NOTES TO THE 2008 FINANCIAL STATEMENTS

1. Accounting policies

a. General

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

The main items presented in accordance with generally accepted accounting principles of central banks are:

1. Revaluation accounts, as detailed in Section 1.m below.
2. Local currency securities, as detailed in Section 1.g below.
3. Cash-flow statements, as detailed in Section 1.t below.

From this year, the Balance Sheet is shown in the format normally used by central banks around the world. Comparative figures for 2007 have also been reclassified.

b. Definitions

In these financial statements:

1. **"The Bank"**—the Bank of Israel
2. **"CPI"**—the Consumer Price Index as published by the Central Bureau of Statistics.
3. **"Adjusted amount"**—the nominal historical amount adjusted to the CPI in respect of December 2003, in accordance with the Provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.
4. **"Reported amount"**—the adjusted amount as at the transition date (December 31, 2003), with the addition of amounts in nominal values that were added after the transition date, less amounts subtracted after the transition date.
5. **"Nominal financial reporting"**—financial reporting based on reported amounts.

c. Financial statements in reported amounts

1. In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12, “Discontinuance of Adjustment of Financial Statements.” Pursuant to this standard and in accordance with Accounting Standard No. 17, was published in December 2002, the adjustment of financial statements for the effect of inflation was discontinued as of January 1, 2004.
2. In the past, the Bank prepared its financial statements on the basis of historical cost, with no adjustment for changes in purchasing power of the Israeli currency. In the financial statements for 2005, comparable figures for the year ending December 31, 2003, were recalculated on a historical-cost basis, adjusted for changes in the CPI as required by Accounting Standard No. 12, in order to prepare for the transition to nominal financial reporting.

   The adjusted amounts included in the financial statements as at December 31, 2003, constituted the starting point for the nominal financial report as of January 1, 2004. Any additions and disposals made during the period were included in their nominal values.
3. Amounts of non-monetary assets do not necessarily reflect their realizable value or current economic value, but only the reported amounts of such assets.
4. The term “cost” in these financial statements denotes the reported amount of cost.

d. Reporting principles

1. Balance sheet
   a. Non-monetary items (mainly fixed assets and investments shown at cost) are stated in reported amounts.
   b. Monetary items are stated in the balance sheet at their nominal values as of the balance-sheet date.
2. Statement of Operations
   a. Income and expenses originating in non-monetary items (e.g., depreciation, prepaid expenses, and deferred income) or from provisions included in the balance sheet are derived from the difference between the reported amount of the opening balance and the reported amount of the closing balance.
   b. All other operating items (such as interest income and expense) are stated at their nominal values.
3. Statement of changes in equity

   In accordance with the Bank of Israel Law, 5714-1954, the Bank must transfer its net profits to the government within 60 days of the end of its business year. The Bank of Israel incurred losses in 2008 and 2007. These losses were added to the accumulated loss, and therefore there was no obligation to transfer funds to the government.

e. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Bank's management to make estimates and assumptions regarding transactions or matters the final effect of which on the financial statements cannot be determined with precision at the time the statements are prepared. Even though the estimates and assumptions are based on management's best judgment, the final effect of such transactions or matters may be different from the estimates and assumptions made in their respect.

f. Income recognition

Income and expenditure are charged to the Statement of Operations on an accrual basis (with the exception of income from local currency securities—see Note 1g).

Realized profits and/or losses—profits and/or losses from foreign currency and foreign currency securities are transferred to the Statement of Operations. These profits or losses are calculated on the basis of average cost of the balances in that asset.

Unrealized profits are not transferred to the Statement of Operations; instead, they are charged to the "Revaluation accounts" line on the balance sheet.

Unrealized losses—losses originating in the difference between the average cost of an asset and its market value are charged to the "Revaluation accounts" line on the balance sheet. At year end, these losses are transferred to the Statement of Operations after offsetting unrealized profits in the same asset.

Unrealized losses from foreign currency securities or from a specific foreign currency are not offset against unrealized profits from other securities or foreign currencies.

Losses recognized in the Statement of Operations are not offset against unrealized profits accrued in the future.

g. Securities

Foreign currency securities

Tradable foreign currency securities are stated at their fair value as of the balance-sheet date. The fair value of quoted securities is based on market prices. Unquoted securities are revalued on the basis of data obtained from outside sources. Securities with maturity dates of up to three months are stated at an adjusted cost that constitutes a reasonable approximation of their fair value.

Interest and indexation income on foreign currency securities are charged to the Statement of Operations on an accrual basis and are shown in the "Interest income from financial assets in foreign currency abroad" item.

Unrealized losses are charged to the Statement of Operations at year end and are shown under "Other financial income from (expenses on) securities and derivatives." The adjusted cost of the securities is their nominal value plus interest, indexation differentials, and the balance of the premium or discount not yet amortized. The premium or discount is amortized over the period from the date of purchase until the date of redemption.

Income from the realization of securities is shown under "Other financial income from (expenses on) securities and derivatives."

Local currency securities

Tradable local currency government securities are stated in the balance sheet at their market value as of the balance-sheet date.

The difference between the market value of securities and their original cost is charged to the "Revaluation accounts" line on the balance sheet.

Income from tradable government securities is included in the Statement of Operations on a cash basis in accordance with the matched timing principle, according to which accrued profits from government securities not yet received in cash from the government are not included in the Bank's income.

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

h. International financial institutions

International Monetary Fund (IMF)

The Bank of Israel's participation in the IMF less its liabilities on account of its participation is shown on the Assets side of the "International financial institutions" item.

Special drawing rights (SDR) allocated by the IMF are shown on the liabilities side of the "International financial institutions" item.

Balances related to other international financial institutions and investment in shares of the Bank for International Settlements (BIS)

The Bank of Israel's participation in other international financial institutions includes initial participation in their capital and additional participation payments toward increases in these institutions' capital. The Bank of Israel's participation in other international financial institutions is shown on the Assets side of the "International financial institutions" item according to the cost in the currency in which the participation was paid, expressed at the exchange rate on the transaction date. Liabilities to international financial institutions are shown on the liabilities side of the "International financial institutions" item.

i. Fixed assets

1. Fixed assets are stated at cost less accrued depreciation. Cost includes expenses directly attributable to the purchase of the asset.
2. Improvements and enhancements are charged to the cost of the assets whereas maintenance and repairs expenses are charged to the Statement of Operations as incurred.
3. Depreciation is calculated by the straight-line method on the basis of the estimated useful life of the asset at issue:
   Buildings—fifty to sixty-seven years;
   Motor vehicles—six and a half years;
   Computers—four years;
   Equipment—ten years.
4. Purchases of fixed assets in insignificant amounts are charged to the Statement of Operations.
5. Software that is not an integral part of the related hardware is shown under fixed assets at cost depreciated by the straight-line method over four years.

j. Banknotes and coins in circulation

Banknotes and coins in circulation that were issued by the Bank reflect a liability on the Bank's part to their holders. The liabilities are shown in the Bank's balance sheet at their face value.

k. *Makam* (short-term bills issued by the Bank of Israel)

The balance of *makam* in the balance sheet reflects the par value (redemption price) of *makam* held by the public less the balance of the unamortized discount. *Makam* sold by the government to the Bank of Israel but not yet sold to the public are not included in this balance.

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

Expenses for amortization of the discount on the balance of *makam* held by the public are shown in the Statement of Operations in the "Interest paid to the banks and the public" item.

l. Liabilities on account of employees' entitlements

All liabilities on account of employer–employee relations have corresponding reserves in accordance with law, agreement, practice, and management's expectations. Liabilities on account of employee pensions and severance pay are calculated by an expert actuary using the method of estimation of cumulative benefits with probabilities taken into account on the basis of past experience. The discount rate applying to the reserves is set in accordance with the rate established in directives of the Supervisor of Banks, and the rate of future wage increase is estimated by the management. The vacation-pay provision is computed on the basis of accrued vacation days due as of the balance-sheet date. (See Note 15.)

m. Revaluation accounts

The revaluation accounts include unrealized profits from exchange rate differentials on balances denominated in foreign currency and unrealized profits from the revaluation of tradable securities in local currency and foreign currency to market value.

Separate revaluation accounts are maintained for each item (currency, security) and are transferred to the Statement of Operations when the item is fully or partly realized. No offsetting among different types of items is performed.

Any net loss in the revaluation accounts that originates in price differentials in foreign currency securities and exchange rate differentials on foreign currency balances is transferred to the Statement of Operations at the end of the year.

n. Foreign currency

Assets and liabilities denominated in or indexed to foreign currency are shown in New Israel Shekel (NIS) according to the representative rate of exchange as published by the Bank of Israel on the balance-sheet date.

Income and expenses in foreign currency are included in the Statement of Operations at the representative rates of exchange in effect on the value day of the performance of each transaction.

Exchange rate differentials arising from the adjustment of assets and liabilities due to changes in the exchange rate include realized and unrealized exchange rate differentials.

Unrealized exchange rate differentials are charged separately for each currency to the "Revaluation accounts" item. Realized exchange rate differentials are transferred to the Statement of Operations and are calculated on the basis of the average cost of the balances of the currency at issue. Realization is calculated separately for foreign currency assets and foreign currency liabilities in each calendar month and for each currency. A loss balance in the revaluation accounts at the end of the year is transferred to the Statement of Operations and is not offset against future unrealized profits. Unrealized losses in one currency are not offset against unrealized profits in other currencies.

The exchange rates are itemized below:

	December 31			Change	
	2008	2007	2006	2008	2007
		(NIS)		(percent)	
US$	3.8020	3.8460	4.2250	-1.1	-9.0
Euro	5.2973	5.6592	5.5643	-6.4	1.7
Special drawing rights (SDR)[a]	5.8561	6.0705	6.3510	-3.5	-4.4
First currency basket[b]	4.5214	4.9857	5.1489	-9.3	-3.2

a SDR rate is based on a weighted 4-currency basket consisting of US$, € , ¥, and £.

b First currency basket was in effect until July 31, 1986, and consisted of: US$ 0.3500; £ 0.1295; and € 0.4667.

o. Indexation

Assets and liabilities indexed to the Consumer Price Index (CPI) are shown according to the indexation terms determined for each balance.

Details of the Consumer Price Index follow[a]:

		December 31			Change	
		2008	2007	2006	2008	2007
			(points)		(percent)	
CPI	November	110.55	105.77	102.90	4.5	2.8
	December	110.44	106.40	102.90	3.8	3.4

a CPI is presented in points based on the 2002 average.

p. Interest rates

Rates of interest charged or paid by the Bank of Israel on the government's and the banks' local-currency balances are based on the Bank of Israel's interest rate or on prime.

	December 31			Change	
	2008	2007	2006	2008	2007
	(percent)				
Bank of Israel interest rate	2.50	4.25	4.50	-41.2	-5.6
Prime	4.00	5.75	6.00	-30.4	-4.2

q. Derivative financial instruments

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

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

   a. **Future remittances of *makam***

   Outstanding liability for future remittance of *makam* as of the date of the financial statement corresponds to or approximates its fair value and is presented at par (redemption price) in Note 18, "Contingent liabilities and special commitments." Receipts on account of future issues of *makam* are shown in the balance sheet under "Other liabilities."

   The Bank discontinued its activity in future remittances of *makam* on August 14, 2008.

   b. **Reverse repurchase agreements (R.Repo) for *makam* and government bonds**

   In October 2007, the Bank of Israel started performing R.Repo transactions in *makam* and government debentures. These transactions are treated as secured debt; accordingly, securities purchased within the framework of these transactions are not shown on the balance sheet.

   Interest income accrued on account of these transactions is shown under "Other income."

   c. **Forward NIS/US$ conversion transactions**

   These transactions are shown net under "Other assets" or "Other liabilities": future receipt of US$ less future remittance of NIS.

   In the Statement of Operations, the results of the transactions are shown under "Other financial income from (expenses on) securities and derivatives."

2. Financial instruments in activities abroad

a. Repurchase (repo) and reverse-repurchase (reverse repo) agreements

The Bank carries out repurchase (Repo) agreements. Such a transaction is composed of the sale of securities under an agreement to purchase them in the future. The transaction is treated as a secure debt; accordingly, the securities sold under its terms are not subtracted from the Bank's assets. The repo liability is included in the "Foreign currency financial liabilities abroad" item. In the Statement of Operations, the results of these transactions are shown in the "Interest expense on financial liabilities in foreign currency abroad" item.

The Bank also carries out reverse Repo (R.Repo) agreements. These transactions are treated as a secure debt, and are included in the "R.Repo agreements" item. Securities purchased within the framework of these transactions are not shown on the balance sheet. In the Statement of Operations, the results of these transactions are shown in the "Interest income from financial assets in foreign currency abroad" item.

b. Foreign currency swaps

These transactions are included in the balance sheet in the sum of the difference between the foreign currency received and the foreign currency to be remitted in the future and are shown in net form in the "Derivative financial instruments" item.

In the Statement of Operations, the results of these transactions are included in the "Interest income from financial foreign currency assets abroad" item.

c. Futures

The balance of futures contracts at market prices on the date of the financial statement is given in Note 18, "Contingent liabilities and special commitments." In the Statement of Operations, the change in the value of the contracts is recorded under "Other financial income from (expenses on) securities and derivatives."

r. Offsetting financial balances

Financial assets and liabilities are presented in the balance sheet in net amount only when the Bank has a legal and enforceable offsetting right, and when it is intended to settle the asset or liability on a net basis or to realize the asset and settle the liability simultaneously.

s. Impairment of assets

The Bank applies Accounting Standard No. 15—Impairment of Assets (hereinafter: the Standard), which establishes procedures that the Bank must apply in order to ensure that its assets in the balance sheet (to which the Standard applies) are not stated in an amount greater than the recoverable amount, i.e., the net sale price or the usage value (the present value of an estimated future cash flow expected to derive from the use and realization of the asset), whichever is higher.

The Standard applies to all balance-sheet assets except for financial assets. The Standard also lays down presentation and disclosure rules for assets that have been impaired. Wherever the value of an asset exceeds its recoverable amount, the Bank recognizes an impairment loss in the amount of the difference between the book value of the asset and its recoverable amount. A loss recognized in this manner is annulled only if changes occur in the estimates that were used to determine the recoverable amount of the asset from the date on which the last loss from impairment was recognized.

t. Cash-flow statements

These financial statements do not include cash-flow statements because such statements provide no significant information beyond that appearing in the financial statements; this practice also corresponds to the general practice among central banks worldwide.

u. Taxes

According to the Bank of Israel Law, 5714-1954, concerning the payment of taxes, the Bank is tantamount to the State of Israel and, therefore, is exempt from paying certain taxes such as income tax and capital-gains tax.

2. Financial foreign currency assets abroad

(see section a below)

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		($ million)	
Demand deposits	4,234	1,074	1,114	279
Short-term deposits	-	20,340	-	5,289
Tradable securities	154,894	97,811	40,740	25,432
Reverse repurchase agreements	2,457	1,210	646	315
Derivative financial instruments[a]	-	5	-	1
Total	**161,585**	**120,440**	**42,500**	**31,316**

[a] Derivative financial instruments are shown net, i.e., future foreign currency liabilities minus future foreign currency assets (see Note 1.q.2).

Financial foreign currency liabilities abroad

(see section a below)

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		($ million)	
Securities sold under repo agreements	-	10,983	-	2,856
Derivative financial instruments[a]	620	-	163	-
Total	**620**	**10,983**	**163**	**2,856**

[a] Derivative financial instruments are shown net, i.e., future foreign currency liabilities minus future foreign currency assets (see Note 1.q.2).

a. Foreign-exchange reserves

In economic terms, as cited in the Explanatory Remarks, the reference to foreign exchange reserves includes the net balance of Repo transactions and derivatives. These balances consist of the balance of the "Financial assets in foreign currency abroad" item less the balance of the "Foreign currency financial liabilities abroad" item.

The currency composition of these balances corresponds to that of their possible uses. These uses, which also constitute a basis for the determination of the desired level of the reserves, are the sale of foreign currency to the government to service its debts and finance emergency imports; use of the reserves for the management of the Bank of Israel's policies relating to the stability of the banking system and the foreign currency market; and use of the reserves as an instrument for the implementation of monetary policy. (The yields on the foreign exchange reserves are shown in Table 2 in the Explanatory Remarks.)

The composition of the foreign exchange reserves is shown below:

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		($ million)	
Foreign currency financial assets abroad	161,585	120,440	42,500	31,316
Foreign currency financial liabilities abroad	(620)	(10,983)	(163)	(2,856)
Total foreign exchange reserves, net	**160,965**	**109,457**	**42,337**	**28,460**

3. International Monetary Fund (IMF)

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		(SDR million)	
International Monetary Fund (IMF) quota	5,436	5,636	928	928
Minus liability for the quota[a]	(4,766)	(5,267)	(814)	(867)
Total[b]	**670**	**369**	**114**	**61**

[a] The balance of the liability to the IMF is in notes and deposits.

[b] The surplus of the reserve tranche over the “basic sum” of SDR 33 million bears interest at a rate set by IMF from time to time. The annual rate of interest on December 31, 2008, was 0.82 percent (on December 31, 2007 – 3.50 percent).

International Monetary Fund (IMF)

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

The IMF quota

Each member country of the International Monetary Fund has a quota for its participation in the Fund’s capital. The quota is determined according to the country’s economic indicators (national income, exports, balance of payments, level of reserves) and it also determines the country’s voting rights. The part of the quota that is paid in cash (the reserve tranche) is transferred to the Fund in foreign currency and may be withdrawn by the country; the rest is deposited with the country's central bank in deposits and notes indexed to Special Drawing Rights (SDR).

Until 1998, Israel drew down its reserve tranche and put up against this withdrawal a non-interest-bearing deposit in favor of the Fund. In the latest increase in members' participation (1999), Israel's quota was increased by SDR 262 million. The foreign currency payment for this increase, approximately SDR 66 million, was deposited with the Fund and has not been withdrawn by Israel.

The IMF Financial Transaction Plan

Israel has been taking part in the IMF's Financial Transaction plan since 1999. The plan is a mechanism through which a member country can exchange SDR or foreign currency against its local currency and another country is asked to execute a counter-exchange. The request to exchange foreign currency is passed on by the Fund on short notice. The IMF manages the sums transferred and received in these transactions in such a way that the share of the reserve tranche in the quota of each member country that participates in the plan remains similar. Until 2004, Israel's reserve tranche balance increased gradually due to transfers of foreign currency from Israel to other countries. In subsequent years, the Fund transferred foreign currency to Israel. In 2008, Israel's reserve tranche was increased by SDR 53 million. (In 2007, it was reduced by SDR 21 million.)

4. Credit to the government

Credit to the government is composed of foreign-currency and local-currency balances.

	December 31	
	2008	2007
	(NIS million)	
In foreign currency (see section a below)		
Long-term indexed advances (see section c below)	985	1,597
Binational funds	126	127
Total foreign-currency credit to the government	**1,111**	**1,724**
In local currency (see section b below)		
Current credit	-	5,132
Long-term unindexed advances (see section c below)	332	415
Total local-currency credit to the government	**332**	**5,547**
Total credit to the government	**1,443**	**7,271**

a. Credit to the government in foreign currency

This credit is composed of long-term advances indexed to the exchange rate of the first basket of currencies and of binational funds. Indexed long-term advances—these are indexed to the first basket of currencies and bear interest at a rate of 8 percent indexed to the same basket. See also Section c below.

Credit on account of binational funds was given to the Government of Israel for investment in conjunction with the United States Government in binational funds for research, industrial development, and science. The funds deposited these amounts with the Bank of Israel; they are shown in the balance sheet on the liabilities side in the "Other liabilities" item. Both the credit and the funds' deposits earn interest on the basis of LIBOR.

b. Credit to the government in local currency

1. Current credit

This item includes balances that are used to finance the government's budgetary activity. These balances are defined as credit that the government may use to finance budgetary and extra-budgetary activity; accordingly, they are subject to Section 45(b) of the Bank of Israel Law, 5714–1954. Financial movements arising from government budgetary and extra-budgetary activity in Israel and financial movements with the Bank of Israel are recorded in these accounts.

All government balances in local currency in Israel (with the exception of several extraordinary balances) may be offset against each other. The government has no intention of offsetting its local currency balances with foreign currency balances; as such, these balances are presented separately. (See also Note 11.)

Interest at prime rate is charged on local currency government balances (when in debit) or is paid (when in credit). The average prime rate in 2008 was 5.11 percent (in 2007, 5.4 percent).

Interest expense on account of government local currency balances are shown in the Statement of Operations in net form. (See Note 25.)

2. Long-term credit in local currency

Unindexed long-term advances—this credit bears interest at prime +2 percent. The average interest rate in 2008 was 7.34 percent (in 2007, 7.6 percent). See also Section c below.

c. Long-term advances

Credit to the government is composed of an unindexed long-term advance and long-term advances indexed to the first basket of currencies. This credit was given until 1988.

(a) Interest and indexation differentials on the principal balance on account of each year are due on December 31 of said year. The principal is payable in annual installments, the last of which will be due in 2012.

(b) i. Correspondence in September 2003 between the Minister of Finance and the Governor of the Bank of Israel included several agreements regarding "Proposals in the Economic Program for 2004 Relating to the Bank of Israel." One of the items in that correspondence was "the repayment of the government's debt to the Bank of Israel due to be repaid on December 31, 2003," and it was determined that "the Bank of Israel will grant a loan to the government to finance the balance of the debt, principal and interest due for repayment on December 31, 2003." The same section also specified the payback dates of the loan, the need for the conclusion of an agreement between the Bank and the Ministry of Finance on the interest payable, and that "If the Attorney General is of the opinion that the debt can be cancelled, then it shall be cancelled." The amount of the debt—principal and interest—due for payback on December 31, 2003, was NIS 1,070 million (the total balance of the government debt, principal plus interest, prior to said payback was NIS 5,460 million).

ii. In February 2005, the Deputy Attorney General submitted his opinion on behalf of the Attorney General. According to the opinion, "There are no legal grounds preventing the Bank of Israel from canceling the government's debt to the Bank as agreed between the outgoing Governor and the Minister of Finance." The summary specifying the basis for this opinion stated, "It appears that from a legal standpoint the Bank of Israel has the authority to cancel a government debt to the Bank that predates the prohibition on granting loans to the government under Section 45 of the Bank of Israel Law." As for the reasonableness of a decision by the Bank of Israel to cancel a government debt to the Bank, the summary noted, "If there are macroeconomic reasons supporting such a decision that are consistent with the Bank's objectives and policies, such a decision would not be unreasonable."

iii. On December 30, 2008, the Accountant General at the Ministry of Finance approached the Attorney General and asked him to intervene immediately to preclude the collection of the debt set for December 31, 2008. His request was not accepted. On January 4, 2009, the Attorney General stated in response that, in his opinion, the dispute between the Ministry of Finance and the Bank of Israel was not a matter for legal decision but a topic to be elucidated and resolved at the echelon of the Prime Minister, the Minister of Finance, and the Governor of the Bank of Israel. On February 4, 2009, the Governor stated, in a letter to the Attorney General, that he agreed that the issue is not suited to a legal decision. The Governor stressed that even in the opinion of the Deputy Attorney General, as noted in Section ii above, the discretion to forgive or not forgive the debt resides with the Governor of the Bank of Israel only.

iv. In view of the foregoing, based on the opinion of the Bank's legal department, and taking into account the fact that the government is making the scheduled repayments, the Bank is of the opinion that the debt will be repaid in full.

5. Loans

The Loans item is composed of monetary loans and other loans.

a. Monetary loans

In 2007 and 2008, the Bank of Israel provided banking corporations with monetary loans via auction and overnight monetary loans. Overnight monetary loans to banking corporations were provided at interest of 0.5 percent above the Bank of Israel rate (until December 23, 2008—1 percent over the Bank of Israel rate). The loans are not limited by quota and are given against appropriate guarantees.

The average interest rate for these loans in 2008 was 3.74 percent (in 2007—3.9 percent).

The average interest rate for overnight monetary loans in 2008 was 4.31 percent (2007—5.1 percent).

The outstanding balance of monetary loans as of December 31, 2008, and December 31, 2007 was zero.

b. Other loans

On December 31, 2007, the "Other loans" item included NIS 476 million in credit to Industrial Development Bank. At the end of 2008, outstanding credit on this account was zero.

In August 2002, Industrial Development Bank encountered liquidity problems and could not meet its liabilities. The Bank of Israel responded to a request from the bank and made available to it a special credit line to enable it to continue operating regularly. The credit line was originally NIS 2,200 million; it was reduced from time to time and was supposed to expire at the end of July 2006. On October 30, 2005, the Bank of Israel agreed to a request from the bank to extend the term of the loan by two years, to July 31, 2008. Subsequently, the line of credit was extended until it was closed in December 2008. In accordance with the decision of the economic-social cabinet, since July 1, 2005, responsibility for repayment of the credit has resided with the government. Accordingly, the government paid off the balance of this credit line, in the sum of NIS 305 million, at the end of the period.

The Industrial Development Bank paid interest at the Bank of Israel rate on the unused portion of the credit.

At the time of the final payback and at the bank's request, the Bank of Israel forgave NIS 48.6 million in debt that the bank had paid in the past on account of interest above the Bank of Israel rate. The forgiving of this debt is included in the Statement of Operations on the "Interest expense to banks and the public" line.

This credit is not expected to result in a future loss to the Bank of Israel.

6. Tradable local currency securities

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

The yield to maturity on the local currency securities portfolio on December 31, 2008, was 2.83 percent, and average term to maturity of the portfolio was 2.32 years. (On December 31, 2007, the yield to maturity was 2.6 percent and the average term to maturity was 3.4 years.)

	December 31	
	2008	2007
	(NIS million)	
Time to redemption		
Less than one year	727	519
Between one and two years	954	715
Between two and three years	80	925
Between three and four years	323	76
Between four and five years	209	306
Five years or longer	134	322
Total	**2,427**	**2,863**

7. International financial institutions

	December 31	
	2008	2007
	(NIS million)	
Investment in BIS shares	282	282
Balance related to other international financial institutions (see section a below)	554	554
Total	**836**	**836**

a. Balances on account of other international financial institutions

The balances are on account of the following institutions:

IBRD—International Bank for Reconstruction and Development

IDA—International Development Association

IFC—International Finance Corporation

EBRD—European Bank for Reconstruction and Development

MIGA—Multilateral Investment Guarantee Agency

IDB—Inter-American Development Bank

IIC—Inter-American Investment Corporation

8. Fixed assets[a]

	Land and buildings[b]	Equipment, furniture and vehicles	Total
Cost		(NIS million)	
Balance as of January 1, 2008	222	98	320
Additions	2	8	10
Subtractions	-	-	-
Balance as of December 31, 2008	**224**	**106**	**330**
Accumulative depreciation			
Balance as of January 1, 2008	30	70	100
Additions	5	8	13
Subtractions	-	-	-
Balance as of December 31, 2008	**35**	**78**	**113**
Net book balance as of December 31, 2008	**189**	**28**	**217**
Net book balance as of December 31, 2007	**192**	**28**	**220**

a A numismatic collection is kept at the Bank of Israel, which includes banknotes and coins issued in Israel from ancient times until today, along with various other items. According to an expert appraisal in November 2005, the value of the ancient coin collection is US$1.7 million. (The rest of the collection has yet to be appraised.) The Bank of Israel also has a library containing professional (economic, financial, etc.), legal, and general literature. According to an assessor's appraisal in 2006, the replacement value of the library was US$3 million. The "Fixed assets" item does not include these items.

b The land of the Bank's premises in Jerusalem, with a depreciated cost of the structures thereon amounting to NIS 177 million as of December 31, 2008 (NIS 180 million as of December 31, 2007), is leased from the Israel Land Administration through June 30, 2016. The Bank holds an option to extend the lease for another 49 years.

9. Other assets

	December 31	
	2008	2007
	(NIS million)	
Loans to employees	208	220
Sundry receivables	2	2
Total	**210**	**222**

10. Banknotes and coins in circulation

	December 31, 2008		December 31, 2007	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
Banknotes in circulation				
NIS 20	31	612	25	505
NIS 50	46	2,298	47	2,370
NIS 100	140	13,998	131	13,098
NIS 200	81	16,132	59	11,748
Coins in circulation		1,287		1,212
Other[a]		33		33
Total		**34,360**		**28,966**

[a] Consisting mainly of old banknotes that can be exchanged in the Bank of Israel.

11. Government deposits

Government balances comprise balances in local currency and balances in foreign currency.

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		($ million)	
Foreign currency (see section a below)				
Deposit for money borrowed under US government guarantee	6,635	6,011	1,745	1,563
Current deposits	204	303	54	79
Other foreign currency deposit	21	238	6	62
Total foreign currency deposits	**6,860**	**6,552**	**1,805**	**1,704**
Local currency (see section b below)				
Current deposits (see section b.1 below)	1,536	2,055		
Bond-price stabilization deposit (see section b.2 below)	6	19		
Total local currency deposits	**1,542**	**2,074**		
Total	**8,402**	**8,626**		

a. Government foreign currency deposits

Government foreign currency deposits derived from borrowing under a US government guarantee and some other foreign currency deposits bear interest at the rate paid on US Treasury bills with an average of 6 months to maturity. The rate of interest on December 31, 2008, was 0.43 percent (December 31, 2007—3.4 percent).

b. Government local currency deposits

1. Current deposits are composed of balances used for bond lending, balances for the financing of budgetary activity, and other balances. The portion of the government balances that is used for bond-lending activity bears the Bank of Israel rate of interest. The average rate of interest on these balances in 2008 was 3.69 percent (2007—3.9 percent). The other portion of the government balances bear (when in debit) or pay (when in credit) interest at prime. The average prime rate was 5.11 percent in 2008 (2007—5.4 percent).

   The balance in this item also includes the balance of the National Insurance Institute and that of the Postal Bank, which, since March 1, 2006, has operated through the Israel Postal Company Ltd., a wholly government-owned corporation. Israel Postal Company Ltd., also operates by means of Postal Bank, Ltd., a government subsidiary.
2. The bond-price stabilization deposit represents the proceeds from the purchase, at source, of government securities by the Bank of Israel in order to stabilize prices on the Tel Aviv Stock Exchange (TASE). In accordance with an agreement with the Ministry of Finance, the proceeds are placed in a special deposit on behalf of the government but may not be used to finance government expenses. At the request of the Ministry of Finance, the bond-price stabilization arrangement was discontinued in January 1993 and the deposit is gradually being reduced against the redemption of such bonds purchased in the past. The redemption of these bonds will end in 2009.

12. Deposits of banking corporations

	December 31		December 31	
	2008	2007	2008	2007
	(NIS million)		($ million)	
Foreign currency deposits (see section a below)				
Demand deposits	14,806	771	3,894	200
Unrestricted deposits	4,905	1,502	1,290	391
Total foreign currency deposits	**19,711**	**2,273**	**5,184**	**591**
Local currency deposits (see section b below)				
Time deposits	28,313	300		
Demand deposits	15,301	12,398		
Total local currency deposits	**43,614**	**12,698**		
Total deposits of the banking corporations	**63,325**	**14,971**		

a. Foreign currency deposits

1. Foreign currency demand deposits (called Pamach) serve as a liquid asset against nonresidents' foreign currency deposits. The reserve requirement ranges from 0 percent to 6 percent, depending on the term of the deposit.
2. At the beginning of September 2007, the Bank of Israel started accepting foreign currency deposits from the banks as collateral for the banks' activities in the Zahav (RTGS) system. The deposits are for a term of 30 days. The balance of the deposits on December 31, 2008, was NIS 4,905 million (December 31, 2007—NIS 1,460 million).

b. Local currency deposits

1. The Bank of Israel receives local currency time deposits from the banking corporations. The deposits are allocated by auction for terms of one day or one week. The deposits are not considered liquid assets for the purpose of fulfilling the banking corporations' reserve requirements. In addition, overnight deposits are received at an interest rate of 0.5 percent under the Bank of Israel rate (until December 23, 2008—1 percent under the Bank of Israel rate).

   The interest rate for overnight deposits on December 31, 2008, was 2 percent (on December 31, 2007—3.25 percent).

   The average interest rate for overnight deposits in 2008 was 2.05 percent (in 2007—3 percent).

The average interest rate for time deposits by auction on December 31, 2008, was 2.45 percent.

The average interest rate for time deposits by auction in 2008 was 3.13 percent (in 2007—3.7 percent).

2. The banking corporations' demand deposits in local currency serve as a liquid asset against residents' deposits in local currency. The reserve requirement ranges from 0 percent to 6 percent, depending on the term of the deposit.

13. International financial institutions

	December 31	
	2008	2007
	(NIS million)	
Special Drawing Rights allocated[a]	624	649
Liabilities to international financial institutions[b]	47	50
Total	**671**	**699**

[a] Special Drawing Rights (SDR) are sums that member states in the International Monetary Fund undertook to purchase from the Fund. The IMF allocates SDR to its constituent states commensurate with the size of their quotas. Israel's allocation thus far is SDR 106.4.

[b] Liabilities in notes or deposits to the following institutions: IBRT, IDA, EBRD, MIGA, and IDB (see Note 1h.)

14. Makam deposits

	December 31	
	2008	2007
	(NIS million)	
Redemption value of *makam* sold to the public	71,722	77,561
Less discount at time of sale to public	(2,620)	(3,277)
Proceeds of sale of *makam* to the public	**69,102**	**74,284**
Plus reduction in discount for period to balance sheet date	1,296	1,702
Total balance of *makam*	**70,398**	**75,986**

The Short-Term Loan Law, 5744-1984, authorizes the government to issue short-term bills (called makam, their Hebrew acronym) to be sold only to the Bank of Israel, with the Bank selling them to, and buying them from, the public in order to regulate the money supply and carry out its functions. The government must deposit all proceeds from sales of these bills with the Bank of Israel and may not use them for any purpose other than repayment of the loan taken under said Law or payment of the yield on it. The purchase of bills from the government by the Bank of Israel and the deposit of the proceeds of this sale with the Bank of Israel are not reflected in the Bank's balance sheet.

The balance of makam shown in the balance sheet reflects the redemption value of bills held by the public less the balance of the unamortized discount.

15. Other liabilities

	December 31	
	2008	2007
	(NIS million)	
Pension and severance pay liabilities[a,c]	3,447	3,320
Other liabilities on employees' rights[b,c]	143	157
Binational funds	131	141
Accounts payable	42	22
Total	**3,763**	**3,640**

a Pension liability is calculated according to the pension agreements with Bank employees and pensioners who commenced their employment before September 2002 and their survivors (on December 31, 2008, this included 430 staff members and 628 retirees; as of December 31, 2007, this included 462 staff and 631 retirees). The pension liability includes future payment of benefits for bank employees, former employees whose pensions have been frozen, retirees, and survivors. It also includes obligations on account of the cash value of unused sick leave upon retirement and retirement grants.

The Bank's liability is calculated on the basis of salary and benefit data for December 2008 and on actuarial calculations. The calculation was performed using a method of estimating benefits being accrued under various parameters: rates of early retirement, pension rates for surviving spouses and orphans, employees' seniority and grade, relevant tax rates, etc.

The actuarial calculation is based on foreseen changes in white-collar mortality rates, in accordance with the Pension Funds Directives published by the Capital Market, Insurance, and Savings Division of the Ministry of Finance on May 17, 2007.

The Bank's actuarial liability was calculated on the basis of a 4 percent discount rate, in accordance with experience and with the public reporting directives of the Supervisor of Banks. The calculation assumes real annual wage increases of up to 2 percent per year.

For Bank employees who commenced their employment after September 2002, the Bank's liability for pension and severance pay is covered by regular deposits with a recognized pension and severance-pay fund on behalf of the individual employee. Since sums deposited in said manner are neither controlled nor managed by the Bank, neither they nor the liabilities against which they were deposited are reflected in the balance sheet.

b This item is composed mainly of an NIS 85 million liability for employees' vacation (2007—NIS 102 million). Bank employees are entitled by law and labor agreements to annual vacation days and advanced-training days. The liability as of December 31, 2008, and December 31, 2007, were calculated on the basis of the determining wage for the redemption of vacation and vacation days as accrued up to the balance-sheet date.

c On December 20, 2007, the Bank of Israel and its employees concluded a collective wage accord. In addition, on August 19, 2008, the Labor Court handed down its decision on a very small number of issues in the form of a compromise ruling. The new wage accord went into effect on August 20, 2008. The items include the effect of the new accord as of December 31, 2008. The main provisions of the new accord had already been applied in 2007.

16. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see also Notes 1.g, 1.m, and 1.n):

	December 31	
	2008	2007
	(NIS million)	
Foreign currency balances	2,169	3,321
Tradable foreign currency securities	2,432	1,591
Tradable local currency securities	698	755
Total	**5,299**	**5,667**

17. Share capital and general reserves in historical nominal values

Data on the Bank's share capital and general reserves appear in the financial statements in reported values. (See Note 1.c.) The following shows the data in historical nominal values:

	December 31	
	2008	2007
	(NIS million)	
Share capital	60	60
General reserve[a]	260	260
Total Bank capital in historical nominal values	**320**	**320**

[a] The general reserve is in accordance with Section 6 of the Bank of Israel Law, 5714-1954, and has been applied in the past to increase the Bank's capital.

18. Contingent liabilities[a] and commitments

	31 December	
	2008	2007
	(NIS million)	
1. Off-balance-sheet financial instruments		
1.1 Documentary credits and guarantees for government imports and exports		
1.1.1 Documentary credits	-	46
1.1.2 Guarantees	193	195
1.2 Liabilities to pay international financial institutions on demand	3,208	3,192
2. Commitments		
2.1 Derivative financial instruments in activity in Israel		
Future remittances of *makam* (at par)	160	640
Reverse Repurchase Agreements (RRepo)	1,740	-
2.2 Derivative financial instruments in activity in abroad		
2.2.1 Currency swaps and forward transactions		
Future receipts of foreign currency	5,009	2,964
Future payments of foreign currency	5,623	2,960
2.2.2 Repurchase Agreements (Repo) and Reverse Repurchase Agreements (RRepo)		
Repo	-	10,626
RRepo	2,382	1,055
2.2.3 Futures		
Sales commitments	797	17,185
Purchase commitments	519	3,192

a Several claims are pending against the Bank of Israel. However it is the Bank's opinion, based on the opinion of Bank's Legal Department, that the probability of these claims being successful is low, and therefore no provisions have been recorded in respect thereof.

19. Interest income from financial assets in foreign currency abroad

(see section a below)

	For the year ended December 31	
	2008	2007
	(NIS million)	
Demand deposits	18	48
Short-term deposits	416	1,310
Tradable securities	2,904	4,446
Securities purchased as part of the RRepo Agreements	37	122
Derivative financial instruments[a]	58	(6)
Total	**3,433**	**5,920**

[a] Interest expense on derivatives is shown net.

a. Interest income from (expense on) foreign exchange reserves

The following shows the composition of interest income from (expense on) foreign exchange reserves (See Notes 2 and 23):

	For the year ended December 31	
	2008	2007
	(NIS million)	
Interest income from foreign currency financial assets abroad	3,433	5,920
Interest paid on foreign currency financial liabilities abroad[a]	(221)	(1,090)
Total income from foreign exchange reserves	**3,212**	**4,830**

[a] See Note 23.

20. Interest income from loans

	For the year ended December 31	
	2008	2007
	(NIS million)	
From monetary loans	173	355
From other loans[a]	16	24
Total	**189**	**379**

[a] Mostly deriving from interest on credit advanced to the Industrial Development Bank (see Note 5).

21. Interest income from the government

	For the year ended December 31	
	2008	2007
	(NIS million)	
Long-term advances		
Indexed	128	174
Unindexed	30	38
From binational funds	69	69
From local currency securities	251	226
Total	**478**	**507**

22. Other interest income

This item consists of interest income from the International Monetary Fund and interest on reverse repurchase agreements of makam and government bonds.

23. Interest expense on financial liabilities in foreign currency abroad

This item consists of interest expense in respect of securities sold within the framework of repurchase agreements (see Note 19).

24. Interest expense to banks and the public

	For the year ended December 31	
	2008	2007
	(NIS million)	
In local currency		
On makam deposits	3,262	4,184
On local currency time deposits	29	25
Other[a]	49	1
Total in local currency	**3,340**	**4,210**
In foreign currency		
On banks' deposits	98	150
Total	**3,438**	**4,360**

a Due to the forgiving of a debt of the Industrial Development Bank (see note 5).

25. Interest expense to the government

	For the year ended December 31	
	2008	2007
	(NIS million)	
On local currency deposits[a]	397	220
On foreign currency deposits	106	290
Total	**503**	**510**

a Government local currency interest expense includes--in addition to interest expense on balances for financing the budget--interest expense on the bond price stabilization deposit, interest expense to the National Insurance Institute, and interest expense to the Israel Postal Company Ltd (see Notes 4 and 11).

26. Other interest expense

This item consists mainly of interest expense:

a. To international financial institutions;

b. On deposits of the US-Israel Binational Industrial Research and Development (BIRD) Foundation and a deposit of the US-Israel Binational Science Foundation.

27. Other financial income from (expense on) securities and derivatives

	For the year ended December 31	
	2008	2007
	(NIS million)	
Foreign currency securities[a]	**2,506**	**1,057**
Derivative financial instruments[b]		
In foreign currency	(68)	137
In local currency	-	3
Total derivative financial instruments	**(68)**	**140**
Total	**2,438**	**1,197**

a Including gain from the realization of securities and loss from reduction in their value at the end of the year.

b Consisting mainly of financial income (expense) from the realization of derivative financial instruments.

28. Other financial income from (expense on) exchange rate differentials

This item consists of realized exchange rate differentials on account of balances denominated in foreign currency; see Notes 1.m and 1.n.

29. Other financial income—miscellaneous[a]

	For the year ended December 31	
	2008	2007
	(NIS million)	
In local currency	8	5
In foreign currency	(9)	3
Total	**(1)**	**8**

a Consisting mainly of income from (expense on) fees and fines deriving from the Bank of Israel's financial activities.

30. Administrative and general expenses

	For the year ended December 31	
	2008	2007
	(NIS million)	
Staff wages and employees' rights[a]	551	548
General expenses	63	64
Total	**614**	**612**

[a] This item consists mostly of employees' salaries (on December 31, 2008 there were 712 employee posts, and on December 31, 2007, 716), pension payments to retirees on unfunded (non-contributory) posts, and an update of the Bank's pension and vacation liabilities to employees.

31. Other income

This item consists mainly of dividend income and an update of the provision for Trade Bank.