



FINANCIAL HIGHLIGHTS FOR 2021

The Covid-19 Crisis and its Effect on the Financial Statements

In response to the global economic crisis resulting from the worldwide outbreak of the Covid-19 pandemic in early 2020 and congruently with other central banks around the world, the Bank of Israel exercised a series of tools designed to cope with the ongoing crisis to secure the regular operation of the domestic financial markets, facilitate credit terms in the market, and support its economic activity and financial stability.

The steps adopted in response to the crisis include buying government bonds in local currency; buying corporate bonds in local currency; providing the banking system long-term loans for extending credit to small businesses; entering into reverse repos as bond collateral; and entering into dollar/shekel swaps.

To achieve its monetary policy objectives and supporting the economy's recovery from the crisis, the Bank of Israel continued to use some of these tools in 2021 such as buying government bonds; providing long-term monetary loans; and entering into reverse repos.

The Bank of Israel also continued to purchase foreign exchange as a monetary tool used at the time of the crisis to sustain the Bank's objectives and the economic recovery from the Covid-19 crisis. In 2021, the Bank purchased a total of about \$34.8 billion.

In 2020–21, as a result of the use of the special market tools discussed above, the Bank's balance sheet increased by about NIS 369.1 billion, to about NIS 809.4 billion at the end of 2021, an increase of some 83.8 percent. The activity also affected the Bank's financial results, as reflected in the rise in the Bank's revenue from foreign exchange reserves and the local tools used, but also enhanced the Bank's exposure to exchange rate fluctuations due to the increase in its foreign exchange reserves. In 2020–21, the Bank incurred significant expenses in respect of exchange rate differentials due to the appreciation of the shekel against the other investment currencies.

In this context it should be noted that the Bank of Israel fulfills its duties as a central bank and acts to achieve its objectives as set forth in the Bank of Israel Law, 5770-2010 ("the Bank of Israel Law"); The Bank's activity for meeting its objectives and performing its functions is not aimed to maximize any profits but rather to maximize nationwide economic benefits.



Initial Adoption of IFRS

The financial statements have been prepared in conformity with International Financial Reporting Standards ("IFRS").

The Bank first applied IFRS in these financial statements as a step toward conforming to the accepted and updated international reporting framework which better reflects the prevailing business and economic conditions and enhances the readers' trust and the transparency of the Bank's financial reporting.

Before 2020, the Bank prepared financial statements in conformity with generally accepted accounting principles in Israel ("Israeli GAAP"), as adjusted to the special functions of a central bank¹. The main item presented in accordance with generally accepted accounting principles applicable to other central banks is revaluation accounts.

As per the Bank of Israel Law, unrealized gains² are not included in the Bank's net income³. Through the financial statements for 2020, these gains were not included in the Bank's net income but rather were carried to the revaluation accounts under the Bank's liabilities.

On the date of transition to IFRS reporting, unrealized gains from exchange rate differentials and from fair value revaluation of financial assets are included in the Bank's annual income. These amounts are then carried to the revaluation reserves in equity until they are realized. According to IFRS, changes in the actuarial calculation of employee benefit liabilities are carried to a capital reserve in Other Comprehensive Income.

The reconciliations of the annual income (loss) as per IFRS to the net income (loss) defined in the Bank of Israel Law, which is used to determine the profits that are distributable to the Government, are disclosed in the statement of Allocation of Profits (see Note 23 to the financial statements).

The Bank's Statement of Financial Position (Balance Sheet)

At the end of 2021, the Bank's Balance Sheet totaled approximately NIS 809.4 billion, an increase of about NIS 163.4 billion (about 25.3 percent) compared with the end of 2020. The increase in the Bank's Balance Sheet was mainly affected by foreign currency purchases and the increase in other assets in keeping with the steps taken by the Bank of Israel for contending with the Covid-19 crisis.

The increase on the asset side mainly results from the following:

- (1) An increase of approximately NIS 108.1 billion in "Total assets abroad", mainly owing to foreign currency purchases by the Bank in the context of

¹ As per Section 75 of the Bank of Israel Law, the financial statements are to be prepared "... in accordance with generally accepted accounting principles as adjusted to the special activity of a central bank".

² Gains on assets which the Bank keeps holding as part of its asset portfolio.

³ Section 76 of the Bank of Israel Law states that "the Bank's net income in the previous year, as presented in the annual financial statements, shall not include profits not yet realized as set forth the annual financial statements".



implementing its monetary policy and assisting the local economy following the crisis.

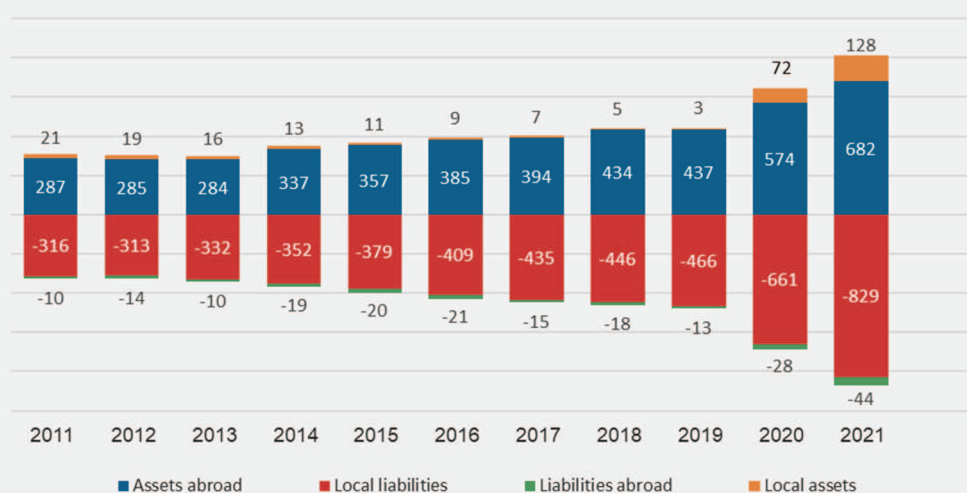
- (2) An increase of approximately NIS 55.3 billion in "Local assets", arising from the measures adopted by the Bank in response to the financial implications of the Covid-19 crisis consisting mainly of pursuing the plan to buy local currency government bonds at a scope of about NIS 38.5 billion and granting long-term loans to the banking system for extending credit to small businesses at a scope of about NIS 20.4 billion.

The increase in the Bank's assets as discussed above is mirrored by a corresponding increase on the liability side, with about NIS 137 billion carried to monetary absorption instruments— Short-term bills (*Makam*) and time deposits—arising from the need to absorb excess cash created in the markets from these purchases.

The composition of assets and liabilities in the Bank's financial statements is indicative of a major currency imbalance. The majority of the Bank's assets are denominated in foreign currency whereas the cast majority of the Bank's liabilities are denominated in NIS.

The increase in the Bank's Balance Sheet (Figure 1), which was mainly affected by the increase in foreign exchange reserves, aggravated the currency imbalance inherent to the Bank's Balance Sheet and the dependence of the Bank's profits on gains from exchange rate differentials and the degree of their volatility.

Figure 1
The Developments in the Bank's Assets and Liabilities, 2011-2021
(NISbillion)



Source: Bank of Israel



Foreign Exchange Reserves

In 2021, foreign exchange reserves grew by about NIS 105.2 billion to about NIS 662.4 billion, which is equivalent to about \$213 billion (Table 1).

The increase in foreign exchange reserves is mainly a result of dollar purchases in an aggregate of some NIS 112.1 billion (about \$34.8 billion) made by the Bank in the context of its monetary policy to support the achievement of the Bank's objectives and to help the Israeli economy to recover from the Covid-19 crisis.

The allocation of SDRs of the IMF enhanced the reserves by about NIS 8.4 billion (about \$2.6 billion) as part of the IMF's allocations in an aggregate of some \$650 billion to all member states in an attempt to increase global reserves, promote the stability of the global economy and assist underprivileged states in dealing with the economic consequences of the pandemic.

The private sector and the Government combined contributed about NIS 5 billion to the foreign exchange reserves.

Table 1
Contribution of sectors to the change in the foreign exchange reserves

	2021	2020	2021	2020
	NIS million		USD million	
Change in foreign exchange reserves	105,242	121,644	39,701	47,283
Bank of Israel				
Purchases	112,143	72,136	34,797	21,238
Profits	15,956	20,701	5,348	6,626
Exchange rate differentials	(36,307)	(25,186)	(4,672)	(3,743)
Other ¹	8,456	78	2,628	8,197
Total Bank of Israel	100,248	67,729	38,101	32,318
The Government²	(1,404)	52,195	(462)	14,634
The private sector³	6,398	1,720	2,062	331

¹ Includes the allocation of SDRs by the IMF in an aggregate of NIS 8.4 billion (about \$2.6 billion) and the Bank's payments and receipts in foreign currency.

² Transfers from abroad by the Government and national institutions.

³ Includes payment of the segment's income tax in foreign currency.



Gains from Foreign Exchange Reserves and Exchange Rate Differentials

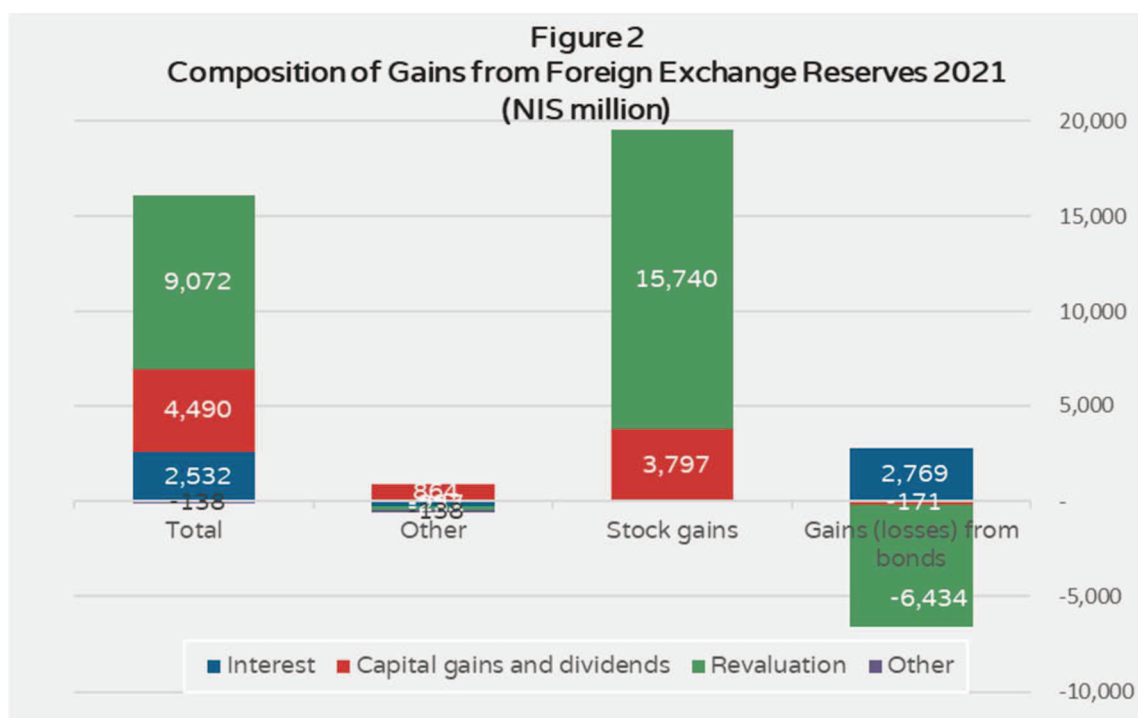
In 2021, gains from foreign exchange reserves, excluding exchange rate differentials, amounted to about NIS 16 billion (2020 - about NIS 20.7 billion).

The gains mostly derived from stock market increases in the year, mainly in the U.S. stock market which experienced the highest markups among the stock markets in which the Bank of Israel invests, and in which it invests in higher rates compared with other markets. The increases were a result of major improvements in corporate business profits recorded in 2021 as opposed to 2020 and the absence of investment alternatives due to low real returns⁴.

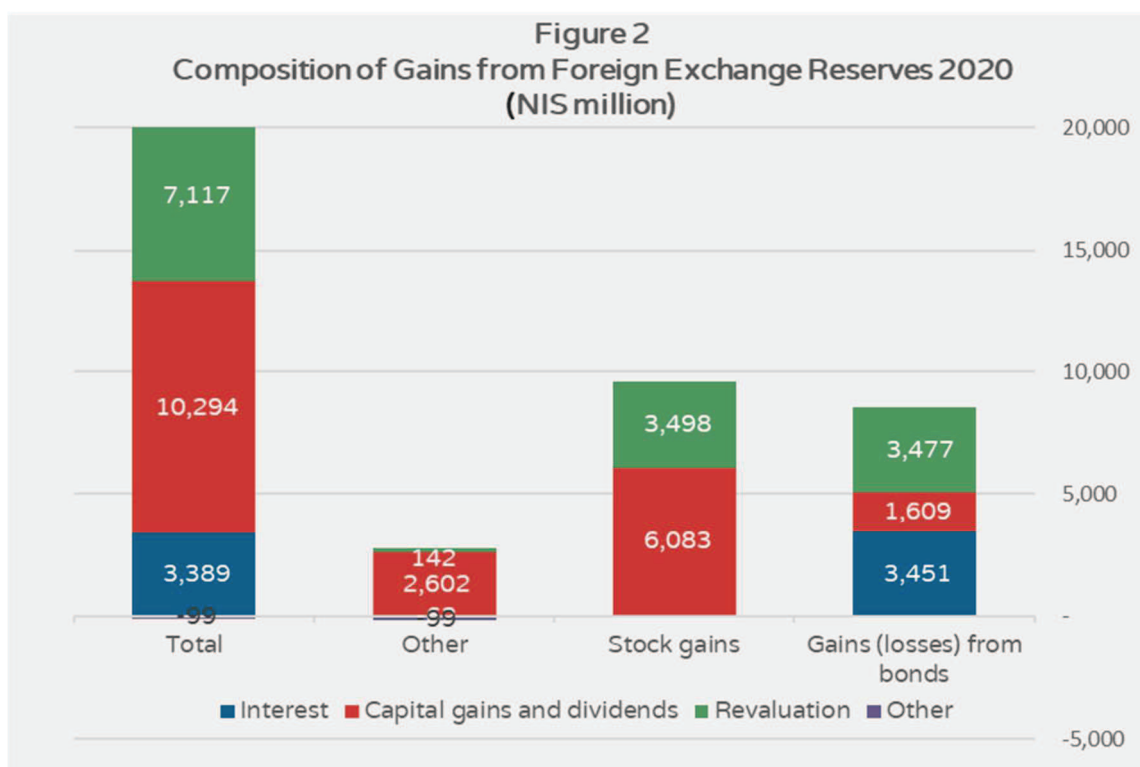
The increase in foreign exchange reserves was accompanied by a corresponding increase in the Bank's relative investments in risk assets. The return on risk assets is expected to be higher on average than the return on other less risky assets and enhances the expected return on the reserves. At the end of 2021, equity investments accounted for 18 percent of the reserve portfolio.

In contrast, in the year, the Bank recorded losses from bond revaluation due to the rise in yields towards year end.

The following figures present the composition of gains from foreign exchange reserves in 2020 and 2021:



⁴ See the Bank's report of foreign exchange reserve investments for 2021 issued separately from these financial statements.



In 2020, a substantial portion of the gains derived from stock portfolio realizations and to a lesser extent from bond realizations whereby both investment channels ended the year with revaluation gains.

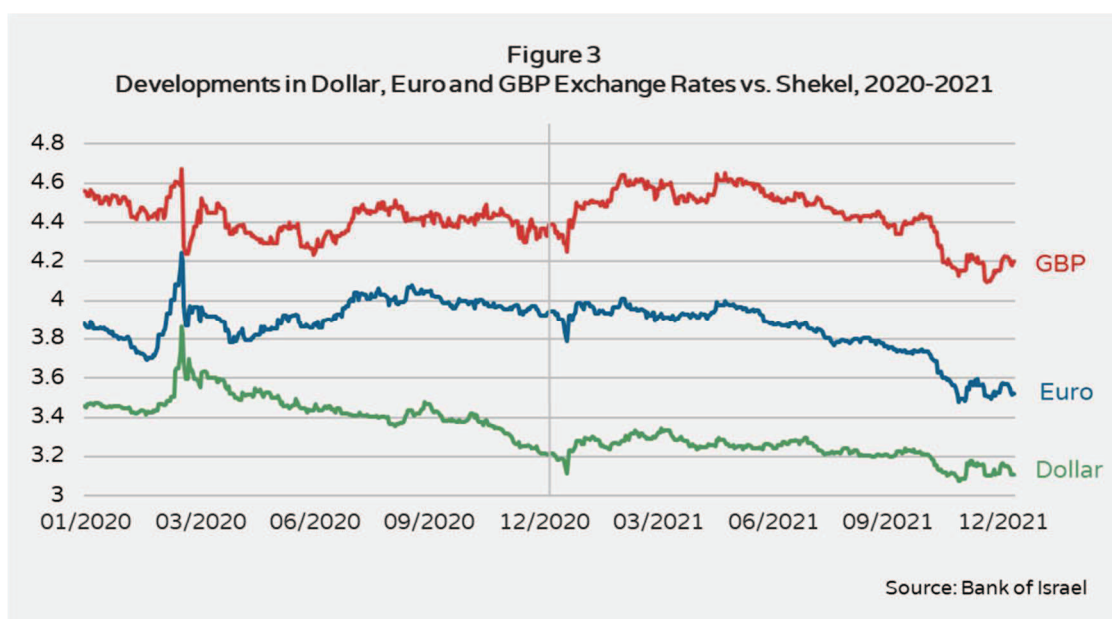
Exchange Rate Differentials on Foreign Exchange Reserves

The Bank's financial statements are presented in local currency and therefore, changes in the shekel exchange rate in relation to the currencies in which the foreign exchange reserves are denominated are likely to cause large fluctuations in the NIS value of the reserves. The Bank does not use any instruments to hedge the effect of these changes and accordingly the fluctuations are reflected in the Bank's profits.

Notwithstanding the aforesaid, due to the consistent increase in the Bank's foreign exchange reserves, substantially all gains from exchange rate differentials are not realized whereby changing trends in the shekel against the currencies underlying the reserve portfolio are likely to offset their effect.

In 2021, the Bank recorded losses of about NIS 36.3 billion from exchange rate differentials on foreign exchange reserves arising from the major appreciation of the shekel mainly against the euro and to some degree against the dollar. Offsetting these losses against NIS gains on foreign exchange reserves led to a negative return of about 2.9 percent in NIS terms.

(In 2020, losses from exchange rate differentials of about NIS 25.2 billion were recorded as a result of the shekel's appreciation, mainly against the dollar) (Figure 3).



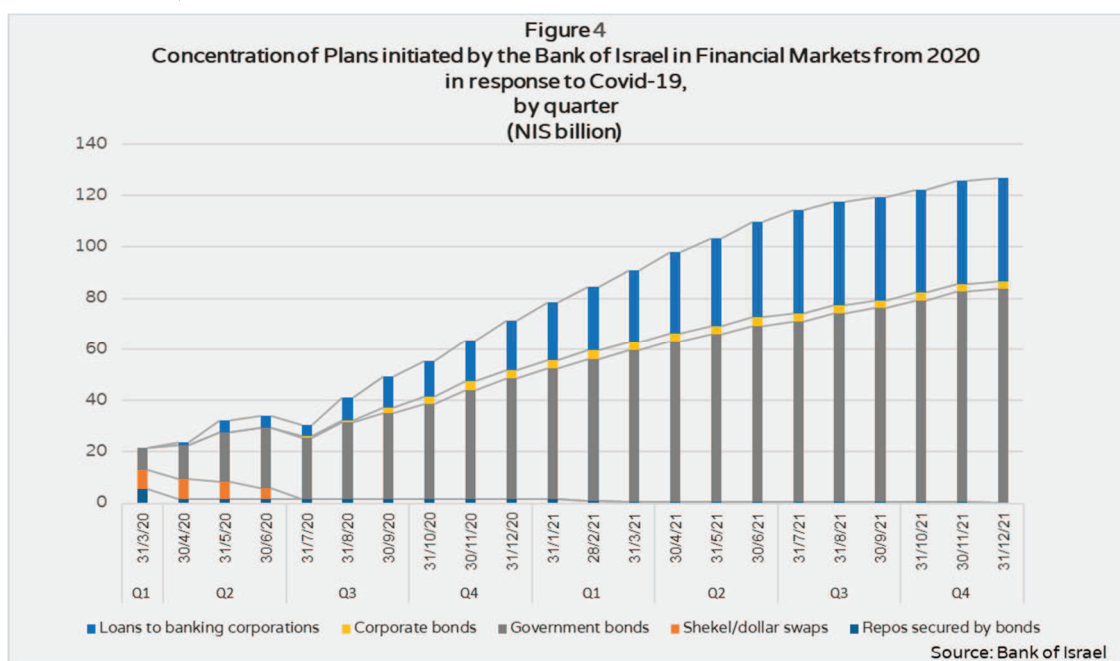
Local Assets

Against the backdrop of the global macroeconomic crisis arising from the outbreak of the Covid-19 pandemic in 2020, the Bank of Israel initiated several plans to address the financial system's cash distress caused by the crisis to ensure the operating continuity of the financial markets, facilitate market credit terms and support the economic activity and financial stability.

In 2021, the Bank continued to use some of the tools at its disposal to achieve the objectives of the monetary policy to support and sustain the local market's recovery such as buying government bonds; providing long-term monetary loans; and entering into reverse repos.

In 2021, an increase of about NIS 55.3 billion was recorded in local assets (Figure 4), deriving mainly from the following:

- (1) An increase of about NIS 36.6 billion in local government bonds as part of the purchase plan implemented in 2021 with related interest income amounting to NIS 0.9 billion.
- (2) An increase of about NIS 20.4 billion in loans granted to banking corporations for enlarging the credit facilities extended by the banks to small and very small businesses in the wake of the Covid-19 crisis with related interest income amounting to NIS 21.6 million.



Local Liabilities

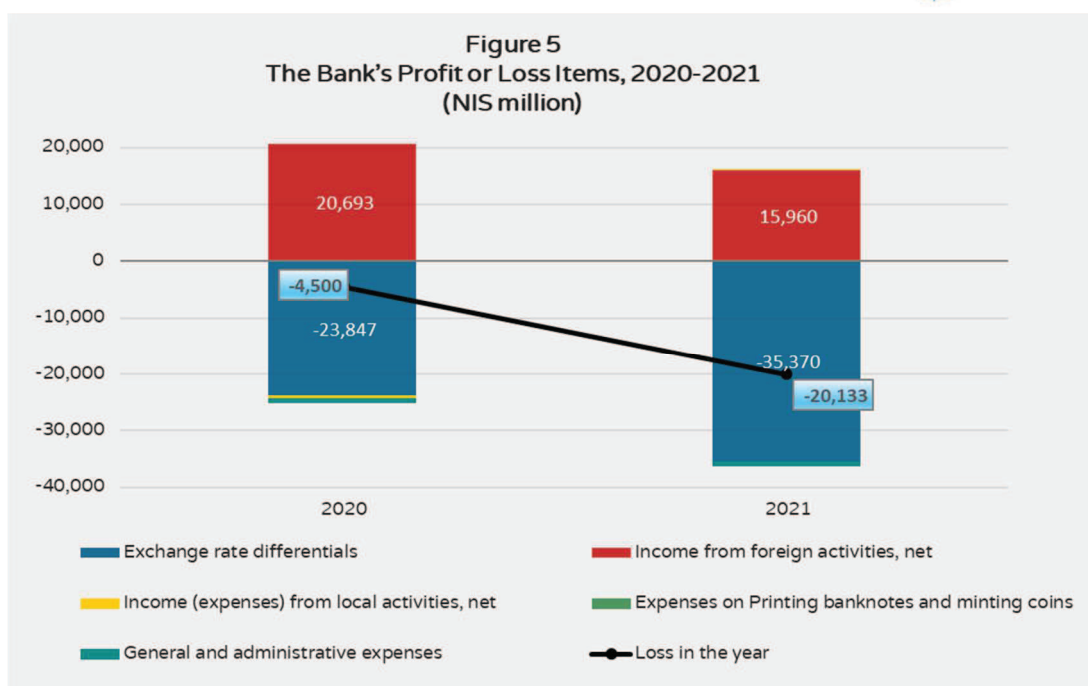
The majority of local liabilities consist of Short-term bills (*Makam*) and time deposits, monetary tools which are used to absorb excess cash in the market.

In 2021, *makam* and time deposits grew by about NIS 137 billion to NIS 589 billion. The Bank's foreign currency purchases in 2021 and the increase in local monetary tools exercised by the Bank in response to the crisis led to cash inflows in the market which were absorbed by the Bank. Despite the increase in these balances, the expenses in their respect decreased in 2021 by about NIS 81 million to NIS 453 million, mainly due to the decline in the average yields on *makam* in the year.

Statement of Profit or Loss

In 2021, the Bank recorded a loss of about NIS 20.1 billion (2020 – a loss of about NIS 4.5 billion). Gains from foreign exchange reserves without exchange rate differentials totaled about NIS 16 billion, mostly deriving from stock appreciation gains and partly offset by bond revaluation losses due to the increase in yields. In contrast, the main cause for the loss in the year in NIS terms is exchange rate losses totaling about NIS 35.4 billion as a result of the major appreciation of the shekel against the euro and dollar.

Figure 5 presents the main items of the Bank's Statement of Profit or Loss.



The Bank's Equity and Revaluation Reserves

At the end of 2021, the Bank's deficit equity and revaluation reserves totaled about NIS 63.5 billion, as opposed to about NIS 43 billion last year.

The Bank's year end accumulated deficit net of revaluation reserve transfers was approximately NIS 103.7 billion, as opposed to about NIS 74.3 billion last year.

The amounts transferred to revaluation reserves as per IFRS consist of changes in the Bank's actuarial accrual for employee rights arising from changes in actuarial assumptions and unrealized gains from fair value revaluation of assets included in the Bank's profit or loss but excluded from the net income which is used to determine the profits distributable to the Government as per the Bank of Israel Law. When these gains are realized, they are reclassified from the revaluation account and included in distributable net profits.

According to the Bank's former reporting framework, these unrealized gains were not included in the Bank's net income but rather in the revaluation accounts as part of the Bank's liabilities. Upon the transition to IFRS reporting in 2021, these reserves are included in the Bank's annual income and equity. It should be noted that this accounting change has no effect on the calculation of the profits distributable to the Government per law.

Revaluation reserves deriving from unrealized gains increased from NIS 27.3 billion in 2020 to NIS 36.2 billion in 2021. The main increase stems from unrealized stock appreciation gains offset by the impairment of foreign currency bonds at year end due to the decline in yields.