CHAPTER XIX

ACTIVITIES OF THE BANK OF ISRAEL

1. SUMMARY OF THE BALANCE SHEET AT THE END OF 1979[1]

(a) Main Developments

The Bank of Israel's balance sheet totaled IL254.2 billion at the end of 1979, compared with IL126.9 billion the year before—an increase of 100 percent, as against 75 percent in 1978. The faster growth this year is explained by the more rapid devaluation of the Israeli pound and the acceleration of inflation, which reached 86 and 111 percent respectively. Discounting these factors, the increase was slower than in 1978. This was reflected in the changes in the main balance sheet items, the most outstanding of which were the much slower increase in foreign exchange reserves in dollar terms and a somewhat slower real growth of Bank of Israel credit for financing exports, relative to the rise of prices last year. The government debt, on the other hand, rose more rapidly than in 1978.

The relatively slow increase in assets reflected the comparatively restrained monetary expansion, which also found expression on the liabilities side: a modest growth of currency in circulation, a slower increase than in 1978 in banking institution deposits against foreign currency deposits of the public, and a decline in banking institution deposits in Israeli currency, most of which constitute the commercial banks' obligatory liquidity deposits with the Bank of Israel.

(b) Foreign currency Accounts with the Rest of the World

In 1979 the rapid expansion of foreign exchange reserves held by the Bank of Israel,[2] which characterized the two preceding years, slowed, and in the second half of the year the level even declined. The reserves totaled $2,570 million at the end of the year, compared with $2,242 million at the end of 1978—a growth of $328 million, as against $883 million last year. The slower rise this year was partly due to

[1] Most of this section is from the Bank of Israel's Financial Statements for the Year 1979, published in February 1980.

[2] Foreign exchange reserves are defined as gold, foreign exchange and foreign securities, less deposits of foreign banks and foreign currency deposits of banking institutions in Israel against nonresidents' deposits.

Table XIX-1

CLAIMS ON AND LIABILITIES TO FOREIGNERS IN GOLD AND FOREIGN EXCHANGE, 1978-79
($ million)

End of year	1979	1978	Increase
Assets			
Gold, foreign currency, and securities in foreign currency	3,120.0	2,678.6	441.4
Other foreign currency assets	37.8	277.7	-239.9
Total claims on the rest of the world	**3,157.8**	**2,956.3**	**201.5**
Liabilities			
Allocation of Special Drawing Rights	84.6	55.9	28.7
Liabilities to IMF	95.4	97.4	-2.0
Foreign currency deposits of foreign banks	13.0	7.7	5.3
Other liabilities	12.0	12.6	-0.6
Nonresidents' deposits (Patach)	536.9	428.7	108.2
Total liabilities to the rest of the world	**741.9**	**602.3**	**139.6**
Net claims on the rest of the world (foreign currency assets)	**2,415.9**	**2,354.0**	**61.9**
Net foreign exchange reserves with the Bank of Israel[a]	**2,570.1**	**2,242.2**	**327.9**

[a] Gold, foreign exchange, and foreign securities, less deposits of foreign banks and foreign currency deposits of banking institutions in Israel against nonresidents' deposits.

an increase of some $900 million in the private sector's balance of payments deficit on currency account, which was not covered by an increase in the sector's capital transfers from abroad. This deterioration was due to the rapid expansion of imports and especially to the rise in fuel import prices.

The growth of net foreign exchange reserves this year reflected the contrasting influence of the private and public sectors. The private sector reduced the reserves through the net purchase of some $910 million of foreign currency (compared with approximately $330 million last year), with most of this huge increase resulting from the financing of the sector's larger current account deficit. The public sector, on the other hand, contributed some $1,230 million to the growth of the reserves, about the same amount as last year. A breakdown of the public sector's contribution also shows no marked change from last year: government and Jewish Agency foreign currency transfers from abroad totaled $970 million, and Bank of Israel income from interest and exchange rate differentials on the investment of reserves amounted to $265 million.[3]

In analyzing the growth of reserves during the year, two main subperiods can be discerned: the first seven months of the year and the last five months. In the initial period the level increased by $408 million, with the main growth factors being government transfers and Bank of Israel profits, which added $568 million to the reserves. The private sector pulled down the level through its foreign currency purchases, which amounted to a relatively modest $160 million, or an average of $23 million a month. These modest purchases reflected the stability of the sector's balance of payments deficit and the receipt of some $100 million of foreign loans in January, mainly for speculative reasons. In the second subperiod the reserves shrank by about $80 million owing to the heavy purchase of foreign currency by the private sector, which reached $740 million during this period, an average of some $150 million a month. This is explained by the noticeable worsening of the sector's balance of payments deficit, which was due, as stated, to the rapid expansion of imports and primarily to the steep rise in fuel import prices. On the other hand, there was no significant change in the government's contribution to the growth of reserves compared with the previous period.

The Bank of Israel's gross foreign currency asset holdings totaled $3,158 million at the end of 1979, as against $2,956 million the year before. The difference between the gross and net figures mainly reflected the commercial banks' obligatory liquidity deposits with the Bank of Israel against nonresident deposits.

(c) **Government Accounts**

Bank of Israel credit to the government amounted to IL42.1 billion at the end of 1979, an increase of IL11.8 billion, compared with IL7.5 billion in 1978. The bigger rise in 1979 only incidentally reflected the larger amount of money pumped into the economy by the government. In order to estimate the government's influence on the economy's liquidity position in 1979, several adjustments have to be made: on the one hand, the interest and exchange rate differentials paid on the government's debt to the Bank of Israel (IL24.6 billion) increased the volume of credit but did not result in the injection of liquidity; on the other hand, the transfer of foreign currency raised by the government abroad for financing its local currency outlays (IL17.3 billion) and the transfer of Bank of Israel profits to the Treasury (IL9.7 billion in 1979) reduced the credit figure but did not absorb liquidity from

[3] It should be noted that when there is a floating exchange rate regime and the interest rates on the various currencies are adjusted to the expected changes in the exchange rates, the differentiation between interest income ($222 million) and exchange rate differentials ($43 million) lacks significance. An additional $43 million of accrued interest on foreign currency deposits and bonds is not included in this item in the Balance Sheet but is included in "Other accounts". This income does not reflect the steep rise in the price of gold, which is included in foreign exchange reserves (see note 1c to the balance sheet).

the public. After adjusting for these changes, the estimated amount of money put into the economy by the government through its activities came to IL14.8 billion this year, compared with IL10.8 billion in 1978.[4] (In the fiscal year 1979/80 the figure came to IL34.6 billion, or IL27.9 billion excluding the Jewish Agency.)

To examine the government's influence on aggregate domestic demand one must estimate the excess of its domestic expenditures over its revenue from taxes and other compulsory payments. This excess doubled from some IL21 billion in 1978 to IL40 billion, and even surpassed the 1979 annual average rise in the price level (78 percent). The deficit was financed, as usual, by Bank of Israel credit, foreign currency conversions, bond issues, and banking institution deposits with the Treasury.

The increase in credit to the government and that in its liquidity injection did not proceed at an even pace during the year, since they were influenced by fluctuations in the government's expenditures and in the timing of linked bond issues to the public, as well as by foreign currency transfer receipts from abroad. Until July the government's debt declined by IL16.9 billion; this found expression in the absorption of IL5.8 billion from the public — an average of IL800 million a month. A major factor in this absorption was the sizable volume of linked bond issues, demand for which was very strong during this period. In August there was a change of trend in the government's accounts: its expenditures rose sharply, while the absorption of money through bond issues came to a halt as demand for such securities fell off sharply. As a result of these developments, during the last five months of the year the government's liquidity injection reached IL20.6 billion, or some IL4 billion a month. The government debt rose during this period by IL28.7 billion, with most of the sum representing the charging of the government with some IL24 billion of linkage differentials on the last day of the year on account of its linked debt to the Bank of Israel.

(d) **Loans and Discounts**

This item, which totaled approximately IL80 billion at the end of 1979, consists of credit granted to the banking institutions in the form of loans and rediscounts, in the main for financing the Bank of Israel's participation in the export funds. Its participation grew during the year by about 140 percent to reach IL76 billion, of which IL66 billion was in foreign currency ($1,864 million) and IL9.5 billion in Israeli currency. This item also includes some IL1.2 billion of credit granted to banking institutions for financing the Bank of Israel's participation in directed credit funds for domestic activities. It should be noted that the changes in this component reflected only the Bank's share in the financing of the directed credit

[4] The estimated government liquidity injection in 1979 has an upward bias compared with 1978, since it includes sums related to Jewish Agency operations, in the amount of some IL6 billion.

funds (on the growth of total nondirected and directed bank credit to the public, see the section on "Bank Credit to the Public" below).

Another component of this item is a special credit granted to the banks from May onward to help them reduce their large liquidity deficiencies; at the end of the year the balance outstanding was IL3.3 billion. The provision of this loan was made conditional on the banks' restricting the growth of their nondirected credit in both local and foreign currency. This arrangement was one of the factors that helped to moderate monetary expansion during the year (see the review of monetary developments below).

Foreign currency credit expanded by about $425 million, or 30 percent, chiefly because of a $280 million (43 percent) growth in the financing of nondiamond exports. This high rate of increase mainly reflected the appreciable $207 million (54 percent) growth of the Export Shipments Fund; the Imports-for-Export Fund expanded by $74 million, or 31 percent—a rate consistent with the dollar gain in exports. That the Export Shipments Fund expanded faster than actual exports was due primarily to the fact that there was a greater utilization of this fund because of an increase in the subsidy element of such cheap credit. The latter development occurred despite the hiking of the interest charged by the funds, and is explained by the sharper rise in interest rates on nondirected foreign currency credit. This was one of the reasons for the formidable growth of the Diamond Fund this year—$144 million, or 18 percent—despite the drop in sales of polished diamonds and in imports of rough stones.

The increase in local currency credit, excluding the special loan to the banks, amounted to some IL5 billion this year. This reflected the rapid growth of directed export credit, most of which was extended through the Export Production Fund, the largest and most important of the funds providing exporters with local currency financing. The balance of the Bank of Israel's participation in this fund rose by some IL4 billion, or 103 percent. The other export funds also expanded appreciably. In contrast, the funds providing credit for domestic production did not grow this year following the decision taken in 1978 to freeze such financing and in compensation to permit more firms to cash in their Employers Loan certificates ahead of maturity (see the next section).

(e) **Securities**

The Bank of Israel's securities portfolio consists overwhelmingly of index-linked government bonds acquired in its capacity as the government's agent for the issue of such bonds and for regulating current secondary market trade therein. Since 1978 the portfolio also includes nonmarketable bonds (the Employers Loan and Defense Loans) which the Bank redeemed ahead of maturity for local firms after the freezing of directed credit for the domestic market.

Table XIX-2

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR ENDED DECEMBER 31, 1979

	Total assets and liabilities (IL million)				Assets and liabilities in or linked to foreign currency (in terms of U.S. $ million)			
	Balance on 31.12.78	Balance on 31.12.79	Increase		Balance on 31.12.78	Balance on 31.12.79	Increase	
			IL million	%			$ million	%
Assets								
Foreign assets	56,214	111,628	55,414	98.6	2,956	3,158	202	6.8
Government debt	30,290[a]	42,088[a]	11,798	39.0	1,348	740	-608	-45.1
Loans and discounts								
In foreign currency	27,354	65,888	38,534	140.9	1,439	1,864	425	29.5
In IL	5,731	13,998	8,267	144.3				
Securities	5,114	14,785	9,671	189.1				
Other assets	2,232[a]	5,781[a]	3,549	159.0	71	122	51	71.8
Total assets	**126,935**	**254,168**	**127,233**	**100.2**	**5,814**	**5,884**	**70**	**1.2**
Liabilities								
Banknotes and coins in circulation	9,747	13,763	4,016	41.2				
Foreign liabilities	2,238[a]	4,260[a]	2,022	90.3	118	121	3	2.5
Foreign currency deposits of the government and National Institutions	6,439	10,402	3,963	61.5	339	294	-45	-13.3
Foreign currency deposits of banking institutions in Israel	91,424	194,610	103,186	112.9	4,808	5,505	697	14.5
Against residents' deposits—restitution	50,150	100,250	50,100	99.9	2,637	2,836	199	7.5
Against residents' deposits—other	33,122	75,381	42,529	127.6	1,742	2,132	390	22.4
Against nonresidents' deposits	8,152	18,979	10,827	132.8	429	537	108	25.2

Deposits of banking and financial institutions in Israel	10,716	9,036	-1,680	-15.7				
Other liabilities	6,371[a]	22,097[a]	15,726		169	277	108	63.9
Total liabilities	**126,935**	**254,168**	**127,233**	**100.2**	**5,434**	**6,197**	**763**	**14.0**
Foreign exchange reserves held by the Bank of Israel[b]					**2,242**	**2,570**	**328**	**14.6**

Note: The notes at the end of the chapter are an integral part of the financial statements.

[a] Consists of sums in, or linked to, foreign currency and unlinked sums.

[b] Defined as gold, foreign exchange, and foreign securities, less deposits of foreign banks and foreign currency deposits of banking institutions in Israel against nonresident deposits (see notes 2 and 8).

Table XIX-3

CURRENCY IN CIRCULATION BY DENOMINATION, 1978-79

End of period	1978 IL million	1978 %	1979 IL million	1979 %
Banknotes				
IL5	55.3	0.6	28.9	0.2
IL10	272.0	2.9	322.5	2.4
IL50	405.2	4.3	386.6	2.9
IL100	3,566.6	37.7	2,797.4	21.1
IL500	5,163.5	54.5	9,711.1	73.3
Total	**9,462.6**	**100.0**	**13,246.5**	**100.0**
Coins				
1-500 prutot	2.0	0.9	2.0	0.5
1 agora	3.1	1.4	3.1	0.7
5 agorot	9.6	4.4	10.4	2.6
10 agorot	33.4	15.2	38.6	9.6
25 agorot	10.1	4.6	12.0	3.0
IL½[a]	30.7	13.9	37.4	9.3
IL1[a]	111.8	50.7	152.9	37.9
IL5	19.7	8.9	146.8	36.4
Total coins	**220.4**	**100.0**	**403.2**	**100.0**
Total banknotes and coins	**9.683.0**		**13,649.7**	
Commemorative coins	108.1		113.6	
Total currency in circulation	**9,791.1**		**13,763.3**	

[a] Includes banknotes still in circulation.

At the end of 1979 the revalued balance of the Bank's portfolio came to IL14.8 billion, an increase of IL9.7 billion, or 190 percent. This accelerated growth includes accrued interest and accumulated linkage differentials of IL5.5 billion on linked government bonds. Excluding these differentials (which were partly realized), the portfolio expanded by about IL4.2 billion. This sum includes IL1.6 billion of marketable government bonds acquired in the secondary market, while the balance consists of nonmarketable bonds acquired from local firms under the early redemption arrangement, the purchase of original-issue bonds in order to regulate trade in the series issued in 1979, and purchases from commercial banks under repurchase agreements. The purchases from banks include both nonmarketable bonds and frozen marketable bonds which in the past served as cover for savings scheme deposits reaching maturity, but which under the existing regulations cannot serve as cover for new savings schemes.

Most of the net secondary market purchases were made in October and November. During this period there was a large supply of bonds by the general public, mainly because of rumors about the possible worsening of the terms of linked bonds and jitters about a change in bond policy by the new Minister of

Finance. The Bank of Israel acted to moderate and stabilize the sharp downswing in the prices of such securities, for in periods of crisis and panic they sometimes fall rapidly and without any relation to the real value of bonds. This situation creates opportunities for speculative profits by institutional investors, but at the same time it results in losses to the less sophisticated saving public, thus impairing total private saving in the economy.

(f) Banknotes and Coins in Circulation

The amount of banknotes and coins in circulation reached IL13.8 billion at the end of 1979—an increase of IL4 billion, or 41 percent, similar to the 1978 figure. The rate of increase this year fell far short of the rise of prices in the economy (111 percent), but was fast relative to the growth of the total money supply, which came to only 21 percent. As a result, the share of currency in the money supply went up 6 percentage points, from 32 percent at the end of 1978 to 38 percent at the end of 1979. The more rapid growth of currency compared with the total money supply is explained by the fact that in a period of accelerating inflation money loses value and the public tries to increase its circulation velocity and to find substitutes for it. It seems, however, that the possibilities for doing this when inflation is worsening are relatively limited, for this entails day-to-day activity. In contrast, demand deposits have become more flexible, for since the foreign currency reform there is a close substitute for them in the form of resident foreign currency deposits, which preserve their value against the devaluation of the IL and are almost as liquid as local currency demand deposits.

Another striking manifestation of the aggravation of inflation was the continued rise in in the weight of the IL500 note—the largest one in use—from 53 percent of the total value of notes in circulation at the end of 1978 to 71 percent at the end of the year reviewed. This was mostly at the expense of the share of IL100 notes, which declined by 16 points to stand at only 21 percent. The share of IL500 and IL100 notes together thus came to 92 percent.

(g) Israeli Currency Deposits of Banking Institutions

Banking institution deposits in Israeli currency with the Bank of Israel totaled approximately IL9 billion at the end of 1979, IL1.7 billion less than at the end of the previous year (in real terms the drop was quite steep). This can be attributed to the stagnation of demand deposit holdings of the public, and while to some extent it was indicative of the monetary restraint that occurred during the year, in part it reflected the tendency of the public to switch part of its liquid balances to foreign currency deposits in the wake of the accelerated devaluation of the IL this year, and in part it also resulted from the purchase of foreign currency by the private sector to finance its larger balance of payments deficit on current account. It should be noted that the contraction of such deposits would have been larger still

Table XIX-4

INTEREST RATES PAID BY THE BANK OF ISRAEL ON IL DEPOSITS OF BANKING AND FINANCIAL INSTITUTIONS[a]

(Percentages)

	Breakdown of required liquid cover by interest rates paid				
	Total liquidity requirement	Interest rate steps (%)			
Type of asset		0	13	23	43
Ordinary demand deposits	60	15	45	—	Balance
Time deposits					
2-3 months	25	9	10	6	Balance
3-4 months	23	8	10	5	Balance
4-5 months	21	7	9	5	Balance
5-6 months	19	6	8	5	Balance
6+ months	17	5	8.5	3.5	Balance
Negotiable certificates of deposit					
3-6 months	26	8	13	5	Balance
6+ months	20	7	8	5	Balance

[a] Rates in force since December 31, 1979.

had the banks not been given a special loan to reduce their liquidity deficiencies, which, as stated, was made conditional on the restriction of bank credit.

The Bank of Israel pays interest on banking institution deposits subject to the liquidity regulations, at rates scaled up in accordance with the balance of the bank's account and its liquidity position. Besides the required liquidity on deposits of the public, the bank must hold 5 percent liquid cover on its outstanding nondirected credit in Israeli currency. The penalties for liquidity deficiencies are also scaled up according to their relative size and duration. During 1979 the penalties were raised in view of the acceleration of inflation and the hiking of domestic interest rates from 12-25 percent at the beginning of the year to 20-32 percent by year's end. As these outlays are not recognized as a deductible expense for tax purposes, the maximum effective interest rate reached some 120 percent (annualized quarterly interest rates, with allowance made for the loss of alternative interest due to the nondeposit of the funds with the Bank of Israel). Since the provision of credit in excess of the limits stipulated in 1979 involved the subtraction of an identical amount from the special low-interest loan granted to the banks by the Bank of Israel to cover their deficiencies, to total effective penalty rate reached such proportions as to curb the expansion of credit by more than the permitted volume.

(h) Foreign Currency Deposits of Banking Institutions

The banking institutions' foreign currency deposits with the Bank of Israel represent their required cover against three types of deposits: those of restitution recipients (Pazak and Tamam), other ordinary deposits (Patam), and deposits of nonresidents and new immigrants (Patach). The balance of these foreign currency deposits reached $5,505 million, equal to IL194.6 billion (about three-fourths of the Bank of Israel's total balance sheet). The increase in these deposits in Israeli currency terms came to IL103.2 billion (including revaluation increments), or 113 percent, compared with 87 percent last year.

The more rapid expansion in 1979 in Israeli currency terms was due to the accelerated devaluation of the IL. In dollar terms, the growth rate slowed to about 15 percent ($697 million), following a 51 percent increase last year. The slowdown occurred in all three deposit categories, and followed strong increases after the lifting of foreign currency control, which led to the diversion of large sums to such accounts, notably Patam (residents' deposits). This year there was a modest rise of 22 percent in ordinary residents' deposits, 25 percent in deposits of nonresidents and new immigrants, and only 8 percent in restitution deposits. In the case of restitution deposits, the deceleration was partly due to the transfer of some $100 million (about 4 percent) to ordinary Patam accounts following the abolition in May of the right of heirs to continue holding such accounts.

It should be noted that the changes described here reflected the fluctuations in the banks' obligatory deposits with the Bank of Israel against these foreign currency deposits of the public.

2. STATEMENT OF INCOME AND EXPENSES FOR 1979[5]

(a) Net Income and Its Appropriation

The Bank of Israel's net income for 1979 totaled IL14.7 billion, compared with approximately IL1 billion last year.[6] This sizable increase largely reflected the rapid rise in net revaluation increments (in IL terms) on the excess of foreign currency assets over foreign currency liabilities in the balance sheet, owing to the accelerated devaluation of the Israeli pound. In accordance with generally accepted accounting practice, these revaluation differentials were recorded as income in IL from the revaluation of foreign currency assets, and as an expense in IL on account of the revaluation of foreign currency liabilities. During the year foreign currency assets

[5] See note 1.

[6] As usual, income from linkage differentials and interest on government bonds that accrued but were not yet paid in the fiscal year corresponding to the financial year has been deducted from net income in accordance with the matched timing principle. These deductions amounted to IL3.3 billion and IL900 million in 1979 and 1978, respectively (see note 1a to the balance sheet).

far exceeded foreign currency liabilities,[7] with the result that income from this source exceeded the expenditures by IL11.1 billion. The Bank of Israel's net operating income, i.e. excluding revaluation, reached IL3.6 billion, compared with IL2.3 billion last year.

Net income for the year amounted to IL14.7 billion; of this, approximately IL5 billion was provided for increasing the Bank's capital and the general reserve, and the remaining IL9.7 billion was transferred to the Treasury. The Bank decided to expand its capital and general reserve, which had last been set in 1958; since they had not been adjusted for the rise of prices over the years, they had depreciated in real terms. The increases were made after the Bank of Israel Law was amended in 1978 to permit this. Most of the increase—IL4 billion—was made in the general reserve, since it provides cover for possible losses arising from exchange rate fluctuations in the major world currencies and from changes in the Bank's foreign currency revaluation balance. The Bank's capital was enlarged by IL1 billion.

(b) **Income**

Total income for the year was IL128.7 billion, as contrasted with IL29.1 billion in 1978. This substantial gain largely reflected the revaluation differentials on foreign currency assets in the wake of the accelerated devaluation of the IL this year (in accordance with generally accepted accounting practice, these differentials are treated as income). Less revaluation, income amounted to IL21.8 billion, as against IL8 billion in 1978. Following is an analysis of the main component items.

The largest item is interest on the investment of the Bank's foreign currency assets, which totaled IL8.1 billion ($265 million), compared with IL2.4 billion ($136 million) in 1978. The virtual doubling of this item in dollar terms was due primarily to the growth of the average balance of such assets this year and to the rise of interest rates on the world money markets.

Income from local and foreign currency loans and rediscounts totaled IL4.8 billion, compared with IL2.1 billion in 1978. This year too the rapid growth was mainly due to the continued accelerated rise in the annual average balance of such credit, and also to a small increase in the interest rate.

Income earned on the Bank's securities portfolio likewise rose strongly, from IL1.5 billion in 1978 to IL4.8 billion. These sums consist mainly of indexation differentials on government bonds, and the rapid rise in 1979 was due to the acceleration of inflation. It should be noted that, in contrast to previous years, a substantial part of such income was not included in the Bank's net income (see note 6).

[7] This excess vanished toward the end of the year as a result of the contraction of foreign exchange reserves and of the government debt linked to foreign currency at the expense of the unlinked component on the one hand, and the increase in the Bank of Israel's foreign currency liabilities to banks arising from the rapid growth of deposits of the public on the other hand.

The interest income on the government's debt declined from IL1.7 billion last year to only IL600 million. This is explained by the fact that in most months of the year reviewed the government did not have to resort to provisional advances from the Bank of Israel, and it even had a deposit balance with the Bank, on which it received interest. This expenditure was set off in the Bank's statement of income and expenses against interest received on the government's debt, which did not increase this year. (The interest on the government's long-term debt is very low since it is fully linked to a basket of currencies.)

Income from fines paid by banking institutions for liquidity deficiencies also went up sharply, from IL325 million in 1978 to IL670 million. This reflected both the growth of the average balance of the fines and the stiffening of the penalties imposed on the banks in order to induce them to reduce their deficiencies by restricting credit to the public.

Under the Bank of Israel's policy of slowing the growth of nondirected bank credit in both foreign and local currency by limiting its expansion and making it more expensive to the public (see below), two new items were added in 1979. The first is some IL1 billion of income from the special loan granted to the banking institutions to help them reduce their liquidity deficiencies, on condition that they restrict the growth of nondirected credit. The second item is IL1.9 billion in interest charged on foreign currency loans obtained from abroad by the public and the banks. To reduce such borrowing, the Bank of Israel made it 12 percent more expensive than the rate charged abroad (see the discussion of the Bank of Israel's monetary policy).

(c) **Expenses**

The Bank of Israel's expenditures in 1979 totaled IL110.8 billion, as against IL26.9 billion last year. This steep rise was largely due to the increase in revaluation differentials on foreign currency liabilities stemming from the accelerated devaluation of the IL (these differentials are recorded as an expense, in accordance with generally accepted accounting practice). The differentials consisted mostly of IL87.6 billion which the Bank of Israel paid on the commercial banks' required cover against their customers' foreign currency deposits. Excluding these differentials, the Bank of Israel's expenses totaled IL14.9 billion, as contrasted with only IL4.6 billion in 1978. Following is an analysis of the main expense items.

The largest item is interest paid on the commercial banks' obligatory liquidity deposits in foreign currency; this reached IL11.3 billion, nearly three-fourths of the total expenditure in 1979. The steep jump this year did not stem only from the continued rapid growth of the average balance of these deposits and the raising of the interest rates in line with their increase on the world foreign currency markets, for the growth of this item was greater than warranted by these two developments.

Another reason was that beginning in April 1979 the Bank of Israel paid the full interest on restitution deposits, whereas previously it had paid only a third, with the other two-thirds being paid by the government.

Interest outlays on the banking institutions' Israeli currency deposits with the Bank of Israel went up from IL900 million in 1978 to IL1.3 billion, owing to the raising of the interest rate on these deposits; the average balance of these deposits declined somewhat.

3. DIRECTED BANK OF ISRAEL CREDIT[8]

The granting of directed credit is the responsibility of the Credit Control Department of the Bank of Israel, which is assisted by committees comprising representatives of the various government ministries. The credit is actually provided by joint funds of the Bank of Israel and the commercial banks, and is intended primarily to meet the working capital requirements of export enterprises. Besides making financing available for preferred purposes, the credit contains a hidden subsidy in the form of a below-market rate of interest. Part of the export credit is granted in Israeli currency, at 26 percent interest, and another part in foreign currency (in the Diamond Fund interest is 8 percent and in most of the other funds 6 percent). Credit from the working capital funds is given in Israeli currency at 40 percent interest, and goes mainly to the industrial and agricultural sectors (except for the Employers Loan Fund, credit from which is linked to the consumer price index). For the sake of comparison it should be noted that in 1979 the market rate of interest was about 30 percent on nondirected credit in dollars (including a 12 percent surcharge) and approximately 100 percent for Israeli currency loans.

The relatively low interest rate on directed credit is made possible by the low rate charged by the Bank of Israel on its participation in the various funds. (For a breakdown of the funds' sources of financing and their interest rates see Table XIX-5.)

The balance of directed credit in Israeli and foreign currency provided by the export and working capital funds came to IL78.8 billion at the end of 1979, compared with IL36.9 billion the year before—an increase of IL42 billion, or 114 percent. The year reviewed saw a continuation of the rapid growth of directed export credit, in contrast to the shrinkage of credit for domestic activity. Outstanding directed export credit in foreign and Israeli currency came to IL75.9 billion at the end of 1979, up 122 percent on the previous year and 87 percent on an annual

[8] The data on directed credit in this section differ somewhat from those in Chapter XVI of this Report, since the figures here are based on the weekly liquidity statement for the last Wednesday of each month, whereas in Chapter XVI they are based on the reports for the last day of each month.

Table XIX-5

STRUCTURE AND TERMS OF DIRECTED CREDIT FUNDS, 1978-79
(Percentages)

	Sources of funds in 1978				Sources of funds in 1979			
		Bank of Israel				Bank of Israel		
End of period	Commercial banks	Liquidity exemptions	Rediscounts or loans	Interest rate in 1978	Commercial banks	Liquidity exemptions	Rediscounts or loans	Interest rate in 1979
Export funds in foreign currency								
Imports for export production	10.0	—	90.0	4.0	5.0	—	95.0	6.0
Regular export shipments	10.0	—	90.0	4.0	5.0	—	95.0	6.0
Special export shipments	10.0	—	90.0	9.0	5.0	—	95.0	11.0
Diamonds	—	—	100.0	8.0	—	—	100.0	7.94
Export funds in IL								
Export production	10.0	25.0	65.0	12.0	7.5	27.5	65.0	26.0
Citrus	10.0	25.0	65.0	12.0	7.5	27.5	65.0	26.0
Indirect exports	10.0	25.0	65.0	20.0	7.5	27.5	65.0	36.0
Working capital funds in IL								
Agriculture	40.0	10.0	50.0	24.0	—	—	—	—
Supervised farm credit	40.0	60.0	—	25.0	15.0	85.0	—	40.0
Assistance to agricultural settlements	40.0	—	60.0	28.0	15.0	—	85.0	44.0
Industry and crafts	40.0	10.0	50.0	24.0	15.0	35.0	50.0	40.0
Assistance to industrial enterprises[a]	40.0	—	—	28.0	15.0	—	25.0	44.0
General fund	40.0	10.0	50.0	24.0	15.0	35.0	50.0	40.0
Employers Loan Fund	—	10.0	90.0	—	—	10.0	90.0	—
Special fund for transport enterprises[b]	33.3	—	33.3	26.0	—	—	—	—

[a] Government deposit—60 percent.
[b] Government deposit—33.3 percent.

Table XIX-6

DIRECTED EXPORT CREDIT, 1978-79
(IL million)

	1978		1979		Percent increase	
	End-of-year balance	Average balance	End-of-year balance	Average balance	End-of-year balance	Average balance
In Israeli currency						
Export production	6,007	4,924	12,244	8,912	103.8	81.0
Citrus	930	570	1,720	962	84.9	66.8
Indirect export	345	313	451	382	30.7	22.0
Total	**7,282**	**5,807**	**14,415**	**10,256**	**98.0**	**76.6**
In foreign currency						
Imports for export production	4,588	3,468	11,000	7,554	139.8	117.8
Export shipments	7,088	5,194	19,772	11,751	179.0	126.2
Special arrangements outside the funds	423	325	731	531	72.8	63.4
Total, excl. Diamond Fund	**12,099**	**8,987**	**31,503**	**19,836**	**160.4**	**120.7**
In $ million	(636)	(514)	(905)	(781)	(42)	(52)
Diamond Fund	14,805	12,527	29,971	21,013	102.4	67.7
Total foreign currency credit	**26,904**	**21,514**	**61,474**	**40,839**	**128.5**	**89.9**
In $ million	(1,415)	(1,231)	(1,766)	(1,608)	(24.8)	(30.6)
Total credit from export funds	**34,186**	**27,321**	**75,889**	**51,105**	**122.0**	**87.1**

Source: Liquidity report of the banking institutions.

average. The increment reflected both the devaluation of the Israeli pound and the expansion of export volume in dollar terms. Directed credit for domestic activity declined 22 percent on an annual average to stand at IL2.1 billion; this was due to the policy of reducing such financing in favor of export credit.

(a) Export Funds

These funds finance all stages of export: production, through the Export Production Fund (in Israeli currency); the import of inputs through the Imports-for-Export Fund (in foreign currency); and shipments through the Export Shipments Fund (in foreign currency). In addition to these, there are two branch funds: the Diamond Fund (in foreign currency) and the Citrus Fund (in Israeli currency); the Indirect Export Fund assists enterprises supplying intermediates for export production. There are also special arrangements for export transactions requiring long-term financing.

The IL75.9 billion balance of directed export credit at the end of 1979 consisted of IL14.4 billion in Israeli currency and IL61.5 billion ($1,766 million) in foreign currency, of which some IL30 billion ($800 million) was in the Diamond Fund.

Directed export credit, as mentioned, continued to expand strongly during 1979. The balance of the funds providing finance in Israeli and foreign currency, apart from the Diamond Fund, grew during the year by 137 percent (103 percent on an annual average). This eclipsed the expansion of exports in currency price terms, and reflected a formidable 160 percent increase in credit from the foreign currency funds, as contrasted with a 98 percent rise in the Israeli currency funds. The foreign currency funds expanded by 42 percent in dollar terms, compared with a 30 percent gain in commodity exports (in current dollar terms). This rapid growth, most of it in the Export Shipments Fund and the Imports-for-Export Fund, can be attributed primarily to the greater utilization this year of the credit facilities available to exporters because of the increase in their subsidy component: the interest charged by these funds was raised by 2 percentage points during the year, but this fell short of the rise in world interest rates. Another factor contributing to the greater resort to these funds was undoubtedly the restrictions and the 12 percent surcharge imposed on nondirected foreign currency credit granted in Israel. A breakdown of the growth of directed export credit in Israeli currency shows a 104 percent increase in the Export Production Fund during the year (81 percent on an annual average), a more moderate 85 percent in the Citrus Fund, and a relatively low 31 percent in the Indirect Export Fund. This brought up the share of the Export Production Fund in such finance to more than 85 percent.

The Diamond Fund, as mentioned, also expanded strongly—at a 15 percent annual average rate in dollar terms. This stands out against the decline this year in both the industry's exports and its imports of rough stones; but the fund also finances the buildup of inventories without any close connection with the current trend of overseas sales. The increase in the subsidy component of such financing may also have stimulated recourse to this source of funds.

With the escalation of inflation and the rise of interest rates in Israel and the world in general, in 1979 the Bank of Israel followed a policy of bringing the interest charge on directed credit into line with the rise in the free market rates. Accordingly, the interest on directed Israeli credit was hiked during the year by 12 points to 26 percent. Toward the end of 1979 the Bank decided to scale up the interest charged by the export funds for Israeli currency credit to 40 percent of the basic rate charged by commercial banks on approved overdraft accounts, and in the case of foreign currency credit to 60 percent of the interbank rate in force for dollar credits. This system went into effect in the Diamond Fund at the end of 1979, while in the other foreign currency funds it will be introduced in April 1980.

Table XIX-7

DIRECTED CREDIT FOR DOMESTIC PRODUCTION, 1978-79
($ million)

	1978		1979		Percent increase	
	End-of-year balance	Average balance	End-of-year balance	Average balance	End-of-year balance	Average balance
Credit from working capital funds	**1,899**	**2,282**	**1,683**	**1,724**	**-11.4**	**-24.5**
Industry and crafts	432	617	453	473	4.9	-23.3
Agriculture	284	392	—	11	—	-97.2
Assistance to agricultural settlements	170	40	288	179	69.4	347.5
Supervised farm credit	289	280	425	482	47.1	72.1
General fund	82	86	68	82	-17.1	-4.7
Assistance to industrial enterprises	217	247	250	209	15.2	-15.4
Assistance to transport enterprises	10	24	—	3	—	-87.5
Employers Loan Fund[a]	415	596	199	285	-52.0	-52.2
Emergency credit	**162**	**212**	**68**	**108**	**-58.0**	**-49.1**
Trucks	85	122	22	51	-74.1	-58.2
Vehicle and equipment imports	77	90	46	57	-40.3	-36.7
Credit from outside the funds	**146**	**161**	**494**	**227**	**238.4**	**41.0**
Liquidity exemptions	12	11	83	41	591.7	272.7
Rediscounts in IL	134	150	411	186	206.7	24.0
Total directed credit for domestic production	**2,207**	**2,655**	**2,245**	**2,059**	**1.7**	**-22.4**

[a] Excludes linkage differentials.
Source: Liquidity report of the banking institutions.

(b) Working Capital Funds for Domestic Production

In 1978 the balance in the funds providing working capital for domestic production contracted, in accordance with the policy of the government and the Bank of Israel to restrict subsidized credit for domestic activity and to divert it to the export sector. The sharpest decline was in the agricultural working capital fund, while supervised agricultural credit and financing provided by the new fund established in the latter part of 1978 to assist agricultural settlements increased this year. There was a precipitous drop in the long-term funds set up after the Yom Kippur War for financing the import of trucks and equipment, which are presently being liquidated. There was also a steep drop in the Employers Loan Fund, which fell to half its 1979 level. To compensate for the reduction of directed credit for domestic uses, the Bank of Israel began to implement the arrangement for the purchase ahead of maturity of Employers Loan certificates from industrial and agricultural enterprises, hotels, building contractors, and public transportation companies, which had been eligible for directed credit. This arrangement is designed to bolster the liquidity position of these enterprises by providing them with working capital from the proceeds of the nonnegotiable Employers Loan certificates, while eliminating subsidized credit for domestic activity. In 1979 the Bank of Israel acquired some IL1.5 billion worth of certificates under this arrangement.

4. FOREIGN CURRENCY CONTROL

In September 1978 the control of foreign currency was transferred from the Ministry of Finance to the Bank of Israel, after it was recognized that this function ought to be performed within the framework of monetary policy, in coordination with the government's economic policy.

Foreign currency control is exercised at the Bank of Israel by two units: the Economic Unit and the Permits Unit. The former deals with changes in the blanket permit procedures for authorized dealers, informational activity, and the conducting of economic surveys and studies in relevant areas. The Permits Unit deals with applications which require a special permit, including investment in, or the establishment of, companies abroad.

(a) **Blanket Permit**

The blanket permit defines those activities which Israeli residents are permitted to undertake in foreign currency and with foreign residents. It was amended in 1979 in the light of economic and monetary developments in the course of the year, as follows:

1. Under the Bank of Israel's monetary policy designed to keep down foreign currency credit, a deposit requirement was imposed on foreign credit obtained directly from abroad. This raised the price of foreign currency credit by 3 percentage points at the beginning of the year, and since April by 12 percent, following the introduction of new and more stringent regulations (for a detailed analysis see Chapter XVI).

2. Deposits of restitution receipts (Pazak and Tamam) were merged into a single account called "residents' restitution deposits".

3. The permit for gold transactions distinguishes between four types of transactions: bullion for industry, bullion for investment or gold deposit certificates, gold coins for investment, and gold coins for collectors (numismatics). The change in this permit relates to the purchase and sale of bullion or deposit certificates and of gold coins for investment by Israeli residents. In these transactions the purchaser must deposit the gold physically with authorized foreign currency dealers. No changes were introduced in the permit for the purchase, sale, and possession of gold coins by Israeli collectors, which remain unrestricted.

4. With the abrogation of previous directives of the Foreign Department, nonresidents may no longer invest in approved savings schemes and social insurance funds in Israel.

5. In order to discourage the tendency to use dollars in transactions between local residents, beginning in February 1980 a ban was imposed on direct transfers of foreign currency from one local resident's deposit to another, except in the case of a special permit. At the same time the amount of foreign currency that a local resident may hold in his possession was reduced from the equivalent of $3,000 to $500; the difference may be held in traveler's or bank checks.

(b) Investment Abroad under Special Permits

Israeli residents are permitted to make financial investments, such as in foreign securities or gold without restriction, but only through an authorized dealer. Other investments abroad require a special permit from the Controller of Foreign Exchange; these amounted to $57 million in 1979, of which $48 million was by Israeli banks for the establishment of subsidiaries or in existing companies. The remaining direct investments were made mainly by companies promoting Israeli exports.

5. ADMINISTRATION OF STATE LOANS

(a) Issue and Redemption of Noncompulsory Government Securities

In 1979 the Bank of Israel issued IL22.9 billion of linked government bonds to the public and institutional investors, compared with IL13.7 billion in 1978.[9] In real terms the level dipped slightly in the year reviewed, since redemptions in 1978 were very high and a significant part of the proceeds was reinvested in bonds issued that year.

Net capital raised through noncompulsory bonds issued by the Bank of Israel (i.e. sales less redemptions at market value and interest payments) rose steeply this year to reach IL10.9 billion, compared with IL1.3 billion in 1978 and a negative figure in 1976 and 1977. This substantial growth was the result of the public's livelier demand in the first eight months of the year, due to the better bond and savings scheme terms offered, the introduction of new schemes, and the aggravation of inflation. The Bank of Israel's activities in the secondary market, which were aimed at regulating and stabilizing bond prices, also helped to promote sales of original-issue bonds. In the last months of the year sales to the public and for savings scheme cover tumbled owing to jitters that linked bond terms might be impaired by the new Finance Minister; the public rushed to shed part of its holdings, causing prices to plummet. During this period redemptions greatly exceeded issues, i.e. most of the redemption proceeds were not reinvested in bonds, but in the main went to buy foreign currency or were placed in other savings instruments or spent on consumption.

[9] The data in this section reflect the operations of the State Loans Administration but do not include issues by other financial institutions. These amounted to IL27.7 billion in 1979, compared with IL19.4 billion the year before.

About two-thirds of the government bond issues in 1979 were purchased directly by the general public, compared with 77 percent in 1978; most of these were bonds linked 80 percent to the index, with a 7 percent coupon. Their sales amounted to IL14.5 billion, as against only IL600 million of optional-linkage bonds with a 5 percent coupon. In view of the smaller volume of sales of the latter type, due mainly to their low interest rate, the Bank of Israel suspended their issue in December 1979.

In June 1979 the Knesset passed the State Loans Law, 5739-1979, which replaced the Development Loan Law, 5720-1960. The main changes in the new law are as follows:

1. Bonds may now be issued to the public at varying prices, which shall not exceed 106 percent nor fall below 96 percent of their nominal value.

2. The total amount of issues authorized is IL50 billion, but the Minister of Finance may, with the approval of the Knesset Finance Committee, increase this to IL60 billion.

3. Bonds may be now be issued by tender, but so far the Ministry of Finance has not requested the promulgation of regulations for such issues.

In July and August the Bank of Israel issued bonds linked 80 percent to the index and with a 7 percent coupon, at prices exceeding 100 percent of their nominal value. In the following months, when the market was depressed, bonds were again issued at face value.

This year the banks purchased more government bonds to cover savings schemes than last year owing to the requirement that they cover a certain proportion of the accumulation with marketable bonds offered also to the public. The banks purchased some IL250 million of original-issue double-option bonds[10] (to cover 20-40 percent of the accumulation in the dollar-option schemes) and IL2.6 billion of 80 percent index-linked bonds carrying 7 percent interest (to cover 13-23 percent of the accumulation in a new scheme launched in December 1978); the banks also acquired IL1.1 billion of a special nonegotiable issue designed solely for banks.

Apart from bank purchases to cover savings schemes, financial institutions bought IL3.8 billion of government bonds from the Bank of Israel in 1979, including IL1.7 billion against insurance company deposits and IL2.1 billion for social insurance and advanced-study funds.

Redemption of noncompulsory government loans dropped precipitately in 1979, to some IL1 billion face value, equivalent to IL11.9 billion redemption value;[11] this

[10] Linked either to the consumer price index or the dollar exchange rate.
[11] The difference consists of linkage differentials, interest, and linkage on accrued interest.

Table XIX-8

STATE LOAN ISSUES AND REDEMPTIONS, 1978-79[a]
(IL million)

	Interest rate	1978 Gross issues (1)	1978 Redemption of principal (2)	1978 Interest and linkage increments (3)	1978 Net issue (1-2-3) (4)	1979 Gross issues (5)	1979 Redemption of principal (6)	1979 Interest and linkage increments (7)	1979 Net issue (5-6-7) (8)
A. Medium- and long-term									
1. To the public and for savings schemes									
For 10 years, 80% index linkage	7.0, 6.0, 4.0	8,302	—	23	8,279	17,135	—	1,028	16,105
For 10 years, 90% index linkage	4.0	—	—	91	-51	—	—	160	-160
For 10 years, full linkage to index	4.0	—	—	294	-294	—	1	493	-493
For 10 years, double linkage option	5.0	2,349	—	—	2,349	846	—	176	670
For 6 years, full linkage to dollar	5.5	49	—	—	49	—	—	6	-6
For 8 years, 70% linkage to dollar	6.0	—	—	5	-5	—	—	4	-4
For 5 years, option-type	4.84	—	1,441	7,942	-9,383	—	634	4,093	-4,727
For 7 years, full linkage to index	6.5, 3.25	—	—	276	-276	—	260	2,979	-3,239
Absorption Loan	4.0	—	30	252	-282	—	30	407	-437
Other[b]	—	6	2	34	-30	—	9	11	-20
Total State loans	—	**12,223**	**1,555**	**9,874**	**794**	**17,979**	**933**	**9,349**	**7,688**

2. For savings schemes									
For 6 years, linked option	4.25	186	—	—	186	1,020	—	—	1,020
For 6 years, dollar option	5.0	32	—	—	32	55	—	—	55
3. For financial institutions									
For 17, 20 years, for social insurance funds	6.5, 5.0	390	9	212	169	2,104	16	430	1,658
Insurance Companies Loan	6.2, 5.8, 8.2	909	23	448	438	1,740	18	768	954
7½% Bank Defense Loan	7.5	—	50	297	-347	—	34	401	-435
B. Short-Term Loan[c]		**500**	**572**	**54**	**-126**	**205**	**281**	**40**	**-106**
C. Compulsory loans (redemption only)[d]									
Defense Loan 1970-73		—	30	199	-229	—	61	503	-564
Savings Loan 1970-72		—	457	1,754	-2,211	—	398	2,270	-2,668
War Loan 1973-74[e]		—	54	111	-165	—	61	430	-491
Cost-of-Living Allowance Loan		—	1	1	-2	—	1	2	-3
Total compulsory loans		—	**542**	**2,065**	**-2,607**	—	**521**	**3,205**	**-3,726**

[a] The data in this table were provided by the State Loans Administration; they do not coincide with the data appearing in the economic analysis of the bond market in Chapter XVIII.

[b] Includes loans under the Absentees' Property Law, unlinked loans, and other loans.

[c] Sales and redemptions by the Bank of Israel.

[d] Includes payments under the Compensation Interest on Compulsory Loans Law.

[e] Includes payments on account of voluntary war loans.

compares with IL1.6 billion face value and IL11.5 billion redemption value at current prices (IL20.5 billion at 1979 prices) in 1978, when a record volume of bonds reached maturity.

In March 1979 the Bank of Israel and the Ministry of Finance decided to discontinue the issue of the Short-Term loan following a long period of stagnation and lack of demand, during which short-term money flowed mainly to foreign currency, bonds, and negotiable certificates of deposit at commercial banks.[12]

(b) **Distribution and Redemption of Compulsory Loans**

The face value of compulsory loan certificates (the Savings, Defense, War, and Cost-of-Living Allowance Loans) distributed in 1979 came to IL845 million, as against IL837 million in 1978. These figures represent the value of certificates delivered to recipients through the mail or banking institutions. This year the distribution of Defense Loan certificates for 1970-73, Savings Loan certificates for 1970-75, and War Loan certificates for 1973-75 was continued, and distribution of the Cost-of-Living Allowance Loan certificates was completed. In 1979, 430,000 certificates were sent out, compared with 730,000 in 1978.

The Bank of Israel continued its efforts to locate those whose certificates had been returned in previous years. In 1979 it concentrated on the 1974 loans, with 172,000 certificates being remailed. For the convenience of the public, the Bank of Israel operates an efficient computer terminal system which provides up-to-date information on individual or company compulsory loan holdings.

In August 1979 redemption began of the following Savings Loan series: the last third of the 1973 Loan, the second third of the 1974 Loan, and the first third of the 1975 Loan. Total redemptions of the 1970-75 series amounted to IL398 million in 1979, equivalent to IL2,622 million redemption value (including accrued interest and linkage differentials), as against IL457 million and IL2,195 million respectively in 1978. In other words, there was a slight decline in nominal terms and a much greater one in real terms. In September 1979 the first interest coupon of the 1973 Voluntary War Loan and the 1973 War Loan fell due. By the end of the year IL148 million worth of coupons had been cashed in.

The Defense and War Loan Laws provide for the cashing in ahead of maturity of certificates in the case of the elderly and of heirs upon the death of the registered owners. In order to adjust the linkage increment for the accelerated inflation, the regulations concerning early redemption were amended, and since mid-1979 the increment is calculated on the basis of the index for the last month prior to redemption date. In 1979 early redemptions amounted to IL108 million face value or

[12] The gross interest on the Short-Term loan was only 22 percent when its sale was suspended; this was far below the domestic inflation rate or the rate of devaluation (the interest was liable to income tax at a limited 35 percent rate).

IL855 million redemption value, as against IL65 million and IL323 million respectively in 1978.

Because of the sharpening of inflation, the interest on late redemptions of compulsory loans was also changed: from 22 to 28 percent in April 1979 and to 40 percent in October 1979. Total interest payments on such redemptions (including the Absorption Loans) came to IL64 million in 1979, compared with IL16 million the year before.

Under the arrangement for the early purchase of nonnegotiable Employers Loan certificates to compensate for the reduction of subsidized credit for domestic purposes, the Bank of Israel in 1979 redeemed certificates with a face value of IL536 million and a currently adjusted value on the date of repurchase of IL1.8 billion; of this, IL524 million was in place of working capital credits (IL1.7 billion adjusted value) and IL12 million in place of conversions of development loans (IL81 million adjusted value).

(c) **Bank of Israel Open-Market Operations**

The Bank of Israel operates in the secondary bond market to stabilize trade in government issues and, taking into account the prevailing economic and monetary situation, to promote private saving by issuing bonds. In 1979 the Bank's Stock Exchange operations expanded as a result of more intensive activity in January-February and October-November; in the other months it did not intervene in the market to any significant extent.

In the first period (January-February) the Bank sold IL400 million worth of bonds (net) to the public on the Exchange, after the heavy demand for such paper in the secondary market caused it to be overpriced (in terms of adjusted value) compared with original-issue bonds. During this period the Bank accounted for 20-25 percent of total Stock Exchange trade.

In October-November the public disposed of an appreciable part of its holdings because of fears of a possible impairment of linked bond terms by the new Finance Minister. This wave of panic sales sharply depressed bond prices below their real value. In order to restore the public's confidence in this form of saving, the Bank of Israel acted to moderate and stabilize the precipitous drop in prices. It should be noted that a considerable portion of the sales proceeds went to purchase foreign currency, thereby drawing down the State's foreign reserves during this period. The Bank's purchases during these months amounted to IL2 billion, most of its at prices far below the bonds' real value; this brought up its share of Stock Exchange trade to a record 31 percent in November. These open-market operations, together with the disclaimers of the Minister of Finance and the Bank of Israel Governor of any intention to worsen bond terms calmed the market and brought an end to panic sales. The Bank of Israel thereupon stopped its net purchases on the Ex-

Table XIX-9

BANK OF ISRAEL OPEN-MARKET OPERATIONS, 1978-79
(IL million)

	Net purchases (-sales) on the Stock Exchange								Percent of total Stock Exchange trade
	Index-linked				Double option	Dollar-linked	Total	Total transactions	
	80%	90%	100%	Others					
1978	118	113	-219	-23	104	4	97	1,793	12
1979	1,921	40	-229	-29	-97	-1	1,605	6,104	16
January	-56	-1	-85	-9	6	—	-145	611	25
February	-140	-17	-99	-5	-9	—	-270	394	20
March	-11	-3	-6	—	-2	—	-22	75	5
April	10	-1	-2	—	-1	—	6	28	3
May	—	—	-2	-1	-1	—	—	20	1
June	-2	—	-1	1	2	—	—	23	1
July	-9	-2	-10	-4	-4	—	-29	44	2
August	—	—	-1	-1	-1	—	-3	36	2
September	-1	1	6	-1	-1	—	4	25	1
October	499	20	76	-1	16	—	610	637	14
November	1,541	21	-51	-10	-26	—	1,475	2,407	31
December	90	22	-54	2	-76	-1	-17	1,804	22

change in December 1979. In the remaining months—from March to October—its intervention was negligible.

(d) **Foreign Loans**

The Bank of Israel handles the conversion (redemption in local currency) of the Independence and Development Loans (Israel Bonds). The Bonds, which are issued abroad, can be converted (ahead of maturity) and redeemed in Israel by institutions, investors, tourists, new immigrants, and returning Israeli residents, in accordance with the conditions prescribed by the Controller of Foreign Exchange and the relevant regulations. Foreign loan conversions in Israel increased 12 percent in 1979 to stand at $147 million ($134 million principal and $13 million interest), compared with $132 million in 1978; in current IL prices, the figure came to IL3,755 million. The weight of conversions in Israel in total foreign loan redemptions declined from 52 percent in 1978 to 46 percent.

A breakdown of conversions by holder shows a continued increase by tourists, who accounted for 34 percent of the total ($50 million) in 1979, as against 27 percent ($33 million) in 1978. The share of institutions dropped from 57 percent ($69 million) in 1978 to 48 percent ($71 million). No significant changes occurred in the shares of new immigrants, returning Israeli residents, and investors.

Table XIX-10

COINS MINTED IN 1978/79

Coin	In Israel	Abroad	Total
1 agora	4,048,763		4,048,763
5 agorot	12,835,709		12,835,709
10 agorot	22,201,469		22,201,469
25 agorot	10,842,147		10,842,147
IL ½	21,403,170		21,403,170
IL1	10,615,464	24,200,000	34,815,464
IL5	5,638,428	32,000,000	37,638,428
Total	**87,585,150**	**56,200,000**	**143,785,150**

6. ISSUE OF CURRENCY AND COMMEMORATIVE COINS AND MEDALS

(a) **Trade Coins**

In 1979 half as many trade coins were issued as in 1978 due to two main reasons: the acceleration of inflation, which led to a smaller use of metal currency because of the "rounding" of prices, and the more extensive use of the IL5 coin (which was put into circulation in September 1978), at the expense of the IL1 coin.

(b) **Commemorative and Special Coins**

In 1979 the commemorative Independence Day coin marking the thirty-first anniversary of the State featured the theme "Mother of Children". It was minted in silver in B.U. and proof form—the former with a smooth and the latter with a milled edge. It is made of silver and copper (500/500), and the rim bears the inscription "31 Years of the State of Israel" in ancient Hebrew script.

In 1979 the Bank issued another in the series of Hanukka coins. The theme of the new coin is a nineteenth century Egyptian Hanukka lamp. The coin was issued in two forms: B.U. with a smooth edge, and proof with a milled edge. Its composition is silver and copper (500/500).

As in the past, the Bank issued a special mint set, identical to the trade coins in circulation, bearing the Hebrew date 5739, but with a mint mark in the form of a tiny Star of David. All seven currency denominations (1,5,10, and 25 agorot and IL ½, IL1, and IL5) were issued in this series of 31,700 units per denomination.

Table XIX-11

COMMEMORATIVE COINS ISSUED BY THE BANK OF ISRAEL, 1978/79-1979/80

Coin	Face value (IL)	Weight (grams)	Diameter (mm)	Amount issued B.U.	Proof	Total
1979 Independence Day	50	20	34	24,200	16,200	40,400
Hanukka 5740-1979	100	20	34	33,000	20,000	53,000

(c) **The Shekel**

On February 24, 1980 a new currency, the shekel, was introduced in Israel after two years of planning and preparation which culminated in 1979. The shekel is equal to IL10 and is divided into 100 new agorot; a new agora is equal to 10 old agorot. On the same day, old 1 agora, 5 agorot, and 25 agorot coins were canceled as legal tender, and can be exchanged at all banks.

The shekel banknotes have the same color, portrait, size, and design as the fourth series of Israeli pound banknotes; the differences are as follows: the denomination of the shekel is one-tenth that on the IL note; the signature of the Governor is that of Mr. Arnon Gafny, and the year of issue is 5738-1978. In this series banknotes have been issued with denominations of IS1, IS5, IS10, and IS50. A IS100 banknote bearing the portrait of Ze'ev Jabotinsky will be issued in the autumn of 1980.

The coins, on the other hand, were changed in form, composition, weight, and diameter; only the theme remains the same as in the IL series. Details of the new series of coins are given below

New coin	Diameter (mm.)	Weight (grams)	Composition	Edge	Equivalent value of former currency
1 new agora	15	0.6	aluminum	smooth	10 agorot
5 new agorot	18.5	0.9	aluminum	milled	IL ½
10 new agorot	16	2.1	bronze	milled	IL1
IL ½	20	3.0	nickel-copper	milled	IL5

The shekel and the Israeli pound will both be legal tender during a transitional period until the government announces the cancellation of the Israel pound.

(d) **Committee for the Planning of Currency and Commemorative Coins**

This committee assists the Bank in planning the banknotes, trade and commemorative coins, and medals to be issued, and recommends to the Governor of the Bank the designs that it has approved from among those submitted by competing artists. (The members of this committee are listed at the end of the chapter.)

7. SUPERVISION OF BANKING AND FINANCIAL INSTITUTIONS

(a) **Institutions Subject to Supervision**

The total number of banking and financial institutions supervised by the Bank of Israel did not change in 1979. The number of commercial banks grew by one after Kupat Aliya changed its status from a cooperative credit society to a commercial bank and became affiliated to the Bank Leumi group. This continued the previous years' trend of the amalgamation of cooperative credit societies with large banking groups; at the end of 1979 only two cooperative credit societies remained in operation.

At the end of 1979 there were 1,020 branches of commercial banks and cooperative credit societies, including head offices, and 23 agencies operating in Israel. During the year 21 new branches were opened, as well as three limited service branches and one agency. The number of branches in Judea, Samaria, Gaza Strip, and Golan Heights rose by three this year to stand at 31.

Israeli banking business abroad continued to expand in 1979, primarily through the purchase of foreign branches by subsidiaries of Israeli banks operating overseas. In addition, two banking subsidiaries were established and three new branches and one agency of Israeli banks opened.

(b) **Commercial Bank Audits**

In addition to the regular audits conducted by teams specializing in various aspects of banking, the examiners dealt with several major subjects. The main one was foreign currency transactions, in view of the rising weight of the foreign currency items in the public's transactions with the commercial banking system. Among the subjects dealt with were foreign currency credit granted to Israeli residents by local banks and their branches and subsidiaries abroad, the public's foreign currency deposits, and Israeli currency guarantees for foreign currency credit. Other subjects included an examination of the practice of value-dating various banking transactions, examination of the trade in negotiable certificates of deposit, examination of the various types of bond investments to cover bank savings schemes, and examination of the banks' intervention in the securities market with respect to their own issues.

Table XIX-12

BANKING AND FINANCIAL INSTITUTIONS UNDER BANK OF ISRAEL SUPERVISION, 1977-79

End of year	1977	1978	1979
Commercial banks[a]	21	25	26
Cooperative credit societies	5	3	2
Mortgage banks	16	16	16
Investment banks[b]	10	9	9
Financial institutions	12	10	10
Total	**64**	**63**	**63**

[a] Excludes four inactive banks, and the Israel Bank of Agriculture, which is defined as a commercial bank but operates mainly as an investment bank; includes the Maritime Bank, which is defined as an investment bank but operates mainly as an ordinary banking institution.
[b] Includes the Israel Bank of Agriculture but not the Maritime Bank.

(c) **Audits of Specialized Banking Institutions (Investment and Mortgage Banks)**

In view of the tight monetary policy carried out in 1979 and the various quantitative restrictions placed on commercial bank credit, audits of specialized banking institutions were stepped up in 1979 in order to ascertain that they did not deviate from their special fields. This year's audits concentrated on subjects related to the institutions' profitability, authorized deposits for the granting of loans, bookkeeping practices, and internal auditing. The unit dealing with investment banks drew up procedures for preparing two reports—one on income and expenses, and the other on sources and uses of funds. The unit dealing with mortgage banks laid down new procedures for the monthly and quarterly reports on assets and liabilities, which were adapted to the principles prescribed for preparing the annual balance sheet. A new annual report was also introduced for indexed balances by maturity date.

(d) **Monitoring Banking Institutions**

In 1979 the emphasis was placed on improving the monitoring of the commercial banks' quarterly growth, and real profitability estimates were made for the major banks. The required information on overseas branch banking was broadened to include further details on such matters as interbank deposits and the public's deposits by size, and an analysis was made of the branches' relations with the parent group in Israel. In accordance with the February 28, 1979 amendment of the Banking Ordinance, which requires a permit for the acquisition of, and a report on the possession of, more than 10 percent of the means of control of a bank, the initial reports were received and the control over banks was charted.

(e) **Research**

In addition to the preparation of the Annual Survey of the Banking System, memoranda on various banking matters, current surveys, and position papers on subjects that engaged the management of the Department of the Examiner of Banks, the research unit dealt with the following:

1. Capital adequacy in Israel's banking system:

2. factors influencing the concentration of the public's local currency deposits;

3. an empirical analysis of the relationship between future rates of exchange and actual rates applicable to transactions in selected currencies;

4. the cost of liquidity deficits to the commercial banking system and to the individual bank;

5. the adjustment of financial reports for inflation in large and medium commercial banks;

6. the reliability of reporting on selected balance sheet items received by telephone from the six largest banks;

7. substitutability between bank credit and suppliers' credit;

8. the effectiveness of the credit squeeze—a study of freezes imposed in the past.

Publications of the unit were as follows (in Hebrew only): *Issues in Banking*, No. 2, which features articles on various banking subjects; *Publications on Banking Subjects;* and *Multinational Banking.*

(f) **Information and Statistics**

1. In 1979 the first statistical annual was published; it presents data on the banking system between 1974 and 1978.

2. In order to reduce the number of bank reports, data on balances which previously were compiled and published by the Foreign Exchange Control Department in the Ministry of Finance will be incorporated in the reports prepared by the Department of the Examiner of Banks, beginning in 1980.

3. New monthly reports were introduced for foreign currency credits extended to local residents by and through the Israeli commercial banking system, according to original periods and periods remaining to maturity.

4. A quarterly report on foreign currency balances in the banking system by maturity periods was introduced.

5. A new system of reporting foreign currency receipts and payments, which will meet the requirements of both the balance of payments and foreign exchange control, is in preparation.

6. Teams from the research unit compiled samples of overdraft accounts (non-directed credits) and calculated the effective interest rates thereon.

The unit continued to publish the current monthly, quarterly, and annual publications.

(g) **Complaints of the Public**

In 1979, 1,304 complaints against banking institutions were received from the public, compared with 1,151 in the previous year, a growth of 13 percent.

Most of the complaints were about savings schemes, foreign currency accounts, and demand deposits (about 60 percent of all complaints). The main subjects were connected with savings scheme terms, interest and management fees, restitution deposit accounts, returned checks, and value-dating.

(h) **Interbank Clearinghouse**

In view of the increase in documents other than checks passing through the clearinghouses, and in order to reduce the number of documents which must be sorted by hand, the Clearinghouse Committee decided to define the types of documents which may be presented at the clearinghouses and to regulate their clearing process. These include checks, credit advices, and various other advices as defined.

In 1979 the total value of documents (checks, notes, and debit advices, excluding credit advices) which passed through the clearinghouses reached IL1,160 billion, compared with IL633 billion in 1978—a growth of 83 percent, as against 56 percent in 1978. During the year some 113 million documents were presented, as against 92 million in 1978—a 23 percent rise—while 8.2 million checks were returned—about 6.5 percent of the number presented, as against 4.8 million checks (5 percent) in 1978.

(i) **Advisory Committee on Matters Relating to Banking Business**

The committee continued to discuss the supervision of banks and various subjects relating to the banking system, including the amending of the Banking Ordinance to cancel the registration of a mortgage and the transfer of a controlling interest in a bank, changes in the rules concerning the granting of loans by mortgage banks, changes in the method of compiling information on the debts of large borrowers, publication of data on the effective cost of overdraft credit facilities, and amending of the guarantees order. The committee approved a circular on internal procedures concerning electronic data processing, which was drawn up following discussions in the committee on the fixing of standard procedures.

8. THE BANK OF ISRAEL AS REPRESENTATIVE OF THE STATE IN INTERNATIONAL FINANCIAL INSTITUTIONS

The Bank of Israel represents the State in all matters connected with its membership in the International Monetary Fund, the World Bank, and the Inter-American Development Bank. It keeps these institutions abreast of developments in Israel's economy, handles all financial transactions and operations with them, and actively follows the discussions and the decision-making process of their boards. Where matters of an overall economic nature are concerned, the Bank of Israel acts in concert with the Ministry of Finance; on matters of political significance it coordinates its activities with the Ministry for Foreign Affairs.

(a) **International Monetary Fund** (IMF)

The IMF, which is the central institution of the international monetary system today, conducts its business on three different levels: (1) it monitors developments in the international system of payments, with the aim of facilitating its proper functioning; (2) it holds annual consultations with all member countries on the state of their economies and current economic policies, with special emphasis on exchange rate policies; (3) it extends financial assistance to members experiencing balance of payments difficulties, making it conditional to the greatest extent possible on the implementation of corrective economic measures.

In 1979 Israel voted in favor of the seventh quota increase, which, upon its ratification by the required majority (expected toward the end of 1980), will bring its quota up from the present 205 million to 307.5 million Special Drawing Rights (SDR).[13] In December 1979 Israel purchased from the IMF, for the third time in the past three years, about 28,000 ounces of gold, for a total of about SDR 1 million (at a price of 35 SDRs per ounce). Such sales to all member-states were decided upon in 1976 as part of the Fund's efforts to reduce the role of gold in the international monetary system and to strengthen the positions of the SDRs and increase their use: this year SDRs were permitted to be used in forward as well as swap transactions and in donations. In January 1980 Israel received a new allocation of SDR 21.3 million, bringing its net cumulative allocation to SDR 85.5 million

The Fund's mission visited Israel in March 1979 to conduct the annual consultation with the authorities. The members of the mission met with leading economic figures and held technical discussions with Bank of Israel and Ministry of Finance officials. After its visit the mission drew up a report on the state of the economy, which was submitted to, and discussed by, the IMF Board of Directors. In addition, two IMF technical assistance missions visited Israel: one in June 1979 on

[13] The value of an SDR in 1979 was equal to an average of $1.29, as against $1.25 in 1978.

matters of banking statistics, and the other in March 1980 on administrative and legal matters connected with foreign exchange control.

As regards the third sphere of IMF activities—the use of Fund resources—despite its balance of payments position, Israel did not apply to the Fund in 1979 for assistance; however, in January 1980 it drew SDR 32.5 million of unconditional assitance from its reserve tranche.

In 1979 Israel repaid SDR 80 million, reducing the Fund's holdings of Israel's currency to SDR 429 million. Of this amount, 96 million represented outstanding repurchases of drawings under the old facility and 128 million under the compensatory financing facility. The remaining 205 million constituted Israel's quota in the Fund, from which, as mentioned, Israel drew 32.5 million of its reserve tranche, substituting its own currency for it, while SDR 172 million represented Israel's quota subscription in Israeli pounds (under certain circumstances this part of the quota may be used by the IMF to provide assistance to other members).

(b) The World Bank Group

1. *International Bank for Reconstruction and Development (IBRD)*

This intergovernmental institution primarily identifies, prepares, and finances development projects in developing countries, particularly in areas in which these countries are lacking in technical skills and available resources.

An increase in the World Bank's capital stock to about $40 billion is expected to be completed in 1980; the quota increase allocated to Israel should bring its share capital to about $210 million.

Israel itself is no longer eligible for aid from the Bank. In recent years the Bank has been phasing out developing members with a high per capita national income from the list of countries eligible for its aid, and Israel was the first to be stricken off the list. However, Israel continued to utilize the loans approved in earlier years; in 1979 this came to about $19 million, bringing the total up to $253 million out of the $284 million approved. The $31 million unutilized balance is earmarked for the completion of projects in highway construction (about $5 million) and sewerage (about $13 million), and for provision of industrial investment credit (about $13 million).

2. *International Development Association (IDA)*

This affiliated institution performs the same functions as the World Bank but grants aid only to the poorest nations on still softer terms. The sixth replenishment of IDA resources presently being made is expected to increase its capital from $21 billion to $32 billion. Israel's participation in the Association's resources has amounted so far to $2.1 million; like a large majority of the developing nations, Israel decided to participate in the present round in an amount required to maintain its voting power.

3. *International Finance Corporation (IFC)*

This World Bank affiliate promotes private investments in developing countries by providing loans as well as participating in share capital in cases where the availability of private capital on reasonable terms to the local investor is limited.

The IFC too decided upon a substantial increase in its capital, which is expected to bring the total up within three years from the present figure of $110 million to $650 million. Israel's additional participation has been set at up to $3.2 million, to be paid over four years (its present participation is only $50,000).

Like the World Bank, the IFC deleted developing countries with a high per capita national income, among them Israel, from the list of countries eligible for its aid.

4. *Inter-American Development Bank (IDB)*

This institution, which after the World Bank, is the largest international financial institution for socio-economic development, finances Latin American countries. In recent years the IDB has lent these countries approximately $2 billion per annum on preferential terms, to finance basic development projects in the countries' infrastructure, agriculture, industry, transportation, and energy. Israel joined the IDB in 1976 together with 15 countries from outside the region, most of them from Europe, in order to strengthen its economic ties with the region and to enable Israeli companies to expand their activities there through projects financed by the IDB. In 1979, under a decision by the IDB's members to increase the capital stock and the fund for special activities, Israel undertook to maintain its relative share in the capital stock and the fund; this will require an additional investment of some $6.5 million in 1980-84.

9. ECONOMIC RESEARCH

As usual, the Bank's Annual Report includes much of the current research on the Israeli economy conducted by the Research Department. Among the additional studies published during 1979 were the following:

(a) *Recent Economic Developments,* No. 28.

(b) The Governor's report on the increase in the money supply for the period between October 31, 1978 and December 31, 1978.

(c) The Governor's report on the increase in the money supply for the period between February 28, 1979 and August 31, 1979.

(d) Periodic internal surveys on monetary developments.

(e) *Economic Indicators*—a weekly publication.

(f) *The Economy of the Administered Areas, 1976 and 1977.*

(g) *The Economy of the Administered Areas, 1977 and 1978.*

In addition to current research, the Department carried out a number of basic studies of specific subjects, of which the following were published:

(a) *Corporate Finance under Conditions of Government Intervention: The Israeli Case, 1950-1972.*

(b) *Foreign Exchange Reserve Management: The Israeli Experience.*

(c) *Economic Review,* No. 51, which includes the following:

1. "An Evaluation of Israel's Reserve Portfolio Performance, 1972-1976."
2. "The Banking System in a Monetary Model of the Israeli Economy".

(d) *Economic Review,* No. 52 (English edition forthcoming), which includes the following:

1. "A Wage Function for Jewish Male Labor in Israel, 1968/69-1975/76".
2. "The Wage-Price Effect on the Composition of Private Consumption, 1956-77".
3. "The Demand for Gasoline in Israel, 1960-75".

The following studies have been completed but not yet published (the English titles are provisional):

(a) "Measured Productivity and Sources of Economic Growth in Israel, 1950-78".

(b) "The Effect of Inflation on Households in Different Population Groups".

(c) "The Inflationary Effect of Changes in the Exchange Rate".

(d) "The Reliability of Seasonal Adjustements: A Guide for the Perplexed".

(e) "Preadjustments for Holidays and Monthly Work Day in Time Series".

(f) "Consumption Demand Equations—Analysis of the 1968/69 and 1975/76 Family Expenditure Surveys".

(g) "A Demand Function for Imports".

(h) "Inclusion of Capital Subsidies in the National Accounts".

(i) "Cost-Inflation Prospects over Time".

(j) "Consumption and Real Balances".

(k) "Inflation, Floating Exchange Rate, and Monetary Policy".

(l) "Productive Factor Relationships in Israel's Foreign Trade, 1965-77".

(m) "Israel's External Debt, Its Significance, Forecast, and Analysis of Debt Remission: The Israeli Case".

10. ADVISORY COMMITTEE AND ADVISORY COUNCIL

As usual, most of the sessions of the Bank of Israel's Advisory Committee and Advisory Council were devoted to economic and monetary developments in general and to the Bank of Israel's policies in particular. In the early part of the year these two bodies discussed the various measures considered by the Bank to check the monetary expansion. The measures recommended were aimed primarily at keeping the growth of nondirected bank credit below the rate of inflation, and curbing the public's demand for credit by raising the real rate of interest on nondirected credit in both foreign and local currency. In the case of foreign currency this was achieved by imposing a 12 percent interest surcharge, and for Israeli currency credit by quantitative restrictions and stiffening the fines for liquid assets deficits.

Within the general framework of the policy approved by the Economic Cabinet in November, upon the recommendation of the new Minister of Finance, the Advisory Council discussed a number of stringent measures, including a freeze on foreign currency credit and the tightening of the restrictions on the growth of nondirected credit in Israeli currency.

The problem of the banks' liquidity deficiencies during the year was the subject of detailed discussion in the Advisory Committee, and in April it decided that the banks should be helped to reduce their deficiencies through the provision of a special Bank of Israel loan. This was made conditional on the banks' refraining from exceeding the nondirected credit ceilings set by the Bank of Israel. At the same time the liquidity ratios on demand deposits were lowered by 10 percentage points and the fines for liquidity deficiences were raised.

Besides discussing economic and monetary developments, the Committee and the Council dealt with general subjects connected with the central bank's activities, including the problem of indexation in Israel's capital market, the introduction of new savings instruments, the State Comptroller's report, and so forth.

The Advisory Council approved the planned issue of coins and banknotes during the year, as described in section 6 in this chapter. The Council approved the Bank's balance sheet and statement of income and expenses for 1978. It also endorsed the appointment of four committees for dealing with the following subjects: branch banking, foreign currency, dealing with a bank in financial difficulties, and examination of the Bank of Israel's administrative budget.

BALANCE SHEET AS AT DECEMBER 31, 1979

and

STATEMENT OF INCOME AND EXPENSES FOR THE YEAR ENDING DECEMBER 31, 1979

BANK OF

BALANCE SHEET AS

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	Notes	Dec. 31, 1979		Dec. 31 1978
Foreign assets				
Gold, foreign exchange, and foreign securities	2	110,291		50,934
Other foreign assets		1,337		5,280
			111,628	56,214
Government debt				
Long-term debt	3	26,673		26,134
Provisional advances		15,415		4,156
			42,088	30,290
Loans and discounts				
In foreign currency		65,888		27,354
In IL	4	13,998		5,731
			79,886	33,085
Securities	5			
Marketable		9,495		3,900
Nonmarketable		5,290		1,214
			14,785	5,114
Other accounts	6		5,781	2,232
			254,168	**126,935**

Note: The accompanying notes are an integral part of the financial statements.

ISRAEL

AT DECEMBER 31, 1979
million)

	Notes	Dec. 31, 1979		Dec. 31, 1978
Banknotes and coins in circulation			13,763	9,747
Allocations of Special Drawing Rights	7		2,989	1,062
Foreign liabilities				
Liabilities to the IMF	2	3,374		1,852
Other liabilities	8	886		386
			4,260	2,238
Foreign currency deposits of the government and National Institutions			10,402	6,439
Foreign currency deposits of banking institutions in Israel				
Against residents' deposits—restitution		100,250		50,150
Against residents' deposits—other		75,381		33,122
Against nonresidents' deposits		18,979		8,152
			194,610	91,424
Deposits of banking and financial institutions in Israel			9,036	10,716
Other deposits	9		1,999	1,298
Other accounts	10		12,109	3,991
Capital and general reserve	11		5,000	20
			254,168	**126,935**

STATEMENT OF INCOME AND EXPENSES FOR THE YEAR ENDED DECEMBER 31, 1979

(IL million)

	Notes	1979	1978
Income[a]			
From investments abroad		63,597	12,468[b]
From the government		24,606	8,181
From loans and discounts		31,969	6,532
From "liquidity loans" to banking institutions	4	1,040	
From banking institutions in respect of liquidity deficiencies		670	325
From securities	13	4,762	1,477
Interest on foreign currency loans to the public from local banks and from abroad	14	1,866	
Other income		206	93
Total income		**128,716**	**29,076**
Expenses[a]			
On foreign currency deposits of banking institutions in Israel	15	98,947	23,079
On IL deposits of banking and financial institutions in Israel		1,292	915
On foreign currency deposits of the government and National Institutions		5,219	1,250
On other deposits and liabilities		4,144	1,060[b]
Administrative and general expenses		772	407[b]
Printing banknotes and minting coins		382	151
Total expenses		**110,756**	**26,862**
Excess of income over expenses			
Before prior years' adjustments		17,960	2,214
Less: Prior years' adjustments			298
Excess of income over expenses		**17,960**	**1,916**
Less: Income from the government subject to matched timing	1a	3,296	908
Net income		**14,664**	**1,008**
Appropriation statement			
Transfer to general reserve	11	4,980	
Transfer to the government		9,684	1,008
Total		**14,664**	**1,008**

[a] Income and expenses include exchange rate and devaluation differentials on assets and liabilities arising from changes in the exchange rate of the IL. Net income includes IL11,057 million in exchange rate and devaluation differentials (in 1978: IL-1,263 million).

[b] Reclassified.

Note: The accompanying notes are an integral part of the financial statements.

NOTES TO THE FINANCIAL STATEMENTS, DECEMBER 31, 1979

(a) Accounting Policies

1. *Basis of Recording and Presentation*

Income and expenses are recorded on the accrual basis. Income from the government is recorded on the accrual basis, but is included in the net income of the Bank on a matched timing basis, i.e. the Bank includes in its net income for the financial year sums due from the government only when they are budgeted and paid by the latter in the fiscal year ending the following March 31. Income receivable from the government after March 31 of the following year is deducted in the Statement of Income and Expenses as "Income from the government subject to matched timing" and is included in the balance sheet in "Other accounts (liabilities)" (see also note 1h).

Accrued interest and other income are included in "Other accounts (assets)", except for accrued interest and linkage differentials on domestic securities, which are included in the balance sheet in "Securities". Accrued interest and other expenses are included in "Other accounts (liabilities)"

2. *Foreign Currency Accounts*

Assets and liabilities in foreign currency are translated into IL at the representative rates published by the Bank of Israel. The rate for the U.S. dollar on December 31, 1979 was IL35.3495 and on December 31, 1978—IL19.0151.

Special Drawing Rights (SDR) are translated into IL on the basis of the SDR-U.S. dollar rate, i.e. IL46.6012 per SDR on December 31, 1979 and IL24.8094 on December 31, 1978.

3. *Gold*

Gold is stated at the rate of SDR 35 per fine ounce.

4. *Foreign Securities*

These are stated at their foreign currency cost (weighted average purchase price) or market value, whichever is lower—calculated separately for each type of security.

5. *Securities Denominated in IL*

These are stated as follows:

Marketable bonds—at the adjusted value (nominal value plus accrued interest and linkage differentials) or market value, whichever is lower—calculated separately for each type of bond.

Nonmarketable bonds—at the adjusted value (nominal value plus accrued interest and linkage differentials).

Linkage differentials are calculated on the basis of the last consumer price index published before the balance sheet date.

6. *Premises and Equipment*

Bank premises and equipment (included in "Other accounts") are recorded at cost net of accumulated depreciation.

7. *Participation in International Financial Institutions*

The participation is included in "Other accounts (assets)" at cost. The cost includes amounts required to maintain the value of the participation in foreign currency terms, in accordance with the terms of the participation in the various institutions (for participation in IMF—see note 2).

8. *Employee Pensions and Severance Pay*

Provision for employee pensions and severance pay, which is actuarially computed and adjusted at the balance sheet date, is included in liabilities ("Other accounts").

Domestic securities in an amount equal to such provision have been earmarked against the employee pensions and severance pay liability. Income from these securities is not subject to matched timing, and is set off in the Statement of Income and Expenses against the increase in the liability.

(b) Gold, Foreign Exchange, and Foreign Securities: Liabilities to the IMF

This item includes IL224 million of holdings of Special Drawing Rights (SDR) in the IMF (on December 31, 1978: IL521 million) and the Reserve Position in the IMF amounting to IL1,470 million.

This Reserve Position balance, which may be drawn upon unconditionally, represents the excess of the quota over the liability on account of this quota.

On December 31, 1978 the liability to the Fund was IL56 million in excess of the quota, and this amount was included in "Liabilities to the IMF".

Accounts with the Fund are as follows:

	IL million		SDR million	
	Dec. 31, 1979	Dec. 31, 1978	Dec. 31, 1979	Dec. 31 1978
1. General Account:				
Quota in the Fund	9,553	5,086	205	205
Less: Liability	8,083	5,142	173	207
Reserve Position	**1,470**		**32**	
Net liability (drawings on credit tranche)		56		2
2. Liability o/a Compensatory Financing Facility	3,374	1,796	72	72

The government's liability to the Fund, amounting to SDR 152 million in respect of the Oil Facility and Compensatory Financing Facility, is not included in the accounts of the Bank (on December 31, 1978: SDR 197 million).

(c) Government Debt—Long-Term

This item consists mainly of: (a) IL25,004 million linked to the basket of foreign currencies, bearing unlinked interest of 5 percent per annum and repayable over the years 1983-2002; interest and linkage differentials are payable on December 31 of each year (the debt and its terms are the same as on December 31, 1978); (b) U.S. $33 million (on December 31, 1978: same amount).

(d) Loans and Discounts in IL

This item includes on December 31, 1979 IL3,345 million in Bank of Israel loans granted to banking institutions for reducing liquidity deficiencies, on condition that they restrict their advances and loans to the public.

(e) Securities

"Marketable securities" consist of government bonds, mostly linked to the consumer price index; their market value is IL10,254 million (on December 31, 1978: IL4,126 million).

"Nonmarketable securities" include mainly: (a) compulsory government bonds purchased from the public in accordance with the Government Loans (Sundry Provisions) Law, 5738-1977; (b) government bonds purchased from banking institutions under repurchase agreements, from their frozen saving schemes portfolios.

(f) Other Accounts (Assets)

This item consists mainly of (1) accrued interest and other income; (2) outstanding debt of the Israel-British Bank Ltd. (in liquidation) in respect of payments under Bank of Israel guarantees; (3) premises and equipment net of accumulated depreciation; (4) participation in the following international financial institutions: the International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Finance Corporation (IFC), and Inter-American Development Bank (IDB).

(g) Allocations of Special Drawing Rights

In 1979 an additional SDR 64 million were allocated to Israel by the IMF, payable in three equal annual instalments, the first of which was received in 1979. At the end of 1979 the balance amounted to SDR 64 million (in 1978: SDR 43 million).

(h) Other Foreign Liabilities

This item includes liabilities to international financial institutions amounting to IL426 million (on December 31, 1978: IL240 million), and deposits of foreign banks amounting to IL460 million (on December 31, 1978: IL146 million).

(i) Other Deposits

This item consists mainly of a deposit of the U.S.-Israel Binational Science Fund and deposits of the U.S.-Israel Binational Industrial Research and Development Fund.

(j) Other Accounts (Liabilities)

This includes mainly (1) accrued interest and other expenses; (2) income from the government subject to matched timing (see notes 1a and 13); (3) provision for employee pensions and severance pay.

(k) Capital and General Reserve

In 1979, IL4,980 million was transferred to the general reserve from net income and IL990 million was transferred from the general reserve to capital. The Bank's capital at the balance sheet date is thus IL1,000 million, and the general reserve—IL4,000 million (on December 31, 1978: IL10 million and IL10 million respectively).

The increase of the capital and the general reserve was made possible by the 1978 amendment to the Bank of Israel Law (amendment No. 11).

(l) **Contingent Liabilities**

The contingent liabilities are as follows: (1) uncalled amounts on account of shares and participations subscribed to international financial institutions—IL4,252 million (on December 31, 1978: IL2,287 million); (2) documentary credits—IL778 million (on December 31, 1978: IL502 million); (3) other liabilities—IL526 million (on December 31, 1978: IL283 million).

(m) **Income from Securities**

This item does not include income from securities held against the employee pensions and severance pay liability, and which partly covered the increase in the liability (see note 1h).

This item includes IL3,296 million income from securities subject to matched timing (in 1978: IL908 million); this is deducted from the excess of income over expenses—see note 1a. The accumulated income subject to matched timing is IL5,033 million (on December 31, 1978: IL1,737 million).

(n) **Interest on Foreign Currency Loans to the Public from Local Banks and from Abroad**

This item includes: (1) interest from banking institutions at a rate of 12 percent in respect of their foreign currency loans to Israeli residents; (2) interest from banking institutions at a rate of 17 percent on obligatory deposits with the Bank of Israel (these deposits constitute 30 percent of the loans received by the public directly from abroad).

(o) **Expenses on Foreign Currency Deposits of Banking Institutions in Israel**

The government's participation in interest expenditure on restitution deposits was terminated on April 1, 1979. In the first three months the participation amounted to IL314 million (in all 1978: IL1,688 million).

BANK OF ISRAEL

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MAY 31, 1980

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