.4</b>	<b>16.6</b>
Other factors, net	47.0	78.6	78.3	56.0	101.7	19.5
Total sources	<b>1,472.5</b>	<b>1,338.3</b>	<b>982.5</b>	<b>42.0</b>	<b>26.9</b>	<b>15.6</b>
<b>Components</b>						
Money supply	530.7	360.0	71.6	26.4	14.2	2.5
Less liquid deposits	941.8	978.3	910.9	63.0	40.1	26.0
Total components	<b>1,472.5</b>	<b>1,338.3</b>	<b>982.5</b>	<b>42.0</b>	<b>26.9</b>	<b>15.6</b>
Bill brokerage	-278.7	-96.4	107.9	-27.3	-13.0	16.7
Short-term loan	109.2	115.6	-27.9	40.5	30.5	-5.7

<sup>a</sup> Including revaluation increments due to the devaluation.

<sup>b</sup> Excluding the change in the Government debt stemming from transactions in Government securities with the public and banks (e.g. sales of the Government Short-Term Loan in the open market).

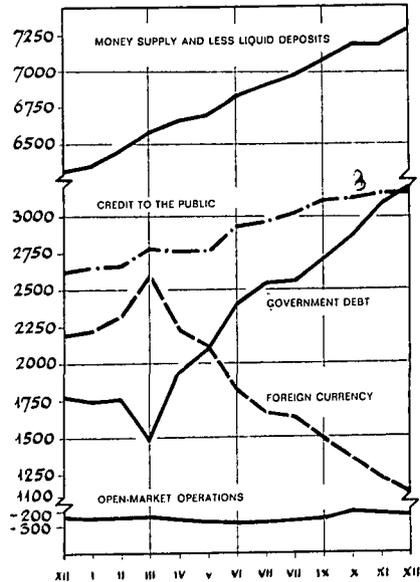
Because of the decrease in liquid asset balances of banking institutions and the stability of the money supply, the monetary policy followed by the Bank of Israel in 1969 was designed to alternately inject liquidity into the economy and to absorb excess liquidity with a view to ensuring the continuation of a tight money market without touching off a crisis. The infusion of considerable liquidity during the months August-November was intended to prevent a sharp contraction of the money supply and the disrupting of the money market at a time when the banking institutions' liquid assets were declining sharply and demand for credit was mounting rapidly as the result of expectations of a revaluation of the German mark and a devaluation of the Israeli pound. The liquidity was pumped into the economy by way of Bank of Israel rediscounts and loans, as well as through open-market operations. Despite these measures, the money supply declined appreciably in the last quarter of 1969.

The strong demand for credit in 1969 was in part a concomitant of the sharp rise in economic activity, and in part it stemmed from a speculative desire to advance payments for imports and other foreign currency outlays while deferring conversions owing to expectations of a general price rise and devaluation. Since the banking institutions could not satisfy this enormous credit demand from their own resources, borrowers turned to the bill brokerage market, driving up the outstanding balance of bills by IL 108 million and interest rates by some 3 percentage points. Also reflecting the liquidity shortage was the heavy pressure for credit from the various export funds.

Credit to the public from the resources of the banking system, plus that granted through the bill brokerage market, increased by IL 664 million, or 20.4 percent, in 1969, compared with IL 493 million (17.8 percent) the year before. It should be noted that in 1968 the outstanding balance of bill-brokerage credits declined by IL 96 million.

The circulation velocity of the money supply increased in 1969, while the turnover rate of other financial assets (mainly those linked to the consumer price index or the foreign exchange rate) decreased. These indicators point to a shift in the public's preferences as regards the holding of financial assets: demand for money weakened, while that for interest-bearing assets, especially

Figure XIV-1  
FINANCIAL ASSETS, BY SOURCE  
AND COMPONENT, 1969  
(IL million)



those that are value-linked, grew. The foremost factor in this development was the hope of earning a high yield on linked assets.

Another contributory factor was the large volume of personal restitution receipts from West Germany and capital transfers by immigrants and returning Israelis; these remained at their 1968 level after having expanded appreciably that year.

These developments were reflected by an increase of only 7.1 percent in the average annual balance of the money supply, as contrasted with 22.0 percent for other financial assets.

The rapid rise in the average annual balance of other financial assets during 1969 did not encompass all component groups. In unlinked financial assets (the Short-Term Loan, brokered bills, and time deposits in Israeli currency) the increase was only 10.5 percent, whereas for linked assets (Pazak, Tamam, and Nataad—which are linked to the exchange rate—and approved saving schemes—linked to the consumer price index) growth came to 31.4 percent.

## 2. THE INFLUENCE OF MONETARY DEVELOPMENTS ON THE ECONOMY

As already mentioned, the year reviewed was marked by a growing scarcity of money. This found expression in the rise of interest rates in the free money market, the inability of borrowers to obtain bill-brokerage credits immediately, the existence of large liquidity deficits among banking institutions, and strong demand for various types of credit. The trend set in during the last quarter of 1968, following the heavy depletion of foreign exchange reserves and the contractionary measures introduced by the Bank of Israel in the second quarter of 1968, which helped to absorb the liquidity surpluses of the banking institutions created after the Six Day War and the institution of reflationary steps by the Bank of Israel during the period of large-scale unemployment. The shortage of liquidity recalled the situation of the money market during the first half of the sixties, up to the 1966–67 recession.<sup>1</sup>

The average annual balance of all financial assets of the public went up by 15.9 percent in 1969, following a rise of 26.6 percent in 1968. The slower rate of expansion affected both component groups: the money supply rose by only 7.1 percent, compared with 19 percent in 1968, while for other financial assets the figures were 22 and 32.6 percent respectively. In 1969 the incremental money supply accounted for 18.3 percent of the total average annual increase in all financial assets, as contrasted with 31.1 percent the year before.

The slower rate of monetary expansion in 1969 and the declining weight

<sup>1</sup> The rate of interest charged borrowers in the bill brokerage market by the big banks was raised by approximately 3 percentage points in 1969, reaching 16 to 17 percent p.a. toward the end of the year—i.e. about the same level as that prevailing until the middle of 1966. The circulation velocity of the money supply relative to the national product was 5.26 in 1969, compared with an average of 5.34 during the years 1960–65. The velocity of demand deposits was 19.9 in 1969, as against an average of 18.3 for the 1960–65 period.

**Table XIV-2**  
**ANNUAL INCREASE IN THE MONEY SUPPLY, 1967-69**  
(IL million)

	Balance at end of year	Change in end-year balance		Average annual balance	Change in average annual balance		Percentage of money supply (average annual balance)
		IL m.	%		IL m.	%	
<b>Currency<sup>a</sup></b>							
1967	965.8	214.7	28.6	920.9	204.2	28.5	38.9
1968	1,091.2	125.4	13.0	1,059.6	138.7	15.1	37.6
1969	1,128.9	37.7	3.4	1,157.2	97.6	9.2	38.4
<b>Demand deposits<sup>b</sup></b>							
1967	1,572.7	316.0	25.1	1,445.5	194.8	15.6	61.1
1968	1,807.3	234.6	14.9	1,755.3	309.8	21.4	62.4
1969	1,841.2	33.9	1.9	1,858.2	102.9	5.9	61.6
<b>Money supply</b>							
1967	2,538.5	530.7	26.4	2,366.4	399.0	20.3	100.0
1968	2,898.5	360.0	14.2	2,814.9	448.5	19.0	100.0
1969	2,970.1	71.6	2.5	3,015.4	200.5	7.1	100.0

<sup>a</sup> Excluding cash held by the Israel Bank of Agriculture and the Ya'ad Agricultural Development Bank, as well as that held by branches of Israeli banks operating in the administered areas.

<sup>b</sup> Including demand deposits in branches of Israeli banks operating in the administered areas; these totalled IL 2.6 million in December 1967, IL 7.1 million in December 1968, and IL 7.3 million in December 1969.

of the money supply within this expansion can be attributed to the liquidity shortage, expectations of a price rise and devaluation, and heavy demand for credit. These drove up the price of money, thereby increasing the circulation velocity of the money supply and the demand for interest-bearing financial assets, in particular of the linked types. The higher price of money took the form of a rise in interest rates on "other unlinked financial assets" (chiefly the Short-Term Loan, bill brokerage, and time deposits in Israeli currency), while a high return was anticipated on holdings of linked assets (mainly Pazak, Tamam, Natad, and approved saving scheme accounts).

The indicators in Table XIV-3 point to a similar development to that described above. The sharp rise in the circulation velocity of the money supply suggests the slackening of demand for money holdings after this item became dearer. Because of the higher price of money, demand for interest-bearing assets (mainly value-linked) increased at a rate exceeding the growth of the national product or resources available to the economy. In other words, there was a decline in the turnover velocity of other financial assets.

Table XIV-3

INDICATORS OF THE TURNOVER VELOCITY OF FINANCIAL ASSETS, 1967-69

	Average velocity of demand deposits <sup>a</sup>	Average annual velocity relative to GNP <sup>b</sup>		
		Money supply	Other financial assets <sup>c</sup>	Total financial assets
1967	18.5	5.01	3.90	2.20
1968	17.8	4.97	3.44	2.03
1969	19.9	5.26	3.15	1.97

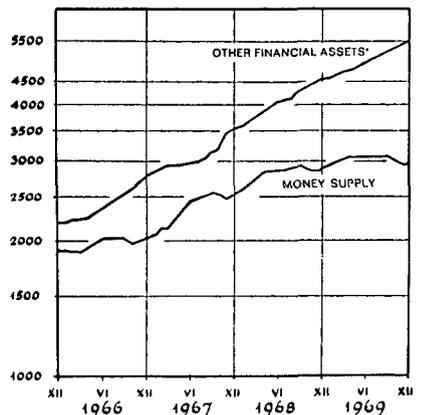
	Average annual velocity relative to the economy's resources <sup>d</sup>		
1967	5.81	4.48	2.53
1968	5.97	4.14	2.44
1969	6.48	3.88	2.43

- <sup>a</sup> Total debits to local-currency demand deposits in banks, divided by the average annual volume of these deposits. Deposits with cooperative credit societies are not included.
- <sup>b</sup> The gross national product at current prices (based on the effective exchange rate), divided by the average annual volume of the three types of financial assets.
- <sup>c</sup> Less liquid deposits of the public with banking institutions, bill brokerage, and Short-Term Loan certificates held by the public.
- <sup>d</sup> The gross national product at current prices plus the import surplus (both based on the effective exchange rate), divided by the average annual volume of the three types of financial assets.

There was also a structural shift in the increment to other financial assets, the weight of linked assets rising and that of unlinked assets falling. It is reasonable to assume that the preference displayed by the public for assets linked to the cost-of-living index or the exchange rate, despite the rise in the relative nominal return on unlinked assets, was due to expectations of a general rise in prices, revaluation of the German mark, and devaluation of the Israeli pound. These expectations were fed by the unstable situation characterizing the international money markets from the last quarter of 1968, as well as by the serious worsening of Israel's balance of payments and foreign currency reserves position.

The expansion of linked deposits of

Figure XIV-2  
FINANCIAL ASSETS HELD BY THE PUBLIC, 1966-69  
(IL million)



Semi-logarithmic scale.

- <sup>a</sup> Less liquid deposits, Short-Term Loan, and bills sold through banks (bill brokerage).

various types likewise reflected the growing preference for linked assets, since it was not at the expense of purchases of linked bonds. As explained in Chapter XVIII, in 1969 there was a notable growth in linked bonds held by the public, both those acquired directly and those acquired through mutual funds.

Some of the special factors operating in 1969 to stimulate demand for financial assets were already in evidence the year before. One was the high level of personal restitution payments from Germany; these totalled \$ 137 million, only \$ 6 million less than in 1968, when there was an appreciable increase. Private transfers in cash likewise remained on a high level—\$ 117 million in 1969 and \$ 134 million in 1968. As in 1968, the large magnitude of this

item probably reflected transfers by immigrants and returning residents; and presumably part of these transfers were invested in financial assets. (The data for 1969 may have an upward bias as regards private transfers; see the discussion in Chapter III, section 5.)

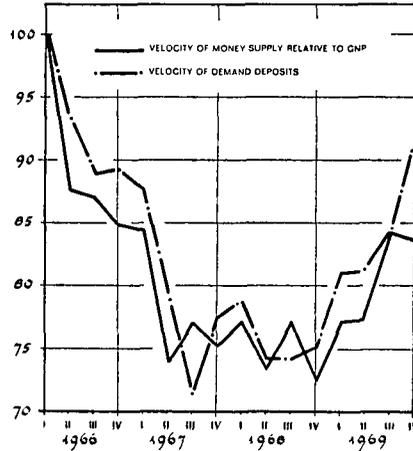
Another factor which in 1968 tended to stimulate demand for linked assets was the instability prevailing in the international money markets owing to expectations that the French franc and the pound sterling would be devalued. Expectations of a devaluation in Israel, which arose in the second half of 1969, had a similar effect. This was reinforced by the crediting of Pazak and Tamam accounts with the increments arising from the revaluation of the German mark.

Because of the speculative nature of part of the credit demand in 1969, it is difficult to assess the impact of the tight money situation upon aggregate demand, price movements, the import surplus, and the country's foreign exchange reserves. Nevertheless, it may reasonably be assumed that one effect was to help check the growth of aggregate demand. Were it not for the expectations of a price increase and devaluation, aggregate demand presumably would have fallen off to a much greater extent. The decelerated expansion of the money supply from May 1968 onward should have left its impress on developments during 1969, especially since the growth rate was very low in 1969 too (see Figure XIV-2).

The expectations prevailing in the country during 1969 influenced the public's behavior in three ways:

(a) Owners of deposits linked to the exchange rate refrained from converting them, while demand for index-linked deposits rose.

Figure XIV-3  
INDICATORS OF THE  
CIRCULATION VELOCITY OF THE  
MONEY SUPPLY, QUARTERLY,  
1966-69



(b) Those intending to buy goods or services advanced their purchases, thus intensifying demand, in particular for imports.

(c) Those engaging in foreign trade tried to defer the transfer of foreign currency receipts and to advance payments due abroad.

These three reactions dampened the desire to hold money or other unlinked assets, and augmented the demand for local currency credit. However, the impact of these developments upon aggregate demand for goods and services was not uniform. The heavier demand for linked deposits increased financial savings and checked the growth of the banking institutions' liquid assets. The advancing of purchases strengthened demand, especially for imports, and was reflected by pressure on domestic resources, an increase in the balance of payments deficit, and the accumulation of stocks. The retention of foreign currency receipts and the advancing of payments in foreign currency did not affect demand, but it did reduce the banking system's foreign currency reserves while increasing the foreign currency assets of those engaging in foreign trade.

The additional credit granted to the public in 1969 made it possible to both finance the growing volume of economic activity and meet the speculative demand. The average annual balance of bank credit to the public, plus bill-brokerage credit, increased by 17.6 percent in 1969, compared with 12.4 percent the year before.

Also contributing to the accelerated growth of credit was the heavier demand for funds to finance various foreign currency transactions. Such financing, of course, does not increase domestic demand nor generate upward pressure on prices, but leads to the expansion of imports and the reduction of the economy's foreign currency balances.

The speculative demand for credit nullified somewhat the moderating effect of the increased cost of bill-brokerage credit, thereby also weakening the dampening effect of the tight money situation on aggregate demand.

### 3. MONETARY POLICY AND THE LIQUIDITY OF BANKING INSTITUTIONS

#### (a) *Main developments*

The Bank of Israel's monetary policy for 1969 was intended to restrain the growth of demand in the economy, thereby slowing down the drain on the country's foreign currency reserves and preventing the disruption of the relative price stability. Toward this end, the central bank attempted to maintain a tight money market (this was in evidence already in the last quarter of 1968) but without causing dislocations. There was no need for it to mop up liquidity, since the external drain due to the loss of foreign currency reserves and the accumulation of foreign currency deposits by the public reduced the banking institutions' liquid assets, despite the much heavier financing of Government operations by the Bank of Israel.

Table XIV-4

## LIQUID ASSETS OF THE BANKING INSTITUTIONS, BY SOURCE, 1967-69

(IL million)

End of period	Credit from the Bank of Israel <sup>a</sup>	Net foreign currency with the Bank of Israel	Bank of Israel open-market operations	Total factors supplying liquid assets (1+2+3)	Less:			Balances in transit or in clearing and other deposits <sup>b</sup>	Total liquid assets of banking institutions (4+8-7)
					Currency held by the public	Net foreign currency balances of banking institutions with Bank of Israel	Total deductions (5+6)		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1967	882.3	2,445.2	-123.3	3,204.2	966.3	1,470.3	2,436.6	15.3	782.9
1968	1,794.1 <sup>c</sup>	2,280.2	-253.4	3,821.0 <sup>c</sup>	1,091.6	1,803.4	2,895.0	3.5 <sup>c</sup>	929.5
1969	3,359.1	1,196.7	-229.6	4,326.2	1,129.5	2,345.2	3,474.7	17.4	868.9
1969 January	1,768.2	2,335.5	-253.3	3,850.4	1,104.0	1,824.9	2,928.9	5.8	927.3
February	1,770.0	2,406.7	-244.3	3,932.4	1,126.7	1,852.5	2,979.2	6.8	960.0
March	1,536.4	2,655.0	-233.4	3,958.0	1,182.9	1,875.8	3,058.7	7.9	907.2
April	2,013.6	2,265.3	-253.5	4,025.4	1,162.8	1,909.5	3,072.3	1.6	954.7
May	2,200.0	2,119.4	-267.7	4,051.7	1,165.6	1,933.5	3,099.1	-2.3	950.3
June	2,479.4	1,856.4	-277.6	4,058.2	1,163.9	1,979.4	3,143.3	-2.2	912.7
July	2,639.8	1,741.8	-280.3	4,101.3	1,184.1	2,018.5	3,202.6	11.5	910.2
August	2,685.0	1,710.6	-260.1	4,135.5	1,181.7	2,083.6	3,265.3	3.2	873.4
September	2,843.4	1,537.3	-236.2	4,144.5	1,178.8	2,179.4	3,358.2	3.6	789.9
October	3,036.0	1,462.1	-198.6	4,299.5	1,168.9	2,328.3	3,497.2	1.2	803.5
November	3,207.6	1,319.3	-214.2	4,312.7	1,148.9	2,330.8	3,479.7	-2.8	830.2
December	3,359.1	1,196.7	-229.6	4,326.2	1,129.5	2,345.2	3,474.7	17.4	868.9

<sup>a</sup> Including credit to the Government and net credit to the public (less deposits of the financial institutions with the Bank of Israel).

<sup>b</sup> Including nonliquid deposits with the Bank of Israel and liquid assets other than deposits held at the Bank of Israel.

<sup>c</sup> Revised figure.

In order to keep money from becoming too tight following a sharp contraction of the money supply, the Bank of Israel decided to infuse liquidity—chiefly during the months August–November—by means of rediscounts, loans, and operations in the open market.

Following are the major factors influencing the liquidity situation of the banking institutions and the measures adopted by the Bank of Israel (see also Table XIV-4):

The first was the positive external infusion resulting from the deficit financing of the Government budget. The IL 1,167 million in Bank of Israel credit to the Government was the principal expansionary factor in 1969. Its effect was fairly uniform throughout the year.

The second factor was the absorption of liquidity as a result of the IL 1,084 million decline in the Bank of Israel's foreign currency balances.

The third factor was the IL 550 million growth in the public's foreign currency deposits. These deposits are completely sterilized, and thus do not augment the institutions' liquid assets.

Yet another development was the unsettled state of the money market during the months August–October 1969 because of expectations of a revaluation of the German mark and devaluation of the Israeli pound. While this was a passing manifestation, its impact was such as to considerably affect the banking system after August 1969.

These restrictive effects fully offset the stimulative influence of the financing of Government activities by the Bank of Israel, so that there was no need for a further absorption of liquidity. Moreover, had the Bank not pumped additional liquidity into the economy through rediscounts and loans to the public (totalling IL 372 million) and open-market operations (IL 24 million), the shortage of money might have assumed critical proportions—in particular after the banking institutions' liquid assets shrank by IL 140 million during the first nine months of 1969 (see Figure XIV-4).

A comparison of the monetary-policy instruments applied in 1969 with those in 1968 shows that the Bank of Israel had to intervene less actively in the money market in 1969 than during the months May–December 1968. In the latter period, it will be recalled, the Bank raised the liquidity ratios on demand and time deposits by 5 percent and absorbed IL 111 million by open-market operations; rediscounts and loans to the public, on the other hand, totalled only IL 5 million during that period.<sup>1</sup>

As already mentioned, the Bank of Israel injected some IL 400 million of liquidity into the economy in 1969, mainly during the second half of the year. Nevertheless, the liquidity ratios were maintained unchanged until May 1970,<sup>2</sup> and pressure was exerted on the banks to limit their import financing as of

<sup>1</sup> After providing IL 42 million for doubtful debts.

<sup>2</sup> In May 1968 the liquidity ratios were raised for a one-year period. In 1969 the period was extended for another year.

November 1969. In addition, the interest paid on the Short-Term Loan was raised twice.

The differential use of monetary-policy instruments in 1968 and 1969 was an outcome of the changing monetary situation between April 1968 and January 1969, as well as of the changed magnitude of the external infusions in these two years.

In April 1968 there was abundant liquidity and interest rates were low, a situation that had prevailed since the introduction of the deflationary measures during the recession. Beginning in May 1968, the Bank of Israel attempted to absorb liquidity surpluses and counteract the expansionary effect of the incremental credit granted to finance Government activities. In 1969, on the other hand, money was already quite hard to obtain, and the expansionary effect of financing the Government by Bank of Israel credit was fully offset by the decline in foreign currency reserves and the growth of the public's foreign currency deposits.

(b) *Developments during 1969*

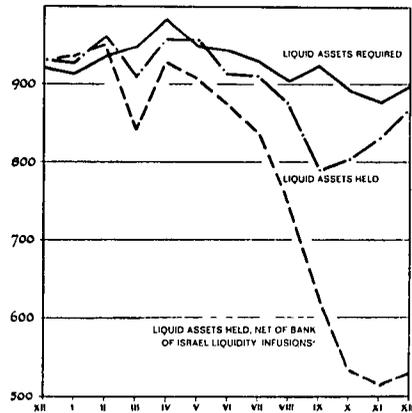
Data on infusions, banking institution liquidity, and Bank of Israel operations reveal such a highly uneven pattern over the year as to render an analysis by subperiods almost imperative.

In January and February, banking institutions possessed free liquidity reserves.<sup>1</sup> During these months, the money market had calmed down following a hectic period in October and November 1968, when the international financial markets were suffering a crisis (see Table XIV-5).

A shortage of money began to be felt again in March, with the termination of the fiscal year and the usual absorption of liquidity by the Treasury during that month.

Bank of Israel operations in the open market pumped some IL 20 million into the economy during the first quarter of 1969, continuing a trend begun in the second half of November 1968. The return on the Short-Term Loan and commissions to distributors were raised at the end of March 1968, thus making it possible to absorb liquidity through open-market operations until the middle of November 1968. At that time, interest rates on near substitutes for the Short-

Figure XIV-4  
**THE LIQUIDITY OF BANKING INSTITUTIONS, 1969**  
 (IL million)



<sup>1</sup> Free reserves are defined as the difference between the liquidity surpluses of institutions with surpluses and the liquidity deficits of institutions with deficits.

Table XIV-5  
LIQUIDITY OF BANKING INSTITUTIONS IN ISRAELI CURRENCY, 1967-69  
(IL million)

End of period	Total liquid assets of banking institutions <sup>a</sup>	Liquid assets in Israeli currency held against deposits requiring special liquid cover <sup>b</sup>	Ordinary liquid assets in Israeli currency (1-2)	Deposits requiring ordinary liquid cover	Effective liquidity ratio on ordinary deposits $\frac{(3)}{(4)} \times 100$	Liquidity deficits	Liquidity surpluses	Free reserves (7-6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1967	782.9	62.5	720.4	1,606.3	44.8	29.4	53.6	24.2
1968	929.5	137.2	792.3	1,835.7	43.2	31.3	39.1	7.8
1969	868.9	144.0	724.9	1,870.0	38.8	54.5	24.4	-30.1
1969 January	927.3	137.1	790.2	1,839.2	43.0	9.9	17.9	8.0
February	960.0	139.5	820.5	1,855.8	44.2	11.0	31.4	20.4
March	907.2	137.6	769.6	1,883.6	40.9	45.2	8.1	-37.1
April	954.7	140.5	814.2	1,907.8	42.7	47.0	11.8	-35.2
May	950.3	140.2	810.1	1,862.8	43.5	30.6	30.7	0.1
June	912.7	141.6	771.1	1,912.4	40.3	47.7	13.1	-34.6
July	910.2	143.4	766.8	1,904.6	40.3	35.8	16.0	-19.8
August	873.4	141.9	731.5	1,880.9	38.9	52.4	21.1	-31.3
September	789.9	137.8	652.1	1,913.8	34.1	139.5	9.5	-130.0
October	803.5	137.0	666.5	1,866.4	35.7	97.6	9.7	-87.9
November	830.2	139.9	690.3	1,829.3	37.7	64.8	17.6	-47.2
December	868.9	144.0	724.9	1,870.0	38.8	54.5	24.4	-30.1

<sup>a</sup> The data are from column 9 in Table XIV-4.

<sup>b</sup> Deposits requiring 15, 90, or 100 percent liquid cover.

Term Loan—such as time deposits in Israeli currency and bill brokerage—were also raised, depressing the relative return on the Short-Term Loan.

The liquidity situation of the banking institutions became graver after April 1969. In contrast to the normal seasonal trend, there was no increase in free reserves during the second and third quarters of the year.<sup>1</sup> Between April and August liquid assets decreased by IL 34 million, and even though credit to the public was stepped up by IL 100 million, only IL 45 million of the increment consisted of credits within the framework of liquidity exemptions; the balance, of course, considerably depressed the volume of free reserves.

The deviation from the seasonal pattern, caused by the heavy depletion of foreign currency assets, was apparently unexpected. Consequently, credit to the public continued to increase even though the banking institutions ran substantial liquidity deficits and paid fines.

Following a fairly steep rise of about 5 percent in the money supply during the first quarter of the year, the return on the Short-Term Loan was raised in April 1969 with a view to absorbing part of the incremental liquidity expected to be generated by the seasonal increase in the Government's liabilities to the Bank of Israel at the start of the new fiscal year.<sup>2</sup> However, the Bank of Israel's operations in the open market succeeded in soaking up only IL 47 million during the months April-July 1969, since yields on bill brokerage transactions and time deposits went up in the latter part of April. These returns rose further in August, but this time the yield on the Short-Term Loan was not increased concurrently. Because of the tight money situation which began to be felt in August 1969, the central bank decided not to absorb additional liquidity.

The market was seriously disrupted in September by expectations of a revaluation of the German mark and devaluation of the Israeli pound. The comparatively protracted process of revaluing the mark and its proximity to the Knesset elections in Israel (toward the end of October 1969) unsteadied the money market for a fairly long period. This situation was reflected by a steep decline in the liquid assets of the banking institutions and a sharp increase in their liquidity deficiencies. In September liquid assets shrank by IL 83 million, credit to the public was expanded by IL 75 million, and free reserves fell by IL 99 million, depressing their already negative level to -IL 130 million.

Money was at its tightest in that month. In October the Bank of Israel eased the situation somewhat by infusing IL 77 million of liquidity into the economy by way of rediscounts and loans. In November rediscounts and loans amounted to IL 68 million, thus helping to reduce the liquidity deficits further—from IL 88 million at the end of October to IL 47 million at the end of November.

The Bank of Israel's operations in the open market also helped to alleviate

<sup>1</sup> See J. Prager, "Free Reserves, Surpluses, and Liquid Asset Deficiencies of Israel's Banking Institutions, 1958-67", published in *Bank of Israel Bulletin* No. 32, January 1970.

<sup>2</sup> The relative returns on unlinked financial assets are discussed in section 5.

the scarcity of money. During the months August-October IL 82 million of liquidity was pumped into the economy as a result of the decline in the relative return on the Short-Term Loan during those months. The raising of the return in November checked the "flight" from this paper and thereby permitted the absorption of IL 35 million in the last two months of the year.

#### 4. THE MONEY SUPPLY

In 1969 the money supply increased by IL 72 million, or 2.5 percent, compared with IL 360 million, or 14.2 percent, the year before. The growth rate in 1969 was not only low relative to 1968, but was in fact the slowest ever experienced by the Israeli economy.

The reasons for the marked deceleration were detailed in sections 2 and 3 of this chapter. Developments in the course of 1969 followed the usual seasonal pattern, even though the monetary forces operating during the year differed from those of previous years.

The rapid expansion during the first quarter of the year was connected, as in the past, with the seasonal accumulation of foreign currency balances. However, the last-quarter decline was largely due to the accelerated decrease in foreign currency reserves, following the revaluation of the German mark and expectations of a devaluation of the Israeli pound after the elections.

Of the IL 72 million increase in the money supply, IL 38 million was in currency in circulation with the public and IL 34 million in demand deposits. The weight of currency in the money supply edged up from 37.6 percent at the end of 1968 to 38 percent at the end of 1969. The figure ranged from a high of 38.8 percent in August and November to a low of 37.7 percent in January. In the previous year as well, there were no marked fluctuations in the weight of currency.

While the effect of the increased weight of currency upon the banks' liquid assets was not very great, it was nevertheless of some significance, since during most months of the year the banking institutions had large liquidity deficiencies.

The data on currency in circulation include the administered areas. According to balance of payments estimates, holdings there decreased in both 1968 and 1969.

Demand deposits in branches of Israeli banks operating in the areas remained virtually unchanged—IL 7.3 million at the end of 1969 as against IL 7.1 million at the end of 1968.

#### 5. OTHER FINANCIAL ASSETS OF THE PUBLIC

This asset category consists of less liquid deposits of the public with banking institutions, the outstanding balance of the bill brokerage trade, and Short-Term Loan certificates held by the public.

Table XIV-6  
THE MONEY SUPPLY, MONTHLY, 1969  
(IL million)

End of period	Currency <sup>a</sup>			Demand deposits <sup>b</sup>			Money supply			Money supply, seasonally adjusted <sup>c</sup>		
	Total	Monthly increase or decrease (-)		Total	Monthly increase or decrease (-)		Total	Monthly increase or decrease (-)		Total	Percent monthly increase or decrease (-)	
		IL m.	%		Percent of money supply	IL m.		%	IL m.			%
1968 December	1,091.2	-14.1	-1.3	37.6	1,807.3	50.0	2.8	2,898.5	35.9	1.2	2,910.0 <sup>d</sup>	0.1
1969 January	1,103.4	12.2	1.1	37.7	1,820.4	13.1	0.7	2,923.8	25.3	0.9	2,986.5	2.6
February	1,126.0	22.6	2.0	38.0	1,835.7	15.3	0.8	2,961.7	37.9	1.3	3,003.8	0.6
March	1,182.1	56.1	5.0	38.9	1,857.5	21.8	1.2	3,039.6	77.9	2.6	3,082.8	2.6
April	1,162.1	-20.0	-1.7	38.0	1,894.8	37.3	2.0	3,056.9	17.3	0.6	3,072.3	-0.3
May	1,164.8	2.7	0.2	38.7	1,847.6	-47.2	-2.5	3,012.4	-44.5	-1.5	2,982.6	-2.9
June	1,163.1	-1.7	-0.1	38.0	1,896.8	49.2	2.6	3,059.9	47.5	1.5	2,985.3	0.0
July	1,183.2	20.1	1.7	38.5	1,888.7	-8.1	-0.4	3,071.9	12.0	0.4	3,017.6	1.1
August	1,180.3	-2.9	-0.2	38.8	1,861.8	-26.9	-1.4	3,042.1	-29.8	-1.0	2,982.5	-1.2
September	1,177.4	-2.9	-0.2	38.3	1,896.6	34.8	1.8	3,074.0	31.9	1.0	3,014.0	1.1
October	1,167.4	-10.0	-0.8	38.7	1,849.0	-47.6	-2.6	3,016.4	-57.6	-1.9	3,028.5	0.5
November	1,147.4	-20.0	-1.7	38.8	1,808.6	-40.4	-2.2	2,956.0	-60.4	-2.0	3,004.1	-0.8
December	1,128.9	-18.5	-1.6	38.0	1,841.2	32.6	1.8	2,970.1	14.1	0.5	3,037.0	1.1

<sup>a</sup> Excluding cash held by the Israel Bank of Agriculture, Ya'ad Agricultural Development Bank, and branches of Israeli banks operating in the administered areas.

<sup>b</sup> Including demand deposits in branches of Israeli banks operating in the administered areas; these totalled IL 7.1 million in December 1968 and IL 7.3 million in December 1969.

<sup>c</sup> The adjustment for seasonal influences was made on the basis of Central Bureau of Statistics data.

<sup>d</sup> Revised figure.

In 1969 the growth of these assets slowed down, the rise amounting to 21.8 percent compared with 28 percent in 1968, 27.7 percent in 1967, and 29 percent in 1966.

The smaller percentage increase in the year reviewed was the resultant of two influences operating in opposite directions: the slower pace of monetary expansion and the shift in the public's preferences in favor of interest-bearing assets (especially value-linked) over money holdings. As explained in section 2, this change in the public's preferences was connected with the adjustment of the money market to the tighter situation and to expectations of devaluation and a general price increase.

The change in the composition of other financial assets stands out prominently when compared with the preceding year. In 1969 unlinked assets accounted for 11.9 percent of the total increase in "other financial assets", as contrasted with 36.7 percent in 1968. The weight of saving schemes was 32.6 and 27.7 percent respectively, while that of assets linked to the exchange rate was 55.5 percent in 1969 as against only 35.6 percent in the previous year.

This structural change is largely explained by the noticeably greater preference displayed in 1969 for linked assets (both those pegged to the consumer price index and those linked to the foreign exchange rate), apparently because of mounting expectations of a general price rise, revaluation of the German mark, and devaluation of the Israeli pound. This factor probably outweighed the impact of the improvement in the relative nominal returns on unlinked assets. These returns, net of tax withheld at source, rose by 1.5–2 percentage points during 1969. The interest on Pazak and Tamam deposits remained unchanged, while the more attractive terms offered on approved saving schemes brought up their return by 0.3 to 1.75 percentage points (on an unlinked basis).

#### (a) *Pazak and Tamam accounts*

The outstanding balance of Pazak accounts swelled by IL 360 million in 1969 (\$ 103 million), following a rise of IL 241 million (\$ 69 million) the year before. Tamam accounts grew by IL 121 million (\$ 35 million), as contrasted with IL 96 million (\$ 26 million) in 1968. The rise in 1969 includes increments arising from the revaluation of the German mark, which totalled IL 117 million (\$ 34 million).

Pazak and Tamam deposits expanded rapidly in the last two years. The crisis that beset international money markets and the resulting expectation that several countries would be forced to alter their exchange rates induced a growing tendency to hold assets linked to foreign currencies. This was reflected in the reduced conversion into Israeli pounds of restitution receipts and interest on foreign currency deposits.

In 1969 personal restitution receipts reached \$ 137 million, compared with \$ 143 million the year before. Interest accumulated on Pazak deposits totalled

\$ 22 million, and that on Tamam deposits came to \$ 6 million. It emerges, therefore, that the growth of Pazak and Tamam deposits amounted to 69 percent of total restitution receipts, plus increments from the revaluation of the mark and interest income; this compares with 57 percent in 1968.

This high ratio of 69 percent may somewhat overstate the growth of demand for foreign currency holdings, since the gradual revaluation of the German mark was completed at the beginning of October and not all deposit owners managed to adjust their asset portfolios accordingly by the end of the year.<sup>1</sup> In 1965 and

Table XIV-7

LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS, 1967-69

(IL million)

End of period	Saving schemes	Time deposits in Israeli currency <sup>a</sup>	Deposits against liabilities	Deposits linked to the exchange rate (Pazak)	Foreign currency deposits (Tamam)	Other foreign currency deposits	Total less liquid deposits
1967	406.2	519.6	15.1	1,018.7	399.1	78.3	2,437.0
1968	682.4	868.8	12.1	1,259.3	491.0	101.7	3,415.3
1969	1,005.4	906.0	12.9	1,618.9	611.9	171.2	4,326.2
1969 January	701.0	873.4	13.8	1,280.6	496.0	68.0	3,432.8
February	719.6	898.6	13.4	1,304.1	500.3	70.3	3,506.3
March	746.4	888.7	12.5	1,315.0	509.0	82.4	3,554.0
April	767.3	897.3	14.8	1,329.6	516.1	89.5	3,614.6
May	789.3	907.2	12.9	1,353.7	521.0	105.9	3,690.0
June	818.6	912.3	15.1	1,380.5	526.8	116.2	3,769.5
July	846.6	915.7	13.8	1,405.2	529.0	120.1	3,830.4
August	877.0	905.8	13.7	1,440.0	536.3	163.3	3,936.1
September	906.1	882.1	14.3	1,491.5	555.9	168.3	4,018.2
October	939.0	871.9	16.1	1,585.9	590.0	178.4	4,181.3
November	969.9	890.3	13.4	1,604.6	597.5	160.2	4,235.9
December	1,005.4	906.0	12.9	1,618.9	611.9	171.2	4,326.2

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

<sup>1</sup> The devaluation of November 1967 led to a big increase in deposits, as well as a rise in the unconverted portion of restitution receipts, which reached 64 percent. It is reasonable to assume that in 1967—even more than in 1969—the increase in the share of unconverted proceeds can be attributed to the fact that the deposit growth due to the devaluation occurred toward the end of the year, so that there was insufficient time for depositors to adjust their asset portfolios. This factor underscores the intensity of demand for deposits linked to foreign exchange in 1968, when the proportion of unconverted receipts was comparatively high despite the accumulation of substantial devaluation increments at the end of 1967.

1966 the unconverted portion of personal restitution receipts amounted to 41 and 45 percent respectively.

The conspicuous growth of Pazak and Tamam deposits in 1969 was probably due primarily to the unwillingness to convert restitution funds because of the expectation of revaluation increments, and also because of a similar behavior on the part of certain other foreign currency recipients, whose share is relatively small. Yet another factor was the mounting demand for Israeli currency credits by those refraining from conversion. Both of these phenomena contributed to the growing tightness of the money market. As already mentioned, a similar development occurred in the last quarter of 1968: the prevailing belief that the exchange rates of several European currencies would be altered led to the deferment of conversions and a strong demand for credit, with the consequence that money became scarcer.

One of the components in the growth of other foreign currency deposits in 1969 was a IL 17 million rise (at the official exchange rate) in Natad accounts,<sup>1</sup> which do not carry interest; this contrasts with an increase of only IL 4 million in the previous year. The rapid growth in the year reviewed was another manifestation of the desire to hold assets linked to foreign currency because of possible exchange rate adjustments.<sup>2</sup>

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

These deposits increased in 1969 by IL 323 million, or 47.4 percent, as compared with IL 276 million, or 68 percent, the year before. The rapid rise in the year reviewed can be ascribed to the preference displayed by savers for linked assets and to the more attractive deposit terms offered. While the rate of growth slowed down somewhat in 1969 as compared with the two preceding years, it should be stressed that monetary expansion was also faster in 1967 and 1968.

A much higher return was earned in 1969 when the right to participate in the "conversion schemes" was extended to all savers.<sup>3</sup> This occurred in April and affected the composition of incremental saving scheme deposits. Whereas in 1968 conversion-type schemes expanded by IL 9 million, representing 2.7 percent of the total increase in saving scheme deposits, during the nine months

<sup>1</sup> These originate from the sale of foreign securities, the receipt of dividends or interest on foreign securities, and the conversion of Tamam accounts. Natad funds may be used only for the purchase of foreign securities.

<sup>2</sup> See the discussion in Chapter XVIII, "The Securities Market".

<sup>3</sup> Deposits in these schemes are made partly in cash and partly in Absorption Loan certificates. The above-mentioned improvement was accompanied by a change in the regulations which allowed cash withdrawals only after a one-year period and withdrawals of Absorption Loan certificates only after two years. This change, of course, worsened the conditions for those who were entitled to invest in such schemes before the right was extended, but improved the conditions for the saving public as a whole.

April-December 1969 they swelled by IL 92 million, accounting for 35.5 percent of the total increase during this period.<sup>1</sup>

The aforementioned change in the regulations increased the yield to depositors in the "conversion schemes" by between 0.3 and 1.75 percentage points, while the interest paid on other option-type schemes remained unchanged.<sup>2</sup>

An analysis of the increase in "conversion scheme" deposits in the various institutions shows that the improvement in terms had only a limited effect on savers. Data from the three big banks reveal that there was a marked differential in the contribution of conversion-type schemes to the total rise in saving scheme deposits in the institutions concerned, and that total saving scheme deposits grew rapidly also in institutions where conversion-type schemes expanded at a sluggish rate.<sup>3</sup> It can therefore be concluded that the notable expansion of saving schemes during 1969 was caused first and foremost by the public's growing preference for linked assets, and only to a lesser extent by the better terms offered on conversion-type schemes.

Several factors apparently prevented a big increase in such schemes:

1. Profitability considerations induced some of the institutions to favor ordinary saving schemes of the option type.

2. Apparently it is not convenient to make small monthly deposits in the conversion-type scheme. This has probably prompted those who deposit small amounts every month to concentrate on the regular option-type schemes, while those making large nonrecurrent deposits tend to prefer the conversion-type scheme.

3. Conversion-type schemes do not pay current interest but accumulate it.

4. Such schemes are a less liquid asset, since the amount deposited in the form of Absorption Loan certificates cannot be drawn upon for two years and that deposited in the form of cash for one year.

The structure of the conversion-type schemes is such that the return on them fluctuates in the same manner as that on bonds. A fall in the market price of Absorption Loan certificates (which increases their return) also brings up the return to depositors in these schemes, since they are able to purchase such certificates at a lower price. Thus we find that the return on these deposits rose toward the end of 1969 concurrently with the increased yield on Absorption Loan certificates during the months September-December.

As in 1968, the growth of non-option-type saving schemes was negligible in

<sup>1</sup> The revision of the regulations in April did not lead to the immediate introduction of conversion-type schemes in all banking institutions. One large institution, which mobilized substantial amounts through this type of scheme in the second half of 1969, began to operate it only at the end of June.

<sup>2</sup> The peak yield on the conversion-type schemes was 10.75 percent p.a., free of tax, during the period up to the end of June. In November the yield dropped to a low of 9.3 percent. These were the rates of return if the deposits were held for a period of five years.

<sup>3</sup> These three banks accounted for 90 percent of the total increase in saving scheme funds during the period April-December 1969.

the year reviewed. Those for secondary and higher education expanded by IL 4 million, and children's schemes by IL 3 million. On the other hand, the outstanding balance of unlinked saving schemes declined by IL 5 million, and that of other linked saving schemes of the nonoption type by IL 3 million.

The growth of saving schemes in 1969 was accompanied by the investment of IL 230 million of the funds in bonds. Besides this, the IL 47 million of Absorption Loan certificates received by the banking institutions under the conversion-type schemes were deposited in a special account with the Treasury. In other words, 85.8 percent of the incremental saving scheme deposits were invested in bonds or deposited with the Treasury. Of the total bond investment in the year reviewed, IL 69 million was in Defense Loan certificates, IL 23 million in a special Development Loan series for banks, and IL 3 million in ordinary Development Loan certificates. Most of the remaining incremental purchases were in bonds issued by financial institutions affiliated to banks operating saving schemes.

Directed credit granted from saving scheme funds remained unchanged in 1969, while the amount utilized at the banks' own discretion totalled IL 46 million.

(c) *Unlinked financial assets<sup>1</sup>*

The increase in the volume of such assets (mainly bills brokered by banks, time deposits in Israeli currency, and the Short-Term Loan) totalled IL 118 million in 1969, compared with IL 366 million in the previous year. The deceleration in 1969 was accompanied by a sharp decline in the weight of this group within "other financial assets". That this occurred despite the higher returns earned on all component items is explained by the public's preference in 1969 for assets linked to the exchange rate or the consumer price index. This section will describe the development of the various components of this group during the year surveyed, as well as the factors that brought up the weight of bill brokerage and depressed that of time deposits and the Short-Term Loan.

The decline of IL 28 million in the outstanding balance of the Short-Term Loan in 1969, as contrasted with a growth of IL 108 million in bill brokerage and IL 37 million in time deposits, can be attributed to the relative advantage offered by the last two assets until the middle of November 1969. The yields on Short-Term Loan certificates, it will be recalled, were maintained unchanged between the end of March 1968 and the middle of April 1969, while the return on bill brokerage increased in November 1968. Consequently, the relative yield on the Short-Term Loan decreased during the first three months of 1969, and

<sup>1</sup> The data on rates of return in the bill brokerage market and on time deposits are based on the schedule of charges of the three big banks. The weight of these three institutions in the bill brokerage trade reached 63.2 percent at the end of 1969, while for time deposits it came to 50.9 percent. There may be a slight downward bias in the yield data, since in certain months there was excess demand for bill-brokerage credit at the official rates, with the result that borrowers had to queue up in this market.

outstanding holdings of the public fell during this period by IL 24 million. On the other hand, the balance of the bill brokerage trade rose by IL 35 million, whereas that of Israeli-currency time deposits increased by some IL 20 million. The raising of the return on the Short-Term Loan by  $\frac{3}{4}$  of a percentage point in April was accompanied by a somewhat smaller rise in the return on bill brokerage and time deposits, so that these two lost some of their attraction. As a result, during the April-July period the balance of the Short-Term Loan increased by IL 47 million, while the balance of the bill brokerage trade rose by IL 22 million and that of time deposits by IL 27 million.

At the beginning of August the interest rate in the bill brokerage market was raised by  $\frac{7}{10}$  of a percentage point, again improving the relative return on this asset. Between July and October the balance of the bill brokerage trade went up by IL 40 million, while the balance of Short-Term Loan certificates held by the public dropped by IL 84 million and that of time deposits by IL 44 million.

The raising of the return on the Short-Term Loan by 1.25 percentage points in the middle of November improved its relative yield considerably, so that the outstanding balance of this paper shot up by IL 32 million during November and December, while bill brokerage expanded by IL 10 million and time deposits by IL 34 million.

The higher relative return on bill brokerage and time deposits until the middle of November helped to increase their balance by IL 97 million and IL 3 million respectively during the first ten months of the year, while depressing the balance of the Short-Term Loan by IL 60 million. The improvement in the return on the Short-Term Loan toward the end of the year failed to completely offset the advantage offered by bill brokerage up to mid-November.

The factors influencing the expansion of bill brokerage relative to deposits were not connected with changes in their relative yields during the year; the differential growth rates were due to other reasons, the most important of which were as follows:

1. From the standpoint of the banking institutions, it was preferable to marshal funds through bill brokerage rather than time deposits, since the former was more profitable. The profit margin on bill brokerage transactions was about 4–5 percent at the beginning of 1969, rising by another percentage point by the end of the year. The profit margin on time deposits was much lower, since the creditory interest rate on loans granted from such funds was limited by the Interest Law and 15 percent liquid cover had to be held against the deposits.

Another factor was the banks' obligation to invest half the incremental time deposit funds in Defense Loan certificates, whereas no such obligation was imposed on bill brokerage transactions.

2. From the standpoint of savers, the desire to hold time deposits diminished, while the preference for bill brokerage gained further ground. The amendment of the liquidity regulations on time deposits at the beginning of April reduced their liquidity, since it rendered early withdrawals more expensive. According

to the new regulations, a time deposit becomes subject to the ordinary liquidity requirements six months after the date of the deposit, unless an agreement is reached to extend the term for another six months.<sup>1</sup>

It should be noted in this context that there are savers who shun the bill brokerage market, as they do not consider it proper banking business. This applies in particular to certain public bodies.

## 6. SOURCES OF MONETARY EXPANSION

The money supply and less liquid deposits of the public expanded during the year reviewed by IL 982 million, or 15.6 percent; this was far below the 1968 increase of IL 1,338 million (26.9 percent).

The main causes of monetary expansion in 1969 were the large-scale deficit financing of the Government budget with the help of IL 1,172 million in Bank of Israel credits, the reduction of the Bank's foreign currency assets by IL 1,084 million, and the IL 550 million growth in the public's foreign currency deposits (mainly Pazak and Tamam).

The magnitude of the external drain resulting from the depletion of foreign currency assets and the contractionary effect of the public's incremental foreign currency deposits were such that, in spite of the much larger volume of Bank of Israel rediscounts and loans (IL 372 million) and the infusion of liquidity by means of open-market operations (IL 24 million), the banking institutions' liquid assets shrank by IL 61 million. Nevertheless, the institutions gave much more credit to the public and the Government than in the preceding year—IL 185 million more to the public and IL 99 million more to the Government (not counting purchases of Government bonds and deposits in connection with the conversion-type saving schemes).

Despite the marked growth of credit and the decline in liquid assets, the free reserves of the banking institutions decreased by only IL 38 million. This is explained by the composition of the sources of funds for the additional credit and by the authorization of IL 57 million in credits exempted from the liquidity requirements. The latter reduced the required liquidity ratio along with the effective liquidity ratio.

### (a) *Foreign currency assets*<sup>2</sup>

Net foreign currency assets with the banking system shrank in 1969 by

<sup>1</sup> This change deprives depositors of the pre-existing option of drawing on such deposits held for over six months upon demand, while obtaining a high rate of interest thereon.

<sup>2</sup> The change in net foreign currency assets is not identical with the change in the economy's foreign exchange reserves, since these two concepts are defined differently, as will be explained below. The data in this section take into account the increase in foreign currency assets stemming from the revaluation of the German mark.

Table XIV-8

## FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM, 1967-69

(IL million)

End of period	Bank of Israel			Banking institutions					Banking system	
	Foreign currency assets	Foreign currency liabilities		Net assets (1-2-3)	Foreign currency assets <sup>b</sup>	Foreign currency liabilities		Net assets (5-6-7)	Net foreign currency assets	
		Patach deposits <sup>a</sup>	Other liabilities			Patach deposits <sup>c</sup>	Other liabilities <sup>d</sup>		IL m. (4+8)	\$ m.
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1967	2,589.3	130.9	13.2	2,445.2	659.5	485.9	258.3	-84.7	2,360.5	674.4
1968	2,415.4	121.1	14.0	2,280.3	807.2	530.0	370.4	-93.2	2,187.1	624.9
1969	1,627.6	152.9	278.0 <sup>e</sup>	1,196.7	1,114.6	675.1	527.8	-88.3	1,108.4	316.7
1969 January	2,468.6	119.4	13.7	2,335.5	773.9	546.9	339.9	-112.9	2,222.6	635.0
February	2,537.5	115.5	15.3	2,406.7	827.1	539.6	368.7	-81.2	2,325.5	664.4
March	2,789.3	120.8	13.5	2,655.0	838.8	538.5	358.4	-58.1	2,596.8	741.9
April	2,406.1	124.6	16.2	2,265.3	885.6	569.2	344.7	-28.3	2,237.0	639.1
May	2,340.6	124.9	96.3	2,119.4	911.3	575.8	341.1	-5.6	2,113.4	603.8
June	2,079.2	127.4	95.4	1,856.4	849.4	588.4	300.5	-39.5	1,816.9	519.1
July	1,961.6	126.2	93.6	1,741.8	904.7	620.7	347.6	-63.6	1,678.2	479.5
August	1,934.7	130.4	93.7	1,710.6	971.6	655.3	388.6	-72.2	1,638.3	468.1
September	1,848.6	137.5	173.9	1,537.3	959.5	642.9	367.6	-51.0	1,486.2	424.6
October	1,766.9	131.1	173.7	1,462.1	990.3	666.8	432.0	-108.5	1,353.7	386.8
November	1,640.2	148.3	172.6	1,319.3	1,053.0	677.2	482.5	-106.6	1,212.7	346.5
December	1,627.6	152.9	278.0	1,196.7	1,114.6	675.1	527.8	-88.3	1,108.4	316.7

<sup>a</sup> Nonresidents' accounts redeposited by the banking institutions with the Bank of Israel.

<sup>b</sup> Mainly deposits with foreign banks and loans to nonresidents.

<sup>c</sup> Nonresidents' deposits, less sums redeposited with the Bank of Israel.

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

<sup>e</sup> Including deposits with foreign banks and Israeli currency deposits to the credit of the International Monetary Fund in connection with drawings on the gold tranche and the first credit tranche.

IL 1,079 million (\$ 309 million), compared with a decline of IL 173 million (\$ 50 million) the year before.<sup>1</sup>

The decrease in 1969 breaks down as follows: Foreign currency assets of the Bank of Israel contracted by \$ 225 million, and its foreign currency liabilities rose by \$ 84 million.

Foreign currency assets of the banking institutions expanded by \$ 87 million, while their liabilities went up by a similar amount—\$ 86 million. Since most of the asset increment was in deposits with banks abroad, and most of the increase in liabilities represents credit from foreign banks, it would seem that the main growth factor here was the arbitrage transactions carried out by a number of institutions because of the advantageous conditions prevailing in international capital markets.

The foreign currency balances in the Bank of Israel (defined as gold, deposits, and other liquid investments held by the Bank, net of time deposits of foreign banks) fell by \$ 281 million in 1969, after declining by \$ 52 million the year before. The decrease in 1969 occurred despite the drawing of the first credit tranche from the International Monetary Fund, in the amount of \$ 22.5 million.<sup>2</sup>

Following the heavy drain on the economy's foreign currency balances in 1968 and 1969, their level stood at only \$ 382 million at the end of the year reviewed.

The rapid dwindling of the banking system's net foreign currency assets in 1969 was a reflection of the widening balance of payments deficit on current account, a result of the expansion of aggregate demand unaccompanied by a larger capital import.

#### (b) *Credit to the Government*<sup>3</sup>

As in the preceding year, the Government's expenditure increased sharply, whereas the amount of capital raised abroad continued downward, without a compensatory increase in domestic revenue from taxes and public loans. In order to finance its activities, the Government borrowed IL 1,167 million from the Bank of Israel, in addition to the IL 901 million obtained in 1968. It also received IL 235 million in credit from the banking institutions, compared with IL 73 million in 1968. It was this credit to the Government from the banking system that accounted for almost all of the monetary expansion in 1969.

Credit from the banking institutions consisted of IL 85 million in purchases of Government securities (including the Defense Loan), the depositing with the Accountant General of IL 47 million worth of Absorption Loan certificates re-

<sup>1</sup> In 1968 there was also a decrease in the Government's foreign currency deposits abroad, but this is not reflected in the system of accounts presented in this chapter.

<sup>2</sup> In addition, in 1969 Israel drew its gold tranche from the International Monetary Fund, in the amount of \$ 22.5 million, but this is not reflected by an increase in foreign currency balances as defined here.

<sup>3</sup> The financing of the public sector and its inflationary influence is discussed in Chapter VII.

**Table XIV-9**  
**CHANGES IN OUTSTANDING CREDIT FROM THE BANKING SYSTEM TO THE GOVERNMENT AND**  
**NATIONAL INSTITUTIONS, 1967-69**  
(IL million)

End of period	From the Bank of Israel			From banking institutions			Total change in credit from the banking system	
	Credit granted <sup>a</sup>	Less: Increase or decrease (-) in Govt. and National Institution deposits	Total	Credit granted <sup>b</sup>	Investments in Govt. securities <sup>c</sup>	Less: Increase or decrease (-) in Govt. deposits		Total
1967	702.3	513.0	189.3	19.1 <sup>d</sup>	136.7	-2.0	157.8 <sup>d</sup>	347.1 <sup>d</sup>
1968	366.8	-534.1	900.9	-15.9 <sup>d</sup>	94.7	5.6	73.2 <sup>d</sup>	974.1 <sup>d</sup>
1969	1,186.4	19.2	1,167.2	160.1	85.6	10.2	235.5	1,402.7
1969 January	-20.1	2.8	-22.9	-15.0	-13.5	-1.3	-27.2	-50.1
February	-15.1	-5.3	-9.8	0.3	17.3	0.0	17.6	7.8
March	-217.6	53.6	-271.2	8.1	-5.2	-0.3	3.2	-268.8
April	407.5	-57.9	465.4	-0.4	-8.5	-0.4	-8.5	456.9
May	180.8	11.9	168.9	0.3	-1.7	0.3	-1.7	167.2
June	263.3	-1.4	264.7	13.2	20.0	1.3	31.9	296.6
July	122.3	-0.1	122.4	31.2	-1.8	10.3	19.1	141.5
August	-4.9	12.1	-17.0	22.6	14.8	-0.1	37.5	20.5
September	137.7	-15.8	153.5	3.7	2.6	1.2	5.1	158.6
October	108.9	9.4	99.5	49.7	1.4	-2.3	53.4	152.9
November	104.1	10.5	93.6	4.3	36.7	-0.3	41.3	134.9
December	119.5	-0.6	120.1	42.1	23.5	1.8	63.8	183.9

<sup>a</sup> Excluding Bank of Israel open-market operations in Government securities, sales of treasury bills to banking institutions, and Bank of Israel purchases of securities from banking institutions under the optional repurchase arrangement; these transactions are not accompanied by a flow of funds between the Bank of Israel and the Government, but between the Bank of Israel and the public and banking institutions.

<sup>b</sup> Excluding banking institution deposits with the Treasury in connection with approved saving schemes of the type involving the deposit of Absorption Loan certificates; these deposits totalled IL 51.2 million at the end of 1969 and IL 4.2 million at the end of 1968.

<sup>c</sup> Excluding changes in holdings of treasury bills and the Short-Term Loan (for reasons that are explained in note <sup>a</sup> to this table). Government securities sold to the Bank of Israel under the optional repurchase arrangement have also been excluded; the outstanding balance of such securities totalled IL 24.7 million at the end of 1969, compared with IL 8.2 million at the end of 1968. (See also note <sup>a</sup> to Table XIV-10).

<sup>d</sup> Revised figure.

ceived from savers in the conversion-type schemes, and IL 113 million in foreign currency credits. Net current credit in Israeli currency declined by IL 11 million.

Under an agreement concluded with the Treasury, banking institutions also undertook to purchase Defense Loan certificates during the year 1969/70 in a specified ratio to their incremental deposits: 50 percent of Israeli-currency time deposits, 13 percent of demand deposits, and 10 percent of saving scheme deposits. Owing to the slow growth of demand and time deposits, the agreement was subsequently revised, and the institutions provisionally lent the Government foreign currency.

(c) *Bank credit to the public*

1. *The expansion of credit*

Bank credit to the public expanded by IL 558 million, or 21.3 percent, in 1969, compared with IL 589 million (29 percent) in the preceding year. There was an especially striking deceleration in banking institution credit, reflecting the appreciable increase in Bank of Israel rediscounts. The slower growth of bank credit

**Table XIV-10**  
**OUTSTANDING CREDIT GRANTED TO THE PUBLIC**  
**BY THE BANKING SYSTEM, 1967-69**

(IL million)

End of period	From the Bank of Israel <sup>a</sup>	From banking institutions <sup>b</sup>	Total bank credit	From earmarked deposits of the public <sup>c</sup>	Against Govt. deposits	From earmarked Govt. deposits	Balance of bill brokerage trade
1967	408.6	1,620.4	2,029.0	662.4	66.8	425.4	742.3
1968	450.1	2,168.0	2,618.1	747.4	56.6	495.9	645.9
1969	821.7	2,352.8	3,174.5	972.4	59.8	700.3	753.8
1969 January	470.3	2,179.3	2,649.6	756.2	56.1	503.4	664.9
February	483.2	2,178.5	2,661.7	757.8	60.2	521.4	673.7
March	517.9	2,278.7	2,796.6	762.1	64.1	540.6	681.2
April	547.3	2,226.6	2,773.9	769.2	61.4	558.4	679.2
May	562.1	2,213.6	2,775.7	802.0	57.1	569.9	698.1
June	580.1	2,356.5	2,936.6	814.0	53.8	598.7	696.0
July	607.3	2,366.9	2,974.2	815.7	55.7	607.3	703.5
August	649.8	2,378.3	3,028.1	821.2	55.0	615.9	723.0
September	663.0	2,453.2	3,116.2	832.0	55.4	637.4	727.4
October	740.4	2,382.5	3,122.9	858.8	55.6	652.2	743.3
November	808.2	2,349.8	3,158.0	877.1	55.7	671.9	762.6
December	821.7	2,352.8	3,174.5	972.4	59.8	700.3	753.8

<sup>a</sup> Including sales of securities by banking institutions to the Bank of Israel under the optional repurchase arrangement; this is credit granted to banking institutions and not the public (see note <sup>c</sup> to Table XIV-9).

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

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

in 1969 is explained by the liquidity shortage prevailing throughout the entire year, which was marked by a high level of economic activity and heavy demand for credit (see Table XIV-10).

The liquidity shortage and brisk demand for credit led to a IL 108 million rise in outstanding bill-brokerage credit. In 1968, with liquidity abundant during the first nine months of the year, the outstanding balance of such credit declined by IL 96 million over the year, despite an upturn in the last quarter.

Bank and bill-brokerage credit together increased by IL 664 million, or 20.4 percent, in 1969; this compares with IL 493 million (17.8 percent) the year before.

The growing weight of bill-brokerage credit within total short-term credit granted through the banking system was accompanied by the revision of interest rates charged borrowers. Whereas at the end of 1968 the big banks were charging 13-14 percent, by the end of 1969 they were lending at 16-17 percent.

It was the larger weight of bill-brokerage credit and its dearer cost that made all credit more expensive in 1969. At the same time, however, there was a rise in the percentage of directed credit granted by the banking system. Of the total

**Table XIV-11**  
**INCREASE IN OUTSTANDING BANK CREDIT TO THE PUBLIC,**  
**BY COMPONENT, 1967-69**  
(IL million)

	1967	1968	1969
<b>From banking institutions</b>			
In local currency			
Directed	85.7	107.8	3.7
Within the framework of liquidity exemptions	50.5	58.2	56.7
Participation in export and working capital funds and credit from saving scheme funds	35.2	49.6	-53.0
Ordinary	282.0	396.3	208.8
In foreign currency	3.1	43.5	-27.7
Total	<b>370.8</b>	<b>547.6</b>	<b>184.8</b>
<b>From the Bank of Israel</b>			
Foreign currency rediscounts <sup>a</sup>	7.8	31.3	156.4
Local currency rediscounts <sup>b</sup>	139.4	10.2	215.2
Total <sup>c</sup>	<b>147.2</b>	<b>41.5</b>	<b>371.6</b>
Total incremental credit from the banking system	<b>518.0</b>	<b>589.1</b>	<b>556.4</b>
Bill brokerage	-278.7	-96.4	107.9
Credit from and against Government deposits	59.0	60.3	207.6
Credit from earmarked deposits of the public	102.5	85.0	225.0

<sup>a</sup> Including IL 42 million in National Institution bills in 1968 and IL 86 million worth in 1969.

<sup>b</sup> See note <sup>a</sup> to Table XIV-10.

<sup>c</sup> After provision of IL 31.0 million for doubtful debts at the end of 1967 and a further IL 42.3 million at the end of 1968.

increment of IL 558 million in bank credit to the public, only IL 209 million, or 37.5 percent, was ordinary (i.e. not directed) credit, bearing interest ranging from 10 to 11 percent per annum, while most of the directed credit was given at 6 percent.

The above figures indicate a considerable increase in the weight of directed credit in 1969, since in the previous year ordinary credit accounted for 67.3 percent of the increment (see Table XIV-11).

Most of the additional directed credit in 1969 consisted of an increase of IL 156 million in the Export Finance Fund, IL 85 million in the Diamond Financing Fund, and IL 13 million in the Import-for-Export Financing Fund. Credit from these funds bears interest of 6 percent per annum.

Besides the rapid growth of these funds, the year 1969 witnessed a change in their financing, the proportion of Bank of Israel rediscounts rising from 35.3 percent at the end of 1968 to 50.6 percent.<sup>1</sup> The absolute increase in Bank of Israel rediscounts amounted to IL 372 million, and was connected primarily with these export funds—both as part of the effort to encourage exports and as an integral part of the monetary policy designed to ease the scarcity of money from August onward. Of these rediscounts, a total of IL 160 million was within the framework of the general export funds and the Import-for-Export Financing Fund, and a further IL 73 million for the Diamond Financing Fund.<sup>2</sup> In addition, the Bank of Israel rediscounted IL 86 million of National Institution bills in foreign currency (this had no expansionary monetary effect), and granted other rediscounts and loans to a total of IL 51 million.

## 2. *The destination of credit*

The sectoral classification of credit relates to credit granted through the banking system; in addition to bank credit to the public, it includes the sum granted from earmarked deposits of the public and those against Government deposits (mainly to tax debtors). Bill brokerage is excluded, as the data thereon are for years ending in June.<sup>3</sup>

A glance at Table XIV-12 shows that of the IL 785 million credit increment in 1969, about IL 194 million went to local authorities, credit and financial

<sup>1</sup> The weight of rediscounts within the resources of the Diamond Financing Fund moved up from 50 percent at the end of 1968 to 66.7 percent at the end of 1969. The change in the fund's structure was connected with the changeover in the financing of diamond transactions from local currency to foreign currency credits. See also Chapter XIX, section 9.

<sup>2</sup> Of the IL 160 million mentioned above, IL 101 million went to institutions which had granted the full amount of export credit possible within the framework of liquidity exemptions (based on the size of their demand deposit balances), yet continued to finance export transactions.

<sup>3</sup> The increase in bill brokerage between June 1968 and June 1969 amounted to IL 48 million, while between the end of 1968 and the end of 1969 it totalled IL 108 million. As may be seen from Table XIV-12, most of the increment went to private nonfinancial sectors, and hence we have assumed that they received the entire increment.

institutions, and the National Institutions; this compares with IL 225 million in 1968. Other economic sectors received IL 591 million, as against IL 478 million in 1968. Taking into account the change in the outstanding balance of bill

**Table XIV-12**

**OUTSTANDING BANK AND BILL-BROKERAGE CREDIT TO THE PUBLIC,  
BY DESTINATION, 1967-69**

(End of period)

Destination	Credit through the banking system <sup>a</sup>			Bill brokerage	
	1967	1968	1969	June 1968	June 1969
	<b>IL million</b>				
Local authorities	293.7	347.7	426.0	8.7	10.2
Public services	86.0	83.3	85.6	8.2	3.3
Credit and financial institutions <sup>b</sup>	123.2	241.8	292.1	36.7	46.6
National Institutions	57.2	109.2	174.8	1.6	1.9
Agriculture	309.0	341.6	378.0	41.3	34.7
Industry	1,059.2	1,279.9	1,581.2	188.5	215.5
Construction	216.8	279.4	290.4	167.5	156.9
Commerce	189.2	233.1	336.9	90.5	107.0
Services	188.3	246.7	298.3	33.2	42.4
Individuals	217.8	250.3	315.7	32.0	40.2
Miscellaneous <sup>c</sup>	110.3	140.9	159.7	39.4	36.6
<b>Total</b>	<b>2,850.7</b>	<b>3,553.9</b>	<b>4,338.7</b>	<b>647.6</b>	<b>695.3</b>
	<b>Percentages</b>				
Local authorities	10.3	9.8	9.8	1.3	1.5
Public services	3.0	2.3	2.0	1.3	0.5
Credit and financial institutions	4.3	6.8	6.4	5.7	6.7
National Institutions	2.0	3.1	4.0	0.2	0.3
Agriculture	10.8	9.6	8.7	6.4	5.0
Industry	37.2	36.0	36.4	29.1	31.0
Construction	7.6	7.9	6.7	25.9	22.6
Commerce	6.6	6.6	7.7	14.0	15.4
Services	6.6	6.9	6.9	5.1	6.1
Individuals	7.6	7.0	7.3	4.9	5.8
Miscellaneous	3.9	4.0	3.8	6.1	5.2
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

NOTE: The sectoral classification of part of the data for 1969 is not identical with that of previous years. Since it was impossible to reclassify the data for 1967-68, they are not strictly comparable with those for 1969.

<sup>a</sup> Including bank credit, credit from earmarked deposits of the public, from Government deposits in export and working capital funds, and from special Government deposits; excluding credit from earmarked development budget deposits of the Government.

<sup>b</sup> Excluding interbank loans, loans between cooperative credit societies, and credit from the Bank of Israel to banking institutions under the optional securities repurchase arrangement.

<sup>c</sup> Other sectors, including credit to artisans.

brokerage, we find that short-term credit to private nonfinancial sectors grew by IL 699 million in 1969, as contrasted with IL 382 million in 1968. This increase reflects the much heavier demand for credit to finance the expansion of economic activity and for speculative purposes.

There was an especially rapid increase in bank credit to commerce, industry, and private individuals, whereas credit for construction purposes expanded slowest of all. Agricultural credit, which under the present classification also includes the financing of farm marketing operations and organizations connected with the agricultural sector, likewise increased at a moderate rate.

## 7. THE DEVELOPMENT OF BANKING INSTITUTIONS

Despite the slower monetary expansion in 1969, the combined balance sheet of the banking institutions rose by 25 percent, compared with 20.2 percent in 1968. Exclusive of contingent accounts, the increases were 24 and 25.4 percent respectively.

The rapid growth of contingent accounts in 1969 (30.8 percent), following a decline in the previous year, was connected with the expansion of the bill brokerage market and with the much larger volume of rediscounts with the Bank of Israel (these are listed as a contingent item).

Other balance sheet items that grew appreciably in 1969 without affecting the monetary situation were earmarked deposits and loans granted from such deposits. The Government's earmarked deposits expanded by 38.4 percent, while other earmarked deposits—in the main of social insurance funds and financial institutions—rose at approximately the same rate.

On the assets side, the outstanding developments were the IL 160 million increase in loans to the Government and the decelerated growth of credit to the public (9.2 percent).

The securities portfolio of the banking institutions expanded by 27.7 percent in 1969, compared with 39.5 percent in 1968. The lower rate of increase was linked with the slower growth of approved saving schemes during 1969 and the higher proportion of schemes of the conversion type.

The rapid rise in foreign currency assets and liabilities was connected mainly with arbitrage transactions conducted by a number of institutions in the international capital markets. Such operations do not contribute to monetary expansion.

“Cash, balances with the Bank of Israel, and treasury bills” increased by IL 500 million in 1969, reflecting primarily the growth of Israeli residents' foreign currency deposits, which are redeposited in full with the Bank of Israel.

On the liabilities side, the outstanding development in the year reviewed was the much slower expansion of demand deposits—only 1.6 percent as contrasted with 15.1 percent in 1968.

The expansion of less liquid deposits likewise slowed down, from 37.5 per-

Table XIV-13

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1968-69<sup>a</sup>

	IL million		Percent		Increase or decrease (-)	
	1968	1969	1968	1969	IL m.	%
<b>Assets</b>						
Cash, balances with the Bank of Israel, and treasury bills	2,841.3	3,341.0	31.9	30.3	499.7	17.6
Loans to the public <sup>b</sup>	2,351.9	2,566.6	26.4	23.3	214.7	9.2
Loans to the Government	52.9	212.9	0.6	1.9	160.0	302.5
Loans from earmarked deposits						
Of the Government	552.1	760.1	6.2	6.9	208.0	37.7
Of the public <sup>c</sup>	899.3	1,243.8	10.0	11.3	344.5	38.3
Foreign currency assets	807.2	1,114.6	9.1	10.1	307.4	38.1
Securities	823.2	1,051.3	9.3	9.5	228.1	27.7
Real estate	113.7	132.2	1.3	1.2	18.6	16.3
Net balances with other banking institutions	-196	-22.7	-0.2	-0.3	-3.1	-15.8
Other accounts	482.0	638.6	5.4	5.8	156.6	32.5
Total	<b>8,904.0</b>	<b>11,038.5</b>	<b>100.0</b>	<b>100.0</b>	<b>2,134.5</b>	<b>24.0</b>
<b>Liabilities</b>						
Demand deposits in Israeli currency	1,800.1	1,828.5	20.2	16.6	28.4	1.6
Less liquid deposits <sup>d</sup>	3,601.4	4,540.0	40.4	41.1	938.6	26.1
Liabilities to foreign banks <sup>e</sup>	1,021.5	1,355.7	11.5	12.3	334.2	32.7
Government deposits	567.2	785.2	6.4	7.1	218.0	38.4
Earmarked deposits	917.6	1,269.8	10.3	11.5	352.2	38.4
Equity capital	333.4	387.7	3.7	3.5	54.3	16.3
Capital notes	45.4	44.2	0.6	0.4	-1.2	-2.5
Other accounts	617.4	827.4	6.9	7.5	210.0	34.0
Total	<b>8,904.0</b>	<b>11,038.5</b>	<b>100.0</b>	<b>100.0</b>	<b>2,134.5</b>	<b>24.0</b>
<b>Contingent accounts</b>						
Balances held by and for banking institutions	87.5	74.0			-13.5	-15.4
Clients' liabilities and guarantees for clients	1,394.4	1,864.7			470.3	33.7
Total	<b>1,481.9</b>	<b>1,938.7</b>			<b>456.8</b>	<b>30.8</b>
Grand total	<b>10,385.9</b>	<b>12,977.2</b>			<b>2,591.3</b>	<b>25.0</b>

<sup>a</sup> Excluding the Ya'ad Agricultural Development Bank and the Israel Bank of Agriculture.

<sup>b</sup> The figures for 1968 and 1969 are respectively IL 183.9 million and IL 213.8 million larger than those cited in Table XIV-10, since they include Bank of Israel loans to banking institutions in these amounts.

<sup>c</sup> The figures for 1968 and 1969 are respectively IL 151.9 million and IL 271.4 million larger than those cited in Table XIV-10, since they include loans to the Government.

<sup>d</sup> Including IL 183.9 million in Bank of Israel loans to banking institutions in 1968 and IL 213.8 million in 1969.

<sup>e</sup> The figures for 1968 and 1969 are respectively 121.1 million and IL 152.9 million larger than those cited in Table XIV-8, since they include nonresidents' deposits redeposited with the Bank of Israel.

cent in 1968 to 26.1 percent. Time deposits in Israeli currency were mainly responsible for the more sluggish increase.

Equity capital was enlarged by IL 53 million, or 16.2 percent. Of this amount, IL 36 million was obtained through share issues.

A total of 22 commercial banks were operating at the end of 1969—the same number as in the preceding year. The Mizrahi Bank merged with the Hapoel Hamizrahi Bank, while two cooperative credit societies, Halva'a Vehisachon Tel Aviv and Zerubavel Bank, merged to form the Halva'a Vehisachon Bank. Thus,

**Table XIV-14**  
**SELECTED INDICATORS OF THE CONCENTRATION OF**  
**BANKING BUSINESS, 1967-69<sup>a</sup>**

(percentages)

End of period	The Big Three	Other banks	Credit cooperatives	Total
<b>Cash and balances with the Bank of Israel</b>				
1967	75.8	21.0	3.2	100.0
1968	80.0	19.0	1.0	100.0
1969	80.0	18.6	1.4	100.0
<b>Loans to the public<sup>b</sup></b>				
1967	65.2	29.5	5.3	100.0
1968	65.9	20.0	5.1	100.0
1969	65.7	32.0	2.3	100.0
<b>Demand deposits in Israeli currency</b>				
1967	70.2	21.4	8.4	100.0
1968	69.7	22.1	8.2	100.0
1969	69.5	26.1	4.4	100.0
<b>Other deposits<sup>c</sup></b>				
1967 <sup>d</sup>	77.9	19.5	2.6	100.0
1968	78.7	18.5	2.7	100.0
1969	81.2	17.7	1.1	100.0
<b>Bill brokerage</b>				
1967	56.1	32.1	11.8	100.0
1968	59.0	30.6	10.4	100.0
1969	63.2	30.6	6.2	100.0
<b>Number of head offices and branches</b>				
1967	55.5	31.1	13.4	100.0
1968	55.8	30.4	13.8	100.0
1969	56.1	35.5	8.4	100.0

<sup>a</sup> The data do not include the Ya'ad Agricultural Development Bank and the Israel Bank of Agriculture.

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

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

<sup>d</sup> Revised figures.

while the number of banks held steady, the number of credit cooperatives decreased by two to stand at 14.

The number of branch offices operated by banks increased by 50 in 1969, while the branch network of credit cooperatives was reduced by 40. The merger of the two Tel Aviv cooperatives mentioned above and their conversion into a bank reduced the number of credit cooperative branches by 42 and added 40 branches to the bank network.

The number of branches of Israeli banks operating in the administered areas did not change in 1969, nor did their geographical distribution.<sup>1</sup>

The weight of the three big banks continued upward in time deposits in both Israeli and foreign currency (from 78.7 percent in 1968 to 81.2 percent) and in bill brokerage business (from 59 to 63.2 percent). On the other hand, their weight fell slightly in demand deposits and loans to the public, and rose somewhat in respect of branch offices.

## 8. OPERATING RESULTS OF BANKING INSTITUTIONS<sup>2</sup>

Despite the slower rate of monetary expansion in 1969, there was an appreciable growth in banking institution income. Expenses also rose rapidly, but less so than income; consequently, there was a substantial improvement in the profitability of the branch.

Operating profit for 1969 totalled IL 78 million, as against IL 56 million the year before. The rate of increase was 39.7 percent, and compares with 51.1 percent in 1968 and 16.1 percent in 1967.

Total profits (operating profit plus capital gains) reached 80 million, a rise of 40 percent as against 33.7 percent in 1967. Operating income amounted to IL 866 million—up IL 208 million, or 31.6 percent, from the previous year.

In income from interest on loans and service charges there was a gain of IL 147 million, or 35.9 percent. Income from deposits with the Bank of Israel and with other banks advanced by IL 38 million. This was a smaller increase than in 1968, a development due primarily to the slower rise in the average annual balance of liquid assets deposited by the institutions with the Bank of Israel.

Other income—mainly from securities and from foreign currency, trustee, and insurance transactions—rose by IL 22 million, or 22.1 percent.

Operating expenses were IL 186 million (30.8 percent) larger than in 1968.

<sup>1</sup> More information on the combined balance sheet of the branches operating in the administered areas will be found in the *Monthly Bulletin of Banking Statistics*, issued (in Hebrew only) by the Examiner of Banks, Bank of Israel.

<sup>2</sup> The data on income and expenses do not include the three banks that ran into difficulties in 1967 and since then are in the process of liquidation. The income and expense items were reclassified in 1969, and therefore the data are not strictly comparable with those of previous years.

Table XIV-15

OPERATING RESULTS OF BANKING INSTITUTIONS,<sup>a</sup> 1968-69

	IL million		Percent		Percent annual increase or decrease (-)		
	1968	1969	1968	1969	1968	1969	
<b>Operating income</b>							
Interest on loans	291.1	401.3	44.2	46.3	29.4	37.9	
Service charges	118.0	155.1	17.9	17.9	4.7	31.4	
Interest on deposits with the Bank of Israel and other banks	148.5	186.8	22.6	21.6	37.4	25.8	
Other income <sup>b</sup>	100.8	123.1	15.3	14.2	84.6	22.1	
Total	658.4	866.3	100.0	100.0	31.6	31.6	
<b>Operating expenses</b>							
Payroll	170.6	198.0	28.3	25.1	14.3	16.1	
Interest on deposits <sup>c</sup>	352.2	500.9	58.4	63.5	43.9	42.2	
Other expenses <sup>d</sup>	80.0	89.7	13.3	11.4	14.9	12.1	
Total	602.8	788.6	100.0	100.0	30.0	30.8	
<b>Profits</b>							
Operating profit	55.6	77.7	97.2	97.0	51.1	39.7	
Capital gains (net)	1.6	2.4	2.8	3.0	-79.0	50.0	
Total	57.2	80.1	100.0	100.0	28.8	40.0	
	1963	1964	1965	1966	1967	1968	1969
Operating profit as a percentage of operating income	11.8	9.2	9.6	5.7	7.4	8.4	9.0
Operating profit as a percentage of equity capital <sup>e</sup>	21.3	13.0	13.3	8.6	11.7	17.3	22.5
Total profit as a percentage of equity capital <sup>e</sup>	32.4	19.7	16.2	8.5	14.3	17.8	23.2

<sup>a</sup> Excluding the three banks that ran into financial difficulties at the beginning of 1967 and since then are in the process of liquidation. Data for 1969 are provisional and based on a new classification of the income and expense items; hence they are not strictly comparable with the data for previous years.

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

<sup>c</sup> Including interest and commissions on loans received and rediscounts, as well as fines for liquidity deficits.

<sup>d</sup> Including administrative overheads, depreciation, donations, and bad debts.

<sup>e</sup> The calculation excludes foreign banks, as they do not have equity capital in Israel.

Interest paid on deposits went up by IL 149 million, or 42.2 percent. Payroll expenditure (salaries and fringe benefits) rose by IL 27 million, or 16.1 percent, following an increase of 14.3 percent in 1968. The growth in the year reviewed was the outcome of a 9.3 percent bigger wage bill per employee (compared with 8.5 percent in 1963) and an increase of 6.2 percent in personnel (5.4 percent in 1968).

Other expenses—administrative overheads, bad debts, and miscellaneous expenses—rose by IL 10 million, or 12.1 percent.

The increase in banking institution income was reflected by an improvement in profitability, as measured by three ratios: operating profit/operating income (the profit margin) went up from 8.4 percent in 1968 to 9 percent; operating profit/equity capital rose from 17.3 to 22.5 percent; and total profit/equity capital advanced from 17.8 to 23.2 percent.