

CHAPTER XVII

MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. MAIN DEVELOPMENTS

The rapid monetary expansion which began at the beginning of 1977 continued in the wake of the foreign currency reform. In 1978, however, the expansion was accompanied by a significant change in the composition of the public's assets and liabilities. The liberalization of foreign currency control induced a switch from local currency to foreign currency assets, in both savings portfolios and liquid holdings. Total liquid assets of the public, which include an element of saving, grew from the time of the reform until the end of 1978 by about 77 percent in annual terms; the real increase was similar to that in uses (excluding direct defense imports and diamonds). This rise reflects a real drop in the money supply and other Israeli currency assets and the swelling of public foreign currency deposits. The development of the various components was not uniform throughout the year, and they traced an irregular path due to the adjustment process, changes in the public's expectations, and monetary policy. Toward the end of the year the growth of the monetary variables slowed, a trend that became more pronounced during the first months of 1979.

The monetary expansion of 1978 was fueled primarily from the supply side. The foreign currency liberalization made available to the economy a quite elastic supply of short-term credit at the international money market interest rate. Since this interest rate plus the expected rate of devaluation was apparently lower than that which would have prevailed in the absence of an open money market, a large amount of imported capital began to flow from overseas and expanded the supply of money. The impact of this factor was greatest in the last quarter of the year, because the subsiding of devaluation expectations during this period, along with the rise in the domestic marginal interest rate, made the price of credit from abroad relatively less expensive.

The injection of liquidity by the public sector and the directed credit granted by Bank of Israel also helped to greatly increase the potential for monetary expansion. The contribution of the public sector injection to the growth of the money base broadly defined amounted to 82 percent, and that of Bank of Israel directed credit (excluding the diamond industry) amounted to 32 percent. All told, these two sources contributed 36 percent to the real growth of the broad money base, most of it during the first three quarters of the year. It should be noted that from the monetary aspect the distinction

between a public sector injection and that generated by directed credit lacks significance; at the same time, the direct influence of the latter on demand is reflected only in its subsidy element, whereas a public sector injection also reflects the demand surplus of this sector.

The renewal of economic growth stimulated demand for liquid assets and credit, but it appears that the supply of credit outpaced the rise in demand. Support for this assumption can be found in the growth of all types of short-term credit for economic activity (excluding diamonds) at a more rapid pace than that of resource uses, and in various indicators which reveal that, despite the fluctuations in the interest rate during the year, it apparently turned down in real terms during the last few months of 1978, in consequence of the intensification of inflationary expectations and the diminished expectation of a devaluation. The average credit balance (excluding diamonds and revaluation differentials on export credit) went up by 13 percent in real terms, compared with 7 percent in total domestic uses (excluding diamonds). It should be noted that the banks made credit available this year for the opening of approved savings scheme accounts; less such financing, credit increased by about 10 percent in real terms.

The rapid monetary expansion in 1978 came on top of a rapid growth in the money supply during the previous year. The latter did not find immediate expression in the commodities market because capital market developments last year resulted primarily in a rise in the financial asset holdings of the public: these grew in 1977 by 74 percent nominally and 23 percent in real terms. The swelling of the public's financial wealth in 1977, together with the largely supply-induced monetary expansion of 1978, obviously led to the adjustment of asset portfolios, which generated a stronger demand for goods. The monetary developments of the past two years were thus responsible to some extent for the expansion of economic activity and the acceleration of inflation, mainly in the last few months of the year, even though the force and distribution of the impact between them are not clear.

After the foreign currency liberalization the main thrust of monetary policy underwent a change. The opening of the economy to capital imports created a situation in which monetary restraint would increase such imports, and thus slow, at least in the short run, the devaluation of the IL and erode the profitability of exports. Hence it was imperative for monetary policy, even more so than in the past, to place the stress on maintaining the desired trend in the exchange rate, while the cooling of inflation had to be based to a larger extent on a restrictive fiscal policy. This approach was evident during the first half of the year, when the Bank of Israel followed a policy of allowing a modest monetary expansion intended to prevent the intensification of capital imports. The heightening of demand pressures in the economy and the sinking of the banks into large

TABLE XVII-1

FINANCIAL ASSETS OF THE PUBLIC, 1975-78

End of period	Eve of reform					Percent increase		
	1975	1976	1977	1977	1978	1977	1978	From eve of reform to end of 1978 (annual rates)
Liquid assets								
Money supply	10.6	13.5	17.7	18.7	27.2	39	45	45
Patam demand deposits	4.0	6.6	3.0	5.3	13.3	..	151	258
Patam time deposits ^a			5.8	10.3	24.6	..	139	244
Bonds ^b	17.0	19.4	10.5	22.0	28.5	13	30	46
Time deposits	3.6	4.1	5.3	5.2	6.5	27	25	19
Total	35.2	43.6	51.3	61.5	110.1	41	63	77
Money Supply + Patam demand	20.7	24.0	40.5	..	69	78
Medium-term financial assets								
Mutual funds	5.2	9.1		15.7	23.5	73	50	..
Stocks	5.0	8.0		20.0	33.0	150	65	..
Restitution deposits	10.2	15.2		32.6	50.1	114	54	..
Savings schemes	12.5	20.1		36.8	63.7	83	73	..
Total	32.9	52.4		105.1	170.3	100	62	..
Total financial assets	68.1	96.0		166.6	270.4	74	62	..

^a Patam time deposits of the public were estimated by subtracting Patam held by trust funds from total Patam time deposits.

^b Bonds held by the public were estimated by subtracting the bonds holdings of financial institutions (banks, social insurance funds, mutual funds, and insurance companies) from total tradable bonds. For lack of data on bonds holdings on the eve of the reform, the figure was estimated using the rate of change in the index of returns on bonds and net bond sales for the first ten months of the year.

liquidity deficits during the third quarter led to the modification of this policy: in the last quarter tougher measures were initiated, resulting in a rise in the domestic marginal interest rate and the inflow of a significant amount of capital into the country. This resulted in the upward revaluation of the Israeli pound, but this was moderated to some extent by the Bank of Israel, which shifted from the sale to the purchase of foreign currency from the private sector. In addition, the Bank took steps at the end of 1978 and beginning of 1979 to make credit from overseas sources more expensive by requiring that a certain percentage of the credit be deposited with it at a negative rate of interest. As a

result, the growth of foreign currency credit was almost completely arrested in February and March of 1979 while foreign currency deposits even declined.

2. DEVELOPMENT OF THE MONEY SUPPLY AND OTHER MONETARY VARIABLES

The rapid monetary expansion in 1978 found expression both in the liquid assets held by the public and in the volume of nondirected and directed credit. This continued the trend which began in early 1977, but, in contradistinction to the previous year, monetary expansion since the reform has been accompanied by a significant revision of the assets portfolio of the public. With the liberalization of foreign currency control it became permissible to hold foreign currency deposits in Israeli banks without restrictions, as well as to borrow freely overseas. The possibility of investing in Patam accounts (foreign currency deposits of Israeli residents) induced the public to reshuffle its assets portfolio, switching from local currency to foreign currency items. This left its mark, not only on the public's savings portfolio, but also in the composition of its liquid asset holdings (see Table XVII-1). This happened for the following reasons: first, for companies engaging in foreign trade the owning of foreign currency decreases the risk associated with changes in the exchange rate for the Israeli pound, so it is reasonable to assume that they began to hold a substantial part of their money in foreign currency. At the same time a number of indicators suggest that firms which operate mainly in the domestic market also began to look upon foreign currency demand deposits as a substitute for money: (a) an examination of the return on Patam demand deposits and their variance, on a monthly or even a weekly basis, during the year which has elapsed since the reform shows that investment in Patam demand deposits was a good substitute for demand deposits in Israeli pounds; (b) the public can hold all its foreign currency in time deposits, which in 1978 bore interest ranging between 6 and 9 percent, and the fact that the public forwent this interest attests that it was also interested in the liquidity of Patam demand deposits; (c) the velocity of such deposits is lower than that of the money supply, but the high velocity of Israeli currency demand deposits stems from the rapid inflation, so that it is preferable to compare the velocity of Patam with that of IL demand deposits during the 1960s, when inflation was more moderate. A provisional estimate indicates that the velocity of Patam deposits amounted to about 14, compared with 18–21 for IL demand accounts in 1965–70. At the same time it should be noted that the rate of substitution between Patam demand accounts and means of payment has not yet been investigated, so that an aggregate analysis of these two assets must be accepted with reservation.

The substitution effect of these two types of assets found expression in a quite rapid real decline in the money supply from the eve of the reform, while the public's foreign

currency deposits swelled. Taking the money supply and Patam demand deposits together, since the reform there has been a 95 percent nominal rise (77 percent in annual terms); deflating by the implicit price index for domestic uses¹ shows a real rise of 8 percent (on an annual basis). This accords with the development of uses (excluding direct defense imports and diamonds), which grew by about 7 percent this year. This bulging of liquid asset holdings came on the heels of a significant real jump in the money supply (about 9 percent) during the nine months preceding the reform, one of whose causes was the soaring volume of trade in shares. It should be noted that 1978 did not see any real growth in share trading, while bond turnover declined in real terms.

An additional indication of the swift monetary expansion can be found in the development of total liquid assets.² Bonds and time deposits in Israeli and foreign currency alike serve as substitutes for money, even though they are much less liquid than Patam demand deposits. An examination of the growth of all liquid assets shows that these shot up from the eve of the reform till the end of 1978 by 96 percent (a 78 percent annual rate). The actual growth of liquid assets was even more rapid than indicated by these figures because bonds became much more liquid during the past year in comparison with the two preceding years³ — a factor which is not reflected in an analysis of the size of the assets portfolio.

A further manifestation of the adjustment of liquid assets portfolio is the relatively large rise in the velocity of demand deposits as variously defined (see Table XVII-2). The aggravation of inflation, which made it more expensive to hold liquid Israeli currency assets, and the possibility of investing in linked liquid assets reduced the share of money in liquid asset portfolios and resulted in its more efficient use. The increase in velocity this year continued an uninterrupted trend begun in 1974. From 1973 until 1978 the

¹ In this chapter, unless otherwise indicated, nominal rates of change were converted into real terms using the price deflator for domestic uses excluding public consumption. This deflator rose in 1978 at an annual average rate of 58 percent and by 57 percent in December levels; from the eve of the reform to the end of 1978 the increase was 78 percent. The index of total uses also moved up at approximately the same pace. Export prices, at the effective exchange rate, averaged 54 percent higher in 1978.

² It should be emphasized that this is not a new definition of money, but is only an indicator of monetary developments.

³ In 1976 and 1977 the average return on index-linked bonds in the secondary market was very low and quite volatile. In 1978, however, it rose, significantly reducing the variance of the returns (see Table XIX-4). This was a result of the offering of better bond terms and the stabilizing policy implemented by the Bank of Israel. An improvement in bond returns and their variance strengthens the demand for this type of asset, for both liquidity and savings purposes.

TABLE XVII-2
**TURNOVER VELOCITY OF DEMAND DEPOSITS
 AND MONEY SUPPLY, 1975-78**

	Average velocity of demand deposits ^a	Annual average velocity of money supply relative to:		
		GNP ^b	Total resource uses ^c	Domestic resource uses ^d
1975	31.9	7.60	11.99	9.30
1976	35.8	8.23	13.20	9.84
1977	38.4	8.19	13.44	9.56
1978	45.1	9.89	17.00	11.70

^a Total debits to Israeli currency demand deposits in banks, divided by the annual average volume of these deposits.

^b GNP at current prices (based on effective exchange rate), divided by the annual average level of the money supply.

^c GNP at current prices, plus the import surplus net of ships and aircraft, and direct defense imports (based on the effective rate of exchange), divided by the annual average level of the money supply.

^d As defined in note c, excluding exports.

SOURCE: Velocity of demand deposits – Department of the Examiner of Banking Statistics; money supply and unlinked assets – Table XVII-A8; GNP, total resource uses, and domestic uses – Table II-1.

turnover of demand deposits jumped 80 percent – a development undoubtedly dictated by the galloping inflation in recent years.

The less liquid components of the assets portfolio – savings schemes, shares, mutual fund participation certificates, and restitution deposits – together expanded at a rate identical to that of liquid assets (see Table XVII-1); most of the increment was in savings schemes and share holdings. The rapid growth in these components came on top of an extraordinary expansion in 1977. All told, medium-term financial assets of the public grew at a real 55 percent rate over the last two years (deflated by the consumer price index), and total financial assets by 35 percent.

The development of the various types of credit strengthens the picture of a rapid monetary expansion in the wake of foreign currency liberalization. Credit from freely loanable funds and directed export credit grew by more than 110 percent from the eve of the reform until the end of 1978 (98 percent on an annual basis). A comparison of the average balances produces a similar picture: credit for the domestic market rose by 74 percent⁴ (see Table XVII-5), and that for exports (excluding diamonds) by 84 percent.⁵ In real terms the increases were 10 and 19 percent, respectively. Part of the extra domestic credit may have replaced credit obtained from abroad other than through the banks.

A number of factors on both the supply and demand sides contributed to the rapid monetary expansion, and in particular the substantial growth of credit for all purposes. The most salient demand factors were the recovery in economic activity and the acceleration of inflation. After two years of economic stagnation GNP increased this year by about 5 percent, and resource uses (excluding direct defense imports and diamonds) by 6 percent. A more buoyant demand for goods and services generates a greater demand for money and credit. In addition, the composition of uses this year may have been more credit-intensive; consumption of durable goods, for example, jumped by 25 percent in real terms. Furthermore, it is reasonable to assume that during a period of accelerated economic activity the need for external sources of financing is likely to grow faster than the level of activity. There was also a turnabout in investments with no concomitant growth in long-term directed credit; while short-term nondirected credit is not a substitute for the latter, it may be that to some extent it was used for interim financing until approval and receipt of long-term directed credit.

The substantial expansion of credit, at a rate far eclipsing that of economic activity, nevertheless indicates that the supply of credit outstripped the rise in demand. In fact, the principal growth factors in the case of credit and other monetary variables are to be

⁴ The analysis of credit is based upon Table XVII-5. It should be noted that such an analysis for the domestic market necessitates a number of adjustments arising from certain changes in 1977 and 1978, such as reclassifications, the provision of credit through the early redemption of the Employers Loan, and the netting out of revaluation differentials and of credit given by banks for the purchase of their own stocks. Since most of these changes cancel each other out, we have preferred not to alter the original figures.

⁵ The average balance of commodity export credit (excluding diamonds) rose 110 percent in 1978 (see Table XVII-5), but in order to correctly assess the growth of this credit we have deducted revaluation differentials at the rate of the relative change between the official devaluation and the devaluation for the effective export rate of exchange. This reduced the growth of such credit to 84 percent.

TABLE XVII-3

**THE MONEY BASE AND LIQUIDITY DEFICITS OF THE BANKING
INSTITUTIONS, 1976-1978**

(IL million)

Year	Narrow money base		Broad money base		Liquidity deficits
	Balance	Percent increase ^a	Balance	Percent increase ^a	
Annual averages ^b					
1976	8,302	12.3	9,642	11.8	-673
1977	13,139	58.3	14,549	50.9	-377
1978	17,029	29.6	18,958	30.3	-2,325
Balances at end of period					
1976	10,550	47.1	11,973	40.6	-287
1977	15,897	50.7	17,474	45.9	-489
1978	20,358	28.1	22,618	29.4	-2,841
March	16,459	3.5	18,037	3.2	-745
June	17,482	6.2	19,381	7.5	-2,575
September	18,201	4.1	20,333	4.9	-3,209
December	20,358	11.9	22,618	11.2	-2,841

^a Annual or quarterly rates of change.^b Based on monthly data.

SOURCE: Tables XVII-A1 and XVII-A2.

found on the supply side. As a consequence of the foreign currency reform, an elastic supply of money was made available to the economy at the international money market interest rate. Since this rate plus the expected rate of devaluation was lower than the domestic interest rate that would have prevailed in the absence of liberalization, there was a massive capital import, which swelled the money supply. The government liquidity injection and directed export credit extended by the Bank of Israel also had an expansionary effect on the money supply this year. In 1978 the public sector injection accounted for 82 percent of the growth of the broad money base, or 16 percent in real terms. The picture is sharper if we distinguish between developments in the first nine

months and those of the last quarter. In the first three quarters of the year (except for April) the public sector injection contributed from 2 to 9 percent monthly to the real growth of the broad money base, or 29 percent for the entire period. There was a much larger Bank of Israel injection this year in the form of directed credit (excluding diamonds⁶), although it contributed less to the expansion of the money base because its magnitude was smaller than that of the government injection. The amount of money pumped into the economy through directed credit (excluding diamonds) was equivalent to 32 percent of the broad money base at the beginning of the year. The total real contribution of these two sources to the expansion of the broad money base came to 36 percent.

It is difficult to determine the development of the interest rate, since the information on many types of credit is deficient. The effective rate on overdraft facilities, which represent a substantial portion of the nondirected IL credit, held steady from the third quarter of 1977 until the end of 1978, except for a slight decline in the third quarter: it fluctuated around 50 percent on an annual basis.⁷ Since February, 1978 the rise in the price index of uses has picked up steam in comparison to the months before the reform, and it is reasonable to assume that expectations of an aggravation of inflation developed and depressed the real interest rate on credit during the second and part of the third quarter. The sinking of the banks into a liquidity deficit position in the third quarter led to a sharp rise in the marginal interest rate on IL credit, whose impact was not felt on the average effective rate because the banks began to ration such credit.

It is even more difficult to estimate the real interest on foreign currency credit, but in view of the similar development of IL and foreign currency credit during the first half of the year, the interest rate on the latter type of credit probably did not differ essentially during this period from that on overdraft facilities. During the second half of 1978 the interest rate (in dollar terms) on foreign currency credit edged up a bit, but the waning expectations of a devaluation in the final months of the year kept the rate below that on IL credit during the last quarter.

The much larger supply of money during the first nine months of 1978 followed the formidable expansion of means of payment during 1977, whose impact was not felt in the commodities market that year, both because the effect operated with a lag and because the expanded supply of money and credit in 1977 found expression in an exceptional growth of the public's financial asset holdings, especially shares, and not in the

⁶ For a detailed discussion of the injection generated by directed credit granted to the diamond industry see section 4, which deals with the money base.

⁷ The estimate of interest rates on overdraft facilities is based on a sample survey by the Department of the Examiner of Banks.

intensification of economic activity and acceleration of inflation. During 1977 the public's financial assets grew by 74 percent nominally (see Table XVII-1) and 23 percent in real terms (deflated by the consumer price index). The significant increase in the public's financial wealth⁸ in 1977, together with the swelling of credit and the public sector liquidity injection during the first three quarter of 1978, probably prompted the public to adjust its assets portfolio, leading to a more buoyant demand for goods in 1978. Hence the monetary developments of the last two years were among the factors that contributed to the expansion of economic activity and aggravation of inflation in 1978. But the distribution on this effect between economic activity and prices is not clear; very likely the impact of these factors was strongest during the last quarter of 1978, which saw a precipitate jump in prices. This induced the adjustment of the public's real balances, a trend which has not yet run its course.

Besides these factors, the monetary developments influenced prices via the interest and exchange rates. In the last months of 1978 devaluation expectations diminished, and consequently the real interest rate on foreign currency credit apparently also declined. These factors had a contrasting effect on demand and prices, and their strength is not clear; in any case, they will be felt only in 1979.

3. DEVELOPMENTS DURING THE YEAR AND MONETARY POLICY

The foreign currency liberalization has confronted the economy with new problems, which require that its impact on the exchange rate be taken into consideration in the management of monetary policy. The reform made an elastic supply of credit available to the economy at the prevailing international money market interest rate. When the interest rate on such credit plus the expected rate of devaluation of the IL is lower than the domestic interest rate, capital flows into the country from overseas, enlarging the supply of foreign currency and appreciating the exchange rate. The upward revaluation of the currency increases the balance of payments deficit on current account and in the long run strengthens the expectations of a devaluation. Despite the intensification of these expectations, there may also be a slowing of the long-run rising trend of the exchange rate, thus improving the profitability of exports. If this process continues for any length of time,

⁸ In order to accurately evaluate the change in the public's total wealth we should add to the financial assets the capital stock of the private sector and deduct liabilities to the government and the foreign sector. Most of the liabilities are owed to the government, and arose primarily from the financing of the private sector's capital stock. The bulk of these obligations are unlinked, and disregarding them and the capital stock presumably underestimates the change in the public's wealth.

it will presumably impede the attainment of the long-term goal, namely the improvement of the balance of payments by increasing exports rather than through capital imports. When the economy is in a full-employment situation and inflation is running at a high rate, a policy of monetary restraint may help to tone down inflation, but at the same time it is also liable to increase capital imports, appreciate the currency, and harm exports. The negative effect of a tighter monetary policy on the exchange rate can be moderated if it is accompanied by the upping of the interest rate on foreign credit. In such a situation, the principal way to slow down inflation is a tight fiscal policy, whereas monetary policy must also stress the prevention of capital flows which detrimentally affect the exchange rate. It is against this backdrop, and also in the light of the general inefficacy of administrative restrictions, that one should view monetary developments during the year and the Bank of Israel's policy.

Since the foreign currency reform there have been many fluctuations in the monetary variables: first because of the adjustment of the public's assets portfolio, and, as the year wore on, in consequence of the monetary policy and the changing expectations concerning the exchange rate and prices.

Despite the many monthly fluctuations, three major subperiods can be discerned from the eve of the reform until the end of 1978. The initial period spans the first three months after the reform, which saw the bulging of the public's foreign currency deposits along with a real decline in unlinked financial assets and a freeze on the volume of non-directed IL credit and foreign currency credit. This restriction was intended to prevent speculative purchases of goods and foreign currency during the period of transition to the new system, and was abolished at the end of January, 1978.

The second period lasted from the end of January through August. At the end of January, when the credit restriction was lifted, both components began to expand rapidly; during the first quarter, the growth of foreign credit gradually gathered strength at the expense of domestic credit, due to the banks' incurring of liquidity deficits. This was liable to push up the marginal interest rate on IL credit and in its wake to attract a large capital import, which would adversely affect the exchange rate. Bank of Israel intervention at the end of the first quarter to reduce the liquidity shortfalls (by decreasing the banks' participation in the export funds by 5 percent), helped to somewhat modify the trends evident during the first quarter: at the beginning of the second quarter the shortfalls vanished and the uptrend in the exchange rate reasserted itself. In addition, sales of foreign currency by the Bank of Israel declined during this period, and between February and May were at their lowest level for the year; this too contributed to the relatively rapid devaluation of the IL.

The limited monetary expansion during the second quarter should have been accompanied by tighter fiscal measures, so that the policy of supporting the exchange rate would not make inflation worse. But the government did not follow such a policy. What is more, monetary expansion was greater than planned, owing to the much heavier lending by banks and their consequent sinking into huge liquid asset deficits from the end of May. The monetary expansion generated by this development, together with the expectation of a further growth of the government's demand surplus, deterred the Bank of Israel from extricating the banks from their deficit position and from permitting the domestic interest rate to climb in order to leash the monetary expansion. Indeed, toward the end of the third quarter the rise in the quantity of money in Israeli currency was curbed, and the amount of IL credit granted decreased. In addition, devaluation expectations weakened in the third quarter, probably because the deterioration in the balance of payments was not severe, and perhaps because of the increase in long-term capital imports. Sales of foreign currency to the public apparently rose significantly between June and September (see Table XVII-4), which goes some way to explain the more sluggish rise of the exchange rate.⁹ As a result of these factors, short-term capital imports started to swell in October, and the devaluation of the IL did in fact slow down.

To diminish the "dollarization" of the economy, at the beginning of the second period the Bank of Israel took action to influence the composition of the public's asset holdings. It recommended a number of measures, which the government adopted, whose purpose was to boost savings in Israeli currency and to achieve a more perfect capital market. This was intended to reduce the shrinkage of the gap between the IL lending and borrowing rates: the terms of new government bond issues were improved, option bonds (linked to either the consumer price index or the dollar) were issued, as were negotiable certificates of deposit, which are more liquid than time deposits. These steps, however, tend to diminish the speculative demand for foreign currency on the one hand and make it more worthwhile to import capital on the other.

Foreign currency deposits of the public continued to expand at a rapid, fluctuating pace until the end of the third quarter of the year. At the same time foreign currency credit also rose strongly, a fact which speaks for itself. The main reason for this development apparently lay in the reshuffling of the public's assets portfolio. Most of the adjustment took place during the first few months after the reform, but presumably it took a longer time for its implications to penetrate the public consciousness. Thus, even after devalua-

⁹ This development stands out if we examine the sum total of foreign currency sales to the private sector and the growth of foreign currency deposits of the public. Total foreign currency conversions, which include (in addition to these items) foreign currency credit, show a similar picture.

tion expectations began to wane somewhat, foreign currency deposits continued to increase. Besides investments from abroad, other factors which may explain the recourse to foreign currency credit are the public's expectations concerning the development of the exchange rate and the relatively small differential between lending and borrowing rates in other countries compared with that in Israel. Various indicators reveal that the contrasting reactions of foreign currency credit and deposits to the devaluation expectations disappeared during the fourth quarter of the year.

The third period, which began in September-October, was characterized by the subsiding of devaluation expectations against the backdrop of the banks' huge liquidity deficits. This stimulated a sizable capital import, rendering the expectations largely self-realizing. This forced the Bank of Israel to modify its foreign currency policy, shifting from the sale to the purchase of foreign currency from the private sector; even if Patam is treated as the purchase of foreign exchange by the public, this does not affect our conclusion. While this policy failed to prevent the appreciation of the IL, presumably it moderated the trend. At the same time apprehension over the acceleration of capital imports moved the Bank of Israel to weigh steps for making foreign credit more expensive, mainly because expectations of a devaluation failed to develop despite the escalation of inflation and the widening of the gap between the development of the exchange rate and that of prices. Concurrently the economy began to fear that restrictions might be imposed on capital imports; as a result, there was a huge \$250 million inflow during the first two weeks of December, which was reflected by a similar rise in Patam deposits (Local residents' foreign currency accounts). The Bank of Israel thereupon implemented its two-pronged plan: foreign currency credit was made subject to the liquidity requirements, and the penalties for liquidity deficits, which were already very high, were further stiffened. These steps helped to check the enormous speculative import of capital, but did not alter the rising trend of foreign currency credit at the expense of that in Israeli currency. This indicates that the effect of the penalties outweighed that of the imposition of liquidity ratios on foreign currency credit. These trends continued through February 1979, when the Bank of Israel decided to make foreign currency credit more expensive by requiring that a certain percentage of the credit be deposited with it at a negative rate of interest. In order to permit the implementation of this policy without additional sharp fluctuations in short-term capital imports, it was decided to temporarily freeze foreign credit for a period of not more than 60 days.

All told, foreign currency credit shot up 45 percent during the last quarter of 1978, while nondirected IL credit shrank 6 percent (see Table XVII-5). Even if we discount the effect of the \$250 million of credit that flowed into the country in December, there was a 16 percent growth of such finance during the last quarter. This can be attributed to the decline in the interest rate on credit from abroad relative to domestic credit, a re-

sult of the fading devaluation expectations, together with the rising domestic marginal interest rate. This expectational change and the sharpening of inflation left their impress not only on the weight of foreign currency credit but also on the composition of the public's assets portfolio: in September-November net sales of bonds to the public soared and exceeded Patam deposits, which decreased significantly.

Examination of the trends during the last quarter (excluding the effect of the speculative capital imports on credit and Patam deposits) shows that both borrowers and depositors apparently thought that the rate of devaluation would slow down and that the interest on foreign currency items would decrease compared with that on Israeli currency items. This was reflected in a relatively steep jump in foreign currency credit during the last quarter and a decline in Israeli currency credit on the one hand, and the growth of financial assets linked to the c-o-l index and a slacker rise in foreign currency deposits on the other.

The public's liquid assets declined in real terms in the final quarter,¹⁰ after having risen strongly from the eve of the reform until the end of the third quarter. It is reasonable to assume that the expansion of liquidity since the reform was one of the factors intensifying demand pressure at the end of the year, and the ensuing price increases caused the public to adjust its liquid asset balances.

4. MONEY BASE

The money base broadly defined grew by 30 percent during 1978, compared with 33 percent in the previous year (see Table XVII-3). This represented a drop only in the potential monetary expansion of the local currency segment. In order to correctly estimate the development of the base defined to include all liquid assets, we must include the liquid asset cover for Patam demand deposits, or at least part of them. Demand deposits in foreign currency are quasi-money, as already pointed out, so that their acquisition must be regarded as a substitute for, rather than the absorption of, money. At the same time it should be emphasized that the liquidity ratios on foreign currency deposits are higher than on IL deposits, so that the impact of external drains after the reform is smaller than in the past.

The public sector liquidity injection rose this year by only 30 percent to reach some IL 14 billion; the government was responsible for about IL 11 billion and the Jewish Agency for the balance. The government's injection was concentrated in the first nine

¹⁰The money supply plus Patam demand deposits, for example, grew by 9 percent, while the consumer price index went up 16 percent during this quarter.

TABLE XVII-4

INFLUENCE OF THE PUBLIC AND PRIVATE SECTORS ON THE MONEY BASE^a, 1977-78
(IL million; [+] denotes an increase and [-] a decrease)

	1977					
	1977	1978	I	II	III	IV
Public sector operations	11,325	14,469	5,001	3,884	4,632	952
Thereof: Government	8,857	20,684	4,077	2,994	3,647	-34
Foreign currency sales by the private sector ^a	-7,660	-5,311	-5,257	-2,088	-4,076	6,110
Change in foreign currency deposits of the public	-5,064	-18,458	-4,465	-3,050	-4,154	-6,789
Foreign currency credit to the private sector	5,089	9,462	4,945	738	2,365	1,414
Israeli currency credit to the private sector	983	2,127	-249	1,428	683	265
Open-market operations	513	141	317	190	-138	-228
Other factors	161	1,982	270	-79	1,407	384
Total increase in narrow money base	5,347	4,412	562	1,023	719	2,108
Liquidity exemptions and recognized liquidity deficiencies	138	683	0	321	234	128
Total increase in broad money base	5,485	5,095	562	1,344	953	2,236

^a See notes to Table XVII-A4.

SOURCE: Tables XVII-A1 and XVII-A4.

TABLE

OUTSTANDING CREDIT GRANTED TO THE

		For financing			
		In IL ^b	In foreign currency, excl. diamonds ^c	Total, excl. diamonds (1+2)	Diamond Fund
		(1)	(2)	(3)	(4)
Annual averages (IL million)					
	1976	2,476	2,291	4,766	2,277
	1977	3,614	3,637	7,250	4,598
	1978	5,879	9,362	15,241	12,988
Percent annual increase					
	1976	32	44	38	53
	1977	46	59	52	102
	1978	63	157	110	182
Balances at end of period (IL million)					
	1976	3,040	2,932	5,972	2,810
	1977	4,588	6,668	11,255	7,630
	1978	7,295	12,330	19,626	15,072
Percent annual increase					
	1976	26	54	38	56
	1977	51	127	88	172
	1978	59	85	74	98
Percent quarterly increase					
1978	I	-13	19	6	54
	II	44	14	24	10
	III	21	11	15	16
	IV	5	22	15	0

^a Does not include credit to the government or National Institutions. For monthly data, component subitems, and changes in classification, see Tables XVII-A5 and XVII-A6.

^b Credit from the Export Production, Indirect Export and Citrus Funds.

^c Credit from the Export Shipments Fund, Imports-for-Exports Fund, financing of shipments from the banks' own foreign currency resources, and foreign currency re-discounts outside the funds.

^d Nondirected credit long-term linked loans; these increased by IL 813 million during

PUBLIC^a BY THE BANKING SYSTEM 1976-78

exports	For financing domestic activity				Total credit to public (5+9)
	Nondirected IL credit ^{d,e}	Directed IL credit ^{e,f}	Nondirected foreign-currency credit ^g	Total (6+7+8)	
Total (5)	(6)	(7)	(8)	(9)	(10)
7,044	7,603	2,142	4,761	14,505	21,549
11,849	10,606	2,725	7,602	20,932	32,781
28,229	18,107	2,708	15,581	36,396	64,625
42	35	10	34	30	34
68	39	27	60	44	52
138	71	-1	105	74	97
8,781	8,609	2,346	6,099	17,054	25,835
18,885	12,793	3,087	10,606	26,487	45,372
34,697	19,912	2,208	24,071	46,190	80,888
43	27	26	51	35	37
115	49	32	74	55	76
84	56	-28	127	74	78
26	17	-10	17	14	19
17	26	-2	18	20	19
15	13	-8	14	12	13
8	-7	-12	45	14	12

1978 (including linkage differentials).

^e Excludes linkage differentials on that part of the credit linked to the consumer price index. Linkage differentials on nondirected credit Loan Fund totalled IL 967 million at the end of 1977 and IL 384 million at the end of 1978.

^f Mostly working capital funds for industry and agriculture, supervised agriculture credit, and the Employers Loan Fund.

SOURCE: Tables XVII-A5 and XVII-A6.

months of the year, while during the last quarter the government siphoned off a small sum from the public (see Table XVII-4). At annual rates, the public sector injection during the first three quarters was about 10 percent higher, in real terms, than the annual average level the year before. The contribution of the injection to the potential monetary expansion can be measured using the ratio of the injection to the money base: the broad money base at the beginning of the year amounted to IL 17.5 billion, so that the public sector injection accounted for 82 percent of its growth in 1978.

The government injection also reflected expansionary fiscal activity, as evidenced by the fact that the government's demand surplus rose from about IL 15 billion in 1977 to roughly IL 20 billion.¹¹ Since the demand surplus is partly financed by issuing indexed bonds, the change in the public's assets portfolio since the reform (*inter alia* a shift from bonds to Patam time deposits) will certainly result in a larger government injection.

The Bank of Israel injection through directed export credit expanded greatly in 1978. The amount pumped in through credit for merchandise exports, excluding diamonds, grew from about IL 1 billion in 1977 to approximately IL 3.5 billion,¹² while for diamonds the figure went up from IL 2.2 billion to about IL 5 billion. The increase in directed credit stemmed chiefly from the lowering of the interest rate on such finance in September 1977, from 6 to 4 percent in dollar terms, whereas during 1978 the dollar interest rate rose on the international money market. The expansion of credit at a rate eclipsing the advance of exports is explained by the underutilization of the directed credit arrangements in the past and the rise in 1978 in the rate of such financing from 75 to 85 percent in terms of the effective exchange rate. A substantial portion of the incremental directed credit went to finance the buildup of rough diamond stocks. It is nevertheless reasonable to assume that such credit contributed to the domestic monetary expansion, and reflected the increased utilization of the fund at the expense of other sources. This is borne out by the estimated cash flow of the industry, which shows that the growth of its outstanding directed credit in 1978 was more than required for its

¹¹ The demand surplus above is measured at the official exchange rate, and does not include any imputation for the subsidy element in government credit to the business sector. For a detailed discussion of this problem see Chapter XI, "Government and Non-Government Public Sector".

¹² This analysis takes into account the classification change arising from the fact that Export Shipments Fund credit was granted solely from Bank of Israel resources instead of partly from the banks' participation in the fund. This change is reflected by a decrease in the Bank of Israel's injection listed in Table XVII-4, by a total of IL 1.9 billion in 1977 and IL 1 billion in 1978.

stockpiling purposes,¹³ and stemmed principally from the widening of the differential between the interest charged by the fund and the rate abroad. The greater resort to the fund was apparently accompanied by the payment of foreign liabilities, chiefly during the first quarter of the year, and the forgoing of other sources of foreign credit. The Bank of Israel thereupon decided, toward the end of the year, to increase the cost of credit from the Diamond Fund, scaling up the interest charge from 6 to 9 percent, at the rate of one point a month beginning in December 1978.

It should be noted that the monetary influence of an injection by way of directed credit is no different from that of a government injection, whereas its fiscal impact is much smaller. For the most part directed credit is a substitute for foreign credit, but carries a lower rate of interest than that charged in the free market; hence it directly affects demands mainly through its subsidy element.

The renewal of economic growth and its sectoral composition also have important implications for the absorption of liquidity via the balance of payments. The upward thrust in economic activity this year was generated primarily by the expansion of domestic demands, which resulted in a faster rise in imports, and to a lesser extent by exports, which made less headway this year. These developments caused the private sector's current deficit to soar by an annual average of some \$230 million.

This was financed by a similar expansion of long-term capital imports (about \$205 million), so that the total deficit in the sector's basic balance of payments hardly changed during the year.

Net short-term capital imports were very volatile in 1978. During the first and second quarters there was a net outflow of approximately \$130 million and \$90 million, respectively. The trend was reversed in the third quarter and grew stronger in the fourth. The ebbing of devaluation expectations and jitters over a possible partial deliberalization sent capital imports soaring in the fourth quarter by more than \$200 million. As a result of these balance of payments trends, sales of foreign currency to the public tumbled from about \$745 million in 1977 to an annual average of \$340 million in 1978.

5. CREDIT TO THE PUBLIC

For the second year in row both directed and nondirected credit expanded at an exceptionally rapid pace, with the two components tracing a highly irregular path.

¹³ This finding does not contradict the statement that the financing given by the Diamond Fund was not greater than warranted by the criteria governing such credit. It should be remembered that the fund finances the maintenance of inventories, so that when rough diamond prices go up, the credit balance also rises even if there is no increase in inventories.

Total credit for all purposes jumped by an annual average of 97 percent in 1978, after rising 52 percent the year before (see Table XVII-5). In real terms (deflated by the implicit price index of resource uses), the increases were about 25 and 10 percent, respectively.¹⁴ Most of increment was in directed export credit (especially for the diamond industry), which outstripped the gain in exports. Credit for the domestic market also rose faster than domestic uses, but the difference was more moderate. Credit for exports and for the domestic market come from different sources, but in a microeconomic analysis of total credit and liquidity there is little point in decomposing such credit since most firms which engage in export also produce for the domestic market and they maintain commercial and credit ties among themselves. The rapid growth of credit is explained by the more buoyant demand with the perking up of economic activity and by an extraordinary increase in the supply of credit. The foreign currency reform gave the economy access to an elastic supply of foreign currency credit at the international money market interest rate; in addition, directed foreign currency credit became more worthwhile in 1978 following the reduction of interest rates on this type of credit in September 1977 and the rise in interest rates abroad during 1978. The supply of credit outpaced the growth of demand, with the result that the real interest rate apparently dipped during part of the year.¹⁵ The data also indicate that credit for economic activity (excluding diamonds) rose faster in 1978 than the uses which it financed — 13 as against 7 percent. To some extent this may reflect the substitution of such credit for foreign nonbank credit, for the differential between the interest rate on such finance and that on credit available to domestic producers widened. It may also be that short-term credit was used for the interim financing of investments, considering the real drop in credit for this purpose.

(a) Credit to the Domestic Market

The amount of credit provided for domestic activity averaged 77 percent higher in 1978, with the monthly increase fluctuating between 4 and 6 percent throughout most of the year (see Table XVII-A5). The only exceptions were May and June, when the level soared by an unprecedented 8 and 13 percent, respectively, owing to the campaign mounted by banks to plug their savings schemes and shares. The Banks offered the public the requisite credit, which carried a relatively low interest of 24–28 percent, even at the cost of incurring heavy liquidity deficits. But even exclusive of this special finance, credit for domestic activity expanded at a substantial 8 percent real annual average rate, following 4 percent real growth the previous year; this compares with a 7 percent increase in domestic uses in 1978, following a standstill the year before.

¹⁴ Less revaluation differentials on export credit, total credit grew in 1978 by 90 percent in nominal terms, or 22 percent in real terms.

¹⁵ For a detailed discussion of interest rates see section 2 above.

During 1978 the share of directed Israeli currency credit for domestic purposes shrank noticeably, owing to the Bank of Israel's policy of gradually phasing out such credit granted on an unlinked basis.

During the first three quarters of the year the ratio between nondirected IL credit and nondirected foreign currency credit did not change significantly: the former grew by 65 percent and the latter by 57 percent. However, the two did not move in step throughout this period, and it is evident that the sources of such finance are substitutes for each other. Since the supply of foreign credit is elastic, were it not for the exogenous increase in the domestic supply most of the incremental credit presumably would have originated abroad; indeed, when the heavy liquidity injection and reduction of the bank's participation in the export funds led to a domestic monetary expansion, the share of foreign credit dropped.

(b) Directed Export Credit

Directed export credit swelled in 1978, with most of the increment going to the diamond industry because of the stocking of uncut stones and the hefty appreciation of the existing inventory. Financing for other export branches also rose strongly. The average balance of commodity export credit (exclusive of diamonds and revaluation differentials) shot up 84 percent in 1978, while such exports (exclusive of diamonds and the administered areas) grow by 68 percent at the effective exchange rate. Part of the increase in the export financing rate is explained by the decline in the interest rate for such credit, compared with a rise in foreign interest rates and the resulting reduction in nonbank credit from abroad. The underutilization of the directed credit arrangements in the past goes a long way to explain this trend.

6. ASSETS HELD BY THE PUBLIC

(a) Money Supply

The money supply grew in 1978 by about 45 percent (see Table XVII-6), while the prices of the various final uses rose by 50 percent or more. The real decline in the money supply took place despite the expansion of economic activity, for the reform enabled the public to hold alternative assets that are both highly liquid and yield a return, and the acceleration of inflation caused a flight from money to linked liquid assets.

During the first half of the year reviewed the money supply decreased, with the fall being particularly sharp during the first quarter after the reform; from the eve of the reform until the middle of the year the level moved down 5 percent in real terms. During the second half of the year, with the intensification of inflation, the downtrend became even more pronounced, while demand for bonds and foreign currency deposits increased.

(b) Other Unlinked Liquid Assets

The public's time deposits contracted noticeably in 1978 in real terms, with the nominal level remaining unchanged. The downturn can be partly attributed to the banks' issuing since the middle of the year of negotiable certificates of deposit, which are a substitute for time deposits but are much more liquid. These certificates, however, have a number of limitations which restrict their use to large companies: the minimum purchase unit is IL 250,000 and there is not trade in fractional units. The issuance of these certificates began in May, when some IL 170 million worth were sold, and the level rose at an increasing pace until the balance reached IL 1.4 billion by the end of the year. But even including certificates of deposit, total time deposits grew by only a nominal 27 percent this year (see Table XVII-6). The reason for this lay in the aggravation of inflation, the improvement of bond issue terms, and the possibility of investing in foreign currency deposits, which earn a higher average return than time deposits in Israeli currency.

The downward trend in the Short-Term Loan, evident for the past several years, sharpened in 1978. This type of asset has in fact practically disappeared from the public's asset portfolio: the outstanding balance, which stood at IL 76 million at the beginning of 1978, plummeted to only some IL 11 million by the end of the year.

(c) Linked Liquid Assets

During the first few months after the foreign currency reform the public adjusted its assets portfolio, investing heavily in Patam (local residents' foreign currency deposits). The widening during the year of the yield differential between foreign currency assets and index-linked assets could have resulted in a further expansion of Patam demand deposits, which are quasi-money, but on the other hand a slowdown in Patam time deposits was to be expected since here the savings element is apparently dominant. It nevertheless seems that during 1978 the two types of deposits continued to surge, which suggests that the reshuffling of the public's portfolios had not yet run its course. The balance of Patam demand deposits swelled 146 percent during 1978, and Patam time deposits by 130 percent. Net of currency valuation adjustments, the balance doubled (see Table XVII-7). Even if we exclude the speculative credit granted from the beginning of December (which was deposited mainly in Patam), there was an extremely rapid growth in foreign currency deposits. This trend was curbed at the end of the third quarter: the acceleration of inflation and the declining expectation of a devaluation in the last quarter altered the relative returns, so that the last quarter apparently witnessed a slump in Patam deposits (excluding the speculative increase in December) and a heavier investment in index-linked assets.¹⁶

¹⁶ A detailed discussion will be found in section 3.

TABLE XVII-6

MONEY SUPPLY AND UNLINKED ASSETS OF THE PUBLIC, 1976-78^a
(IL million)

	Money supply		Other unlinked assets						Money supply and other unlinked assets (1+9)	
			Time deposits ^b			Liquid assets		Deposits against liabilities (8)		Total (6+8)
	IL m. (1)	Percent increase (2)	IL m. (3)	Percent increase (4)	Short-Term Loans (5)	IL m. (3+5) (6)	Percent increase (7)			
Annual averages										
1976	11,331	14.3	3,635	2.8	109	3,744	1.2	161	3,905	15,237
1977	16,335	44.2	4,759	30.9	93	4,852	29.6	325	5,177	21,512
1978	22,474	37.6	5,846	22.8	31	5,877	21.1	383	6,260	28,735
Balances at end of period										
1976	13,487	27.1	4,064	15.9	67	4,132	15.1	152	4,284	17,771
1977	18,718	38.8	5,152	26.8	76	5,228	26.5	663	5,891	24,609
1978	27,151	45.1	6,544	27.0	11	6,555	25.4	538	7,093	34,244
March	20,629	10.2	4,817	-6.5	44	4,861	-7.0	322	5,183	25,812
June	23,373	13.3	5,909	22.7	38	5,947	22.3	381	6,329	29,702
September	24,831	6.2	6,434	8.9	20	6,454	8.5	397	6,851	31,682
December	27,151	9.3	6,544	1.7	11	6,555	1.6	538	7,093	34,244

^a Annual or quarterly rates of change.

^b Including negotiable certificates of deposit.

SOURCE: Table XVII-A8.

TABLE XVII-7
LINKED ASSETS OF THE PUBLIC IN THE BANKING SYSTEM, 1976-78
(IL million)

	Deposits linked to the consumer price index				Foreign currency deposits				
	Total	Thereof: approved savings schemes			IL million		Percent increase, less devaluation & exchange rate differentials		
		Total	Principal	Monthly average of net deposits ^a	Balance	Devaluation & exchange rate differentials	Total	Patam	Patam Restitution
1976	20,242	20,110	10,806	205	22,314	5,401	17.0	33.8	9.9
1977	37,479	36,790	18,359	468	49,681	23,519	17.2	39.5	6.8
1978	66,047	63,731	30,520	678	90,322	20,686	40.2	97.2	10.3
March	41,382	40,326	19,976	775	59,135	5,016	8.9	20.7	2.8
June	49,918	48,650	24,601	775	66,516	3,078	7.3	16.4	1.8
September	55,193	53,419	27,567	580	76,312	6,758	4.6	9.5	1.3
December	66,047	63,731	30,520	580	90,322	5,834	10.7	21.8	2.9

^a These figure are not identical with the changes in principal since withdrawals include linkage differentials.

SOURCE: Table XVII-A10.

TABLE XVII-8
ESTIMATED CONVERSION OF PAZAK RESTITUTION AND TAMAM
FUNDS, 1976-78
(IL million)

	Potential increase in Pazak restitution and Tamam		Total con- versions to IL	Conversion rate (%)	
	Total	Less de- valuation & exchange rate differentials		A ^a	B ^b
1976	7,274	3,261	2,250	31	69
1977	21,044	4,648	3,612	17	78
1978	23,264	9,187	5,814	25	63
1977 I	1,664	995	687	41	69
II	1,704	1,021	880	52	86
III	2,988	1,045	798	27	76
IV	14,688	1,587	1,247	8	79
1978 I	5,677	2,228	1,315	23	59
II	4,428	2,136	1,464	33	69
III	6,419	2,253	1,749	27	78
IV	6,740	2,570	1,286	19	50

^a The ratio between total conversions into IL and the total potential accumulation in Pazak restitution and Tamam accounts.

^b The ratio between total conversions and the total potential accumulation in Pazak restitution and Tamam accounts, less devaluation and exchange rate differentials.

SOURCE: Table XVII-A9.

Deposits of personal restitution receipts also expanded at a formidable rate this year. Net of devaluation and exchange rate differentials on the balance of the beginning of the year, the accumulation doubled (see Table XVII-8), due principally to the marked appreciation of the Deutsche mark. Despite the faster accumulation, the share of Pazak and Tamam in total foreign currency deposits declined because of the exceptional increase in Patam (see Table XVII-7). The rate of conversion of these deposits did not change significantly, the level remaining about the same as in preceding years, even though one of the factors which had previously prevented large conversions – the multiplicity of exchange rates – was eliminated with the foreign currency reform. The main causes may

TABLE XVII-9

NET FOREIGN CURRENCY ASSETS IN THE BANKING SYSTEM, 1976-1978
(\$ million)

End of period	Bank of Israel (1)	Banking institutions			Net assets in banking system (1+4) (5)
		Assets (2)	Liabilities (3)	Net (2+3) (4)	
1976	1,243	1,976	2,841	-865	378
1977	1,427	2,470	3,513	-1,043	384
1978	2,368	3,361	5,000	-1,639	729
March	1,391	2,181	3,338	-1,157	235
June	1,458	2,391	3,673	-1,281	176
September	1,567	2,741	4,095	-1,354	213
December	2,368	3,361	5,000	-1,639	729

SOURCE: Table XVII-A11.

have been the tax exemption granted on restitution deposits and the fact that they carried a higher-than-market interest rate. Monthly conversions have fluctuated sharply since the reform (see Table XVII-9), which is apparently connected with the fluctuations in the value of the mark against the dollar.

Savings scheme deposits also increased rapidly, though much less so than foreign currency deposits. The balance of such accounts grew by 73 percent; less interest, linkage differentials, and grants, average monthly deposits rose about 40 percent (see Table XVII-7). Most of the increase took place in May and June as a result of the energetic sales campaign conducted by the banks, which made cheap credit available for this purpose.

The balance of long-term index-linked deposits jumped from IL 700 million in 1977 to IL 2.3 billion at the end of 1978 (see Table XVII-A10). These deposits, which are made in sums of IL 500 million or more, belong mostly to nonprofit institutions, and bear a higher interest rate than bonds. Their rapid growth was apparently related to the increase in foreign transfers to these institutions.

7. THE BANKING INSTITUTIONS' BALANCE SHEET

The combined balance sheet of the banking institutions grew by 68 percent in 1978, compared with 90 percent in the previous year, and reached IL 548 billion (see Table XVII-10). As in 1977, the foreign currency items outstripped the rise in Israeli currency items — 77 vs. 60 percent. The difference between the growth of the two components was smaller than last year, both because the effect of the change in the exchange rate was smaller and because the adjustment was apparently greater during the first months after the reform.

The decline in the share of transactions in Israeli currency and its implications for the banking system are even more prominent in the balance of freely loanable funds. In the face of the rapid inflation of recent years, the weight of the traditional sources of non-directed short-term credit in Israeli currency has shrunk significantly. The traditional sources are demand and time deposits and negotiable certificates of deposit. Their weight during the past two years in the nominal increment of nondirected IL credit amounted to only about a third (see Table XVII-3). This was one of the reasons that impelled the banks to greatly increase their equity capital in recent years. The incremental funds were invested in bank branches, equipment, overseas operations, and shares. Equity capital accounted for 16 percent of the additional sources for expanding nondirected short-term lending in Israeli currency during 1978. If we deduct from the amount of capital mobilized the credit given to purchasers of shares, we find that the net impact of the incremental capital on the expansion of credit was even smaller. This heightens the doubt as to the possibility of planning a future expansion of credit by means of capital mobilization. This was already apparent in 1978 in the sharp decline in the weight of this component in the additional resources, a development reflected in the rise in the banks' liquidity deficits as a source for expanding IL credit this year.

There was a large variance in the growth rates of Israeli currency assets: government bonds and securities of local companies and institutions increased by 83 and 68 percent, respectively, while liquid assets in the Bank of Israel rose at a mere 21 percent nominal rate. On the liability side there was a steep 73 percent jump in savings scheme accounts and one of 51 percent in equity capital.

As stated, the foreign currency items rose faster than those in Israeli currency; this was evident in both transactions with local residents and overseas transactions. Foreign currency deposits of local residents grew by 82 percent, while nondirected foreign currency credit to local residents soared 110 percent. Foreign currency credit from earmarked

TABLE XVII-10
 ASSETS AND LIABILITIES OF BANKING INSTITUTIONS,^a 1977-78
 (IL million)

End-of-year balances	1977			1978		
	Israeli currency	Linkage differentials	Foreign currency	Israeli currency	Linkage differentials	Foreign currency
Assets						
Liquid IL assets at the Bank of Israel ^b	9,578			11,581		
Foreign currency deposits with the Bank of Israel			45,649			83,494
Loans and deposits abroad	338		38,007	10		63,917
Nondirected credit	12,793	1,323		19,912	1,934	
Participation in directed credit	3,370	287	59	3,784	311	51
Nondirected foreign currency credit to local residents			11,437			24,071
Foreign currency credit to local residents from approved earmarked deposits			5,831			10,906
Credit to the public from earmarked deposits	14,877	14,490		22,651	24,498	
Credit to the public from government deposits	6,876	192		10,046	304	
Securities of Israeli companies and institutions	14,810	11,577	119	22,227	22,103	234
Premises and equipment	1,452			2,113		
Loans to the government from the banks' own means	2,638	1,134	6,872	6,309	3,087	6,400
Government bonds ^c	1,720	1,926		3,592	3,047	
Loans to the government from earmarked deposits	24,808	25,459	4,108	38,952	45,029	7,270
Cash items in process of collection and banking institution deposits	1,605	923	3,329	3,628	1,534	5,566
Other accounts	8,441	807	1,339	14,229	1,594	2,079
Sundry accounts ^d	4,161 ^e	467 ^e	16,418 ^f	5,625 ^e	384 ^e	35,472 ^f
Contingent accounts ^g	9,716	599	17,002	13,452	946	26,030
Total assets	117,184	59,183	150,170	178,110	104,771	265,492

Liabilities

Equity capital and capital notes	7,892	47	2,103	2,499	131	2,544
Foreign deposits			54,052			95,078
Rediscounts	305			51		
Demand deposits	12,399			18,374		
Time deposits	5,152	12		6,544	13	
Approved saving schemes	19,672	17,118		32,331	31,400	
Linked long-term deposits	523	166		1,694	622	
Foreign currency deposits of the public			49,681			90,322
Approved earmarked deposits	38,227	41,038	1,129	58,030	71,934	1,920
Earmarked government deposits ⁱ	7,732	33	2,236	12,243	44	4,426
Government accounts ^j	296		1,857	246		192
Banking institution deposits and cash items in process of collection	1,545	569	3,467	2,332	883	5,772
Other accounts	8,911	17	1,232	14,440	16	1,842
Sundry accounts	4,824 ^k	467 ^k	16,516 ^l	6,163 ^k	384 ^k	35,477 ^l
Contingent accounts	9,716	599	17,002	13,452	946	26,030
Total liabilities	117,196	60,066	149,275	178,397	106,373	263,604

a The balance sheet published by the Department of the Examiner of Banks has been adjusted to conform to the definition in this chapter.

b IL deposits with the Bank of Israel treated as a liquid asset, treasury bills, and vault cash.

c Including the Short-Term Loan.

d Includes all adjustments mentioned in note a.

e IL rediscounts for the public.

f Foreign currency rediscounts for the public, rediscounts for the Jewish Agency, and Patach funds deposited with the Bank of Israel (as reported by the banking institutions).

g Acceptances, guarantees, and documentary credits.

h Deposits of foreign banks and overseas branches of Israeli banks, nonresidents, new immigrants, and temporary residents, less deposits with the Bank of Israel.

i Utilized earmarked deposits.

j Demand, time, and unutilized earmarked government deposits.

k As in note e, plus deposits against liabilities, demand deposits of the public in the Israel Bank of Agriculture.

l As in note f, but with Patach funds according to Bank of Israel data.

SOURCE: Monthly balance sheet of the banking institutions; rediscount and Patach in Bank of Israel – Bank of Israel balance sheet.

deposits was up 87 percent.¹⁷ At the same time there was also a rapid growth in Israeli deposits abroad and in deposits from overseas.

¹⁷In the analysis of bank credit in this chapter foreign currency loans from earmarked deposits were not included, because they are given for a long period and in the main finance investments. For a discussion of credit from this source see the chapter on the financial institutions.

APPENDIX

APPENDIX
TABLE XVII-A1
INDICATORS OF THE LIQUIDITY POSITION OF BANKING INSTITUTIONS 1976-78
 (IL million)

	Required liquidity on ordinary deposits ^a (1)	Required liquidity on time deposits ^b (2)	Required liquidity on non-directed credit (3)	Total required gross liquidity ^c (4)	Total required liquidity less liquidity exemptions (5)	End of month liquidity deficits(-) ^d (6)	Daily average liquidity deficits(-) for month (7)	Liquidity deficits/gross required liquidity ^e (daily average, in percent) (8)	Liquidity deficits/net required liquidity ^e (daily average, in percent) (9)
1976	6,211	765	418	7,459	6,036	-287	-418	-7.4	-6.0
1977	9,027	1,057	612	10,924	9,347	-489	-1,033	-11.6	-9.9
1978	12,680	1,006	913	15,378	13,118	-2,841	-1,311	-10.6	-9.0
January	8,206	977	661	10,043	8,517	-1,566	-676	-7.9	-6.5
February	8,745	945	692	10,559	9,081	-2,242	-1,450	-16.8	-14.0
March	9,868	925	672	11,673	10,091	-745	-1,828	-20.0	-17.4
April	9,692	1,002	692	11,631	9,908	-278	-70	-0.7	-0.6
May	10,411	1,063	761	12,497	10,660	-1,654	-139	-1.3	-1.1
June	11,264	1,095	875	13,675	11,770	-2,575	-1,406	-12.6	-10.8
July	10,986	1,115	957	13,512	11,481	-2,577	-2,127	-18.0	-15.4
August	10,828	1,121	984	13,347	11,256	-2,582	-1,630	-13.9	-11.8
September	11,257	1,110	989	13,979	11,847	-3,209	-2,597	-22.2	-18.8
October	10,783	1,052	1,089	13,768	11,426	-4,398	-3,017	-25.6	-21.5
November	11,107	1,023	996	13,746	11,496	-3,229	-3,205	-27.6	-23.0
December	12,680	1,006	913	15,378	13,118	-2,841	-1,311	-10.6	-9.0

^a Demand deposits and deposits against liabilities in Israeli currency.

^b Including time deposits withdrawn before maturity.

^c Required liquidity on other factors, such as savings, directed credit, unutilized balance of earmarked deposits.

^d Free reserves represent the balance between liquid assets and required liquidity net of liquidity exemptions. The liquid assets on which this table is based are taken from liquidity reports, and include certain adjustments which do not appear in the liquid assets data from the banking institutions' monthly balance sheet which appears in Table XVII-A2.

^e The gross required liquidity is before deducting liquidity exemptions, recognized liquidity deficiencies; the net required liquidity is after deducting these items.

SOURCE: Monthly liquidity reports of the banking institution, Department of the Examiner of Banks, *Banking Statistics*.

TABLE XVII-A2
 THE MONEY BASE BY COMPONENT, 1976-78
 (IL million)

End of period	Currency in circulation (1)	Liquid assets of banking institutions (2)	Narrow money base (1 + 2) (3)	Liquidity exemptions (4)	Recognized liquidity deficiencies (5)	Broad money base (3+4+5) (6)	Growth of broad money base (7)
1976	4,777	5,772	10,550	1,376	47	11,973	40.6
1977	6,319	9,578	15,897	1,367	210	17,474	45.9
1978	8,777	11,581	20,358	2,184	76	22,618	29.4
January	6,190	7,755	13,945	1,339	186	15,470	-11.5
February	6,540	7,655	14,195	1,311	168	15,673	1.3
March	6,878	9,581	16,459	1,498	80	18,037	15.1
April	7,214	10,286	17,500	1,637	86	19,223	6.6
May	7,470	9,332	16,802	1,656	181	18,639	-3.0
June	7,719	9,763	17,482	1,812	87	19,381	4.0
July	7,891	9,701	17,592	1,943	88	19,623	1.3
August	8,261	9,283	17,544	2,019	73	19,636	0.1
September	8,541	9,660	18,201	2,050	82	20,333	3.6
October	8,470	7,840	16,310	2,199	143	18,653	-8.3
November	8,652	9,307	17,959	2,164	89	20,212	8.4
December	8,777	11,581	20,358	2,184	76	22,618	11.9

SOURCE: Liquid assets of the banking institutions - monthly balance sheet of the banking institutions; liquidity exemptions and recognized liquidity deficiencies - monthly liquidity report of the banking institutions; currency in circulation - Department of the Examiner of Banks, Banking statistics.

TABLE
THE BANKING INSTITUTIONS' FREELY
(IL

	Jan- Dec, 1977 ^b	Jan.	Feb.	March
Uses				
1. Credit from banks' own resources	5,108	1,101	667	-19
2. Net credit to the government	1,454	-368	72	323
3. Bond and share purchases in excess of required investment (including linkage differentials)	1,616	126	251	-231
4. Surplus of foreign currency assets	98	106	-184	97
5. Premises and equipment	356	45	42	44
6. Total uses	8,632	1,010	848	214
Sources				
7. Demand deposits, and other deposits and creditors	1,253	-361	208	424
8. Time deposits	802	-59	-85	-134
9. Negotiable certificates of deposit	-	-	-	-
10. Required liquid cover on credit	-194	-49	-31	20
11. Approved savings schemes and long-term linked deposits ^c	1,535	104	139	270
12. Equity capital and capital notes	3,863	65	23	308
13. Rediscounts and recognized liquidity deficiencies	-23	238	-31	-337
14. Other accounts, net (including net linkage differentials (other than on securities))	1,194	-5	-51	1,160
15. Total sources	8,430	-67	172	1,711
16. Change in liquidity deficiencies (6-15)	202	1,077	676	-1,497

^a This table measures the net impact of the various items on freely loanable resources.

^b Revised data.

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LOANABLE RESOURCES, 1977-78^a

(million)

April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan- Dec. 1978
-315	1,434	3,044	1,003	431	1,170	1,036	-1,092	-547	7,913
224	685	1,003	-66	221	231	305	-164	782	3,248
-75	501	-1,466	485	855	-343	1,176	-152	336	1,463
180	143	-37	-39	7	6	-111	33	455	656
45	53	50	57	68	66	83	92	11	656
59	2,816	2,594	1,440	1,582	1,130	2,489	-1,283	1,037	13,936
-86	241	471	-223	160	287	-348	-11	1,083	1,845
304	293	14	43	57	-58	-185	-137	-88	-35
-	131	103	175	79	103	172	233	67	1,063
-20	-68	-114	-81	-27	-4	-100	93	83	-298
265	293	367	239	280	165	201	287	340	2,950
2	4	1,069	1,059	158	558	27	81	1,191	4,545
6	94	-95	4	48	-8	24	-51	-19	-127
55	449	-138	222	821	-539	1,509	-609	-1,256	1,617
526	1,437	1,677	1,438	1,576	504	1,300	1,401	1,401	11,560
-467	1,379	917	2	6	626	1,189	-1,169	-364	2,367

SOURCE: The monthly balance sheet of the banking institutions and monthly liquidity report.

TABLE

MONTHLY INFLUENCE OF PUBLIC AND
(IL

	1	2	3	4	5
1. Public sector operations, net	1,579	1,111	2,311	546	1,930
Thereof: Government	1,151	835	2,091	296	1,105
2. Foreign currency sales by the private sector ^a	-1,810	-2,631	-816	203	-1,171
3. Change in foreign currency deposits of the public	-3,291	-222	-952	-1,100	-1,066
4. Foreign currency credit to the private sector ^{a,b}	1,517	1,857	1,571	155	587
5. IL credit to the private sector ^b	-149	35	-135	698	152
6. Open-market operations ^c	118	62	137	101	21
7. Other factors	84	38	148	438	-611
8. Total increase in narrow money base	-1,952	250	2,264	1,041	-698
9. Liquidity exemptions, recog- nized liquidity deficiencies ^a	-52	-47	99	145	114
10. Total increase in broad money base ^a	-2,006	203	2,263	1,186	-584

^a In September 1977 the arrangement in force since May 1976 for financing export shipments from the banks' own foreign currency means was cancelled. This ar-

1. A IL 1.4 billion rise in foreign currency sales in 1976 and a decline of IL 1.9 billion in 1977 and IL 1 billion in 1978.
2. A IL 900 million reduction of credit to the public in 1976 and an increase in 1977 of IL 1.9 billion, and in 1978 of IL 1 billion.
3. A IL 300 million reduction in liquidity exemptions in 1976 and a IL 2 million increase in the broad money base that year.
4. The change in the arrangement had no effect in 1977 and 1978 on the money base or on liquidity exemptions but increased the liquidity requirements of the

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PRIVATE SECTORS ON THE MONEY BASE, 1978
(million)

6	7	8	9	10	11	12
1,948	1,244	2,196	1,192	-2,348	379	2,921
1,593	1,014	1,861	772	-2,648	11	2,603
-1,120	-1,769	-726	-1,581	-105	2,400	3,815
-884	-1,506	-2,054	-594	-436	-1,525	-4,828
-4	1,036	67	1,262	227	-16	1,203
578	462	-29	250	192	131	-58
68	-25	-78	-35	-96	-137	5
49	668	576	163	675	417	-708
680	110	-48	657	-1,891	1,649	2,350
62	132	61	41	156	-35	7
742	242	13	698	-1,735	1,614	2,357

banking institutions, which have to hold liquid assets in the ratio of 15 percent of the Export Shipments Fund balances. Most of the effect in 1977 occurred in the last quarter of the year, and in 1978 in the first quarter.

agement (and its cancellation) had the following effects:

- b From the beginning of 1977 rediscount in shipments fund was transferred from Israeli currency credit to foreign currency credit.
- c Only including open market activities: The acquisition of non-negotiable securities, which are substitutes for IL credit, is included in item (5). Redemption of bonds from the portfolio and purchasing of bonds at source appear in item (7), "other factors", since they represent Bank of Israel transactions with the government, not with the public.

TABLE

**OUTSTANDING CREDIT GRANTED TO LOCAL RESIDENTS
(IL**

	Nondirected credit, in IL ^b	Directed credit in IL		Directed foreign currency through		
		Total	Rediscounts & liquidity exemptions	Total	Export Shipments Fund	Rediscounts & liquidity exemptions
1977	12,793	7,675	5,672	13,998	7,630	12,895
1978	19,912	9,503	7,927	26,976	15,072	26,628
January	13,895	7,635	5,644	15,704	8,649	14,903
February	14,500	7,324	5,384	17,796	10,317	17,387
March	14,937	6,777	5,463	19,444	11,768	19,261
April	14,410	7,956	6,475	19,644	11,875	19,522
May	15,813	8,036	6,549	21,122	12,506	20,994
June	18,806	8,472	6,945	21,810	12,954	21,616
July	19,825	9,406	7,830	22,743	13,296	22,650
August	20,255	9,228	7,627	23,448	14,146	23,285
September	21,315	9,430	7,791	24,700	15,013	24,532
October	22,404	9,546	7,986	25,210	15,271	25,130
November	21,212	9,733	8,097	25,533	14,990	25,345
December	19,912	9,503	7,927	26,976	15,072	26,628

a Excluding credit to the government and National Institutions.

b Linkage differentials on nondirected credit totalled IL 1,323 million in December 1977, and IL 1,975 million at the end of 1978; these are not included in the credit balances in this table.

c Linkage differentials on credit from the Employers Loan Fund totalled IL 467 million in December 1977 and IL 384 million in December 1977. These are not included in the credit balances in this table.

d Includes the financing of export shipments from the bank's foreign currency means.

e Excludes the financing of export shipments from the banks' foreign currency means.

f After the foreign currency reform the approved foreign currency credit item was reclassified,

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BY THE BANKING SYSTEM (EXCL. INDEXATION), 1976-78^a
 million)

funds	Non- directed foreign currency credit ^{e,f}	Total bank credit to the public	Credit from earmarked foreign currency deposits ^f	Credit from earmarked nongovern- ment deposits	Credit from government deposits (to tax debt- ors etc.)	Other credit from earmarked government deposits
Rediscounts outside funds						
300	10,606	45,372	5,831	14,877	1,817	5,059
426	24,071	80,888	10,906	22,651	2,775	7,271
301	10,963	48,498	6,044	15,122	1,709	4,970
295	11,493	51,409	6,802	15,657	1,669	5,109
284	12,409	53,850	7,029	16,483	1,984	5,342
276	13,005	55,290	6,935	17,142	1,897	5,455
256	13,788	59,014	8,971	17,461	1,867	5,661
255	14,637	63,980	8,887	18,291	2,003	5,771
323	15,750	68,048	9,087	18,772	1,966	5,993
408	16,116	69,454	9,444	19,246	2,127	6,227
420	16,649	72,514	9,950	19,762	3,232	6,464
409	17,842	75,412	10,851	20,366	2,957	6,447
418	20,248	77,143	12,661	21,352	2,808	6,517
426	24,071	80,888	10,906	22,651	2,775	7,271

being apportioned between "nondirected foreign currency credit" and "credit from earmarked foreign currency deposits". The latter type of credit is mostly long-term and is not discussed in this chapter. In other changes loans were transferred from "nondirected foreign currency credit" to "credit to local residents" (about IL 2 billion in October 1979) and from "credit from earmarked foreign currency deposits" to "credit to local residents" (about IL 1.8 billion in December 1977). "Credit to foreign residents" is listed as a foreign currency asset of the banking institutions in Tables XVII-9 and XVII-A11.

SOURCE: Monthly balance sheet of the banking institutions, monthly liquidity report of the banking institutions.

TABLE XVII-A6

DIRECTED CREDIT TO THE PUBLIC, 1977-78
(IL million)

	Balance at end of year				Annual averages			
	1977	1978	Percent increase		1977	1978	Percent increase	
			1977	1978			1977	1978
1. IL credit for domestic activity	3,087	2,208	32	-28	2,725	2,708	27	-1
Working capital funds	2,325	1,599	44	-31	2,003	1,932	40	-4
For industry	981	641	96	-35	739	825	72	12
For agriculture	386	270	-16	-30	466	335	17	-28
Supervised agricultural credit	184	279	44	52	139	186	33	34
Employers Loan Fund	774	410	46	-47	660	586	33	-11
Other	762	608	5	-20	721	777	1	8
2. IL export credit	4,588	7,295	51	59	3,614	5,879	46	63
Export Production Fund	3,492	6,034	64	73	2,797	4,994	54	79
Citrus and Cotton Fund	695	930	13	34	499	578	19	16
Indirect Exports Fund	401	331	38	-17	318	307	33	-3
3. Export credit in or linked to foreign currency	13,998	26,976	156	93	7,958	22,011	86	177
Credit for export shipment in IL linked to foreign currency	4,340	7,387	128	70	2,204	5,464	46	148
Export Shipments Fund	3,509	7,387	956	111	864	5,365	29	521
From lines of credit	831	-	-47	-100	1,339	99	59	-93
Diamond Fund (foreign currency)	7,630	15,072	172	98	4,598	12,988	102	182
Imports for export production (foreign currency)	2,028	4,517	171	123	1,156	3,559	140	208
4. Foreign currency rediscounts outside the funds	300	426	8	42	277	339	-7	22

SOURCE: Monthly balance sheet of the banking institutions; monthly liquidity report of the banking institutions.

TABLE XVII-A7
 OUTSTANDING IL CREDIT GRANTED TO THE GOVERNMENT BY THE BANKING SYSTEM, 1976-78
 (IL million)

	From the Bank of Israel			From banking institutions			
	Credit granted to govt. ^a (1)	Govt. & National Institution deposits ^b (2)	Net credit (1-2) (3)	Credit granted to govt. ^c (4)	Government securities ^d (5)	Less government deposits ^e (6)	Net credit (4+5+6) (7)
1976	11,313	291	11,022	1,110	1,292	189	2,213
1977	23,031	3,724	19,307	2,638	1,714	296	4,057
1978	30,366	9,816	20,550	6,309	3,592	246	9,655
January	23,610	3,555	20,055	2,305	1,704	284	3,724
February	14,760	3,789	20,971	2,506	1,719	267	3,958
March	25,506	3,614	21,892	2,770	1,765	265	4,270
April	26,014	5,075	20,939	3,010	2,033	257	4,787
May	25,972	3,922	22,050	3,714	2,640	261	6,093
June	26,792	3,681	23,111	4,741	2,714	256	7,199
July	26,369	2,949	23,420	4,712	3,004	252	7,464
August	28,218	2,969	25,249	4,960	2,609	239	7,691
September	29,082	3,375	25,707	5,242	3,005	258	7,990
October	25,845	698	25,147	5,606	3,317	276	8,647
November	22,719	2,598	20,121	5,470	3,488	247	8,711
December	30,366	9,816	20,550	6,309	3,592	246	9,655

^a Includes the monthly credits to the government's account for Bank of Israel profits, transferred to the Treasury.

^b Includes the Bank of Israel's capital and the "other accounts" item in its balance sheet.

^c The substantial growth of credit to the government stems from long-term linked deposits of the banking institutions with the Accountant General, which constitute the use of the freely loanable savings schemes funds.

^d Excludes treasury bills and the banks' Short-Term Loan holdings.

^e Israeli currency deposits, the government's deposits earmarked for loans to the public and the loans actually extended.

SOURCE: Bank of Israel balance sheet; monthly balance sheet of the banking institutions.

TABLE

**MONEY SUPPLY, THE PUBLIC'S UNLINKED DEPOSITS,
(IL**

End of period	Money supply				Money supply seasonally adjusted	
	Cash (1)	Demand deposits (2)	Total (1+2) (3)	Percent increase from previous period (4)	Total (5)	Percent increase from previous period (6)
1976	4,777	8,709	13,487	27.1	13,209	27.6
1977	6,319	12,399	18,718	38.8	18,332	38.8
1978	8,777	18,374	27,151	45.1	26,671	45.5
January	6,190	11,576	17,766	-5.1	17,927	-2.2
February	6,540	12,263	18,803	5.8	18,955	5.7
March	6,878	13,751	20,629	9.7	20,526	8.3
April	7,214	13,477	20,691	0.3	20,527	0.0
May	7,470	14,543	22,013	6.4	21,903	6.7
June	7,719	15,654	23,373	6.2	23,164	5.8
July	7,891	15,194	23,085	-1.2	23,318	0.7
August	8,261	15,347	23,608	2.3	23,514	0.8
September	8,541	16,290	24,831	5.2	24,658	4.9
October	8,470	15,120	23,590	-5.0	23,877	-3.2
November	8,652	15,501	24,153	2.4	24,446	2.4
December	8,777	18,374	27,151	12.4	26,671	9.1

^a Including negotiable certificates of deposits.

SOURCE: Examiner of Banks, *Banking Statistics*, monthly balance sheet of the banking institutions; State Loans Administration, weekly survey of the money and capital markets.

AND SHORT-TERM LOAN BALANCE, 1976-78
million)

Percent of cash in money supply (original data) (7)	IL time deposits ^a (8)	Short- Term Loan held by public (9)	Deposits against liabil- ities, in IL (10)	Total	
				IL million (3+8+9+10) (11)	Percent in- crease from previous period
35.4	4,064	67	152	17,771	24.0
33.8	5,152	76	663	24,609	38.5
32.3	6,544	11	538	34,244	39.2
34.8	5,089	49	279	23,183	-5.8
34.8	4,985	51	323	24,161	4.2
33.3	4,817	44	322	25,812	6.8
34.9	5,200	58	410	26,359	2.1
33.9	5,607	42	307	27,969	6.1
33.0	5,909	38	381	29,702	6.2
34.2	6,200	19	475	29,778	0.3
35.0	6,376	23	334	30,341	1.9
34.4	6,434	20	397	31,682	4.4
35.9	6,422	7	427	30,446	-3.9
35.8	6,566	12	407	31,138	2.3
32.3	6,544	11	538	34,244	10.0

TABLE XVII-A9
ESTIMATED CONVERSION OF PAZAK RESTITUTION AND TAMAM FUNDS,^a 1976-78
(IL million)

	Personal restitution (1)	Interest (2)	Exchange rate & linkage differentials (3)	Total poten- tial increase (1+2+3) (4)	Actual increase (5)	Amount con- verted to IL (4-5) (6)	Conversion rate (%)	
							A ^b (6/4) (7)	B ^c (6/[1+2]) (8)
1976	2,560	701	4,013	7,274	5,024	2,250	31	69
1977	3,616	1,032	16,396	21,044	17,432	3,612	17	78
1978	7,119	2,068	14,077	23,264	17,450	5,814	25	63
January	569	115	1,226	1,910	1,377	533	28	78
February	537	186	1,730	2,453	2,001	452	18	63
March	558	263	493	1,314	984	330	25	40
April	547	182	-267	462	117	345	75	47
May	555	126	1,195	1,876	1,398	478	25	70
June	544	182	1,364	2,090	1,449	641	31	88
July	567	94	1,486	2,147	1,382	765	36	116
August	606	133	1,543	2,282	1,837	445	20	60
September	697	156	1,137	1,990	1,452	538	27	63
October	537	250	5,770	6,557	5,801	756	12	96
November	697	134	-4,440	-3,609	-4,009	400	-11	48
December	705	247	2,840	3,792	3,661	131	3	14

^a The data relate to Pazak restitution funds, and Tamam, but not to other Pazak accounts.

^b This calculation assumes that the recipients treat exchange rate differentials in the same manner as restitution and interest receipts.

^c This calculation assumes that the recipients treat exchange rate differentials as capital gains on the deposits.

SOURCE: Personal restitution receipts and exchange rate differentials - Ministry of Finance, Foreign Exchange Department; interest on Pazak and Tamam - Bank of Israel balance sheet; actual increase - monthly balance sheet of the banking institutions.

TABLE XVII-A10
LINKED ASSETS OF THE PUBLIC IN THE BANKING SYSTEM, 1976-78
(IL million)

End of year	Approved savings scheme deposits		Long-term linked deposits ^a	Foreign currency deposits				Total deposits	
	Total	Principal		Restitutions ^b		Patam ^b		Total	Exchange rate and devaluation differentials
				Total	Exchange rate and devaluation differentials	Total	Exchange rate and devaluation differentials		
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	
1976	20,110	10,806	167	15,199	4,013	7,115	1,388	42,556	5,401
1977	36,790	18,359	689	32,631	16,396	17,050	7,123	87,160	23,519
1978	63,731	30,520	2,316	50,081	14,077	40,241	6,609	156,369	20,686
January	37,832	18,837	790	34,007	1,226	19,950	716	92,579	1,942
February	39,074	19,364	856	36,008	1,730	21,918	494	97,856	2,224
March	40,326	19,976	1,056	36,993	493	22,142	357	100,517	850
April	42,157	20,531	1,154	37,110	-267	23,030	237	103,451	-30
May	45,837	22,396	1,238	38,507	1,195	25,189	-111	110,770	1,084
June	48,650	24,601	1,268	39,957	1,364	26,559	660	116,434	2,024
July	50,252	25,678	1,315	41,338	1,486	28,616	1,740	121,521	3,226
August	51,991	26,776	1,427	43,175	1,543	31,768	721	128,361	2,264
September	53,419	27,567	1,774	44,627	1,137	31,685	131	131,504	1,268
October	55,559	27,832	1,774	50,428	5,770	33,476	1,285	141,238	7,055
November	59,066	29,214	1,985	46,420	-4,440	34,526	-698	141,997	-5,138
December	63,731	30,520	2,316	50,081	2,840	40,241	1,077	156,369	3,917

^a The principal amounted to IL 132 million at the end of 1976, IL 523 million at the end of 1977, and IL 1,694 million at the end of 1978.

^b Including foreign currency valuation adjustments due to changes in the external value of the various foreign currencies. After the foreign currency reform all nonrestitution foreign currency deposits were classified as "Patam".

SOURCE: Monthly balance sheet of the banking institutions.

TABLE XVII-A11
FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM, 1976-78
(\$ million)

End of period	Bank of Israel				Banking institutions				
	Foreign currency assets (1)	Non-residents' deposits ^a (Patach) (2)	Other liabilities ^b (3)	Net foreign currency assets (1+2+3) (4)	Foreign currency assets ^c (5)	Non-residents' deposits ^d (Patach) (6)	Other liabilities ^e (7)	Net foreign currency assets (5+6+7) (8)	Net foreign currency assets in the banking system (4+8) (9)
1976	1,638	206	189	1,243	1,976	1,186	1,655	-865	378
1977	1,827	202	198	1,427	2,470	1,468	2,045	-1,043	384
1978	2,970	396	206	2,368	3,361	2,066	2,935	-1,639	729
January	1,773	221	167	1,385	2,253	1,508	1,766	-1,021	364
February	1,733	248	153	1,332	2,199	1,548	1,734	-1,083	249
March	1,798	275	132	1,391	2,181	1,594	1,744	-1,157	235
April	1,860	274	135	1,452	2,275	1,633	1,788	-1,146	306
May	1,833	277	134	1,421	2,345	1,669	1,880	-1,204	217
June	1,853	273	123	1,458	2,391	1,697	1,976	-1,281	176
July	1,880	283	113	1,483	2,444	1,767	1,947	-1,269	214
August	1,944	278	115	1,550	2,600	1,848	2,039	-1,287	263
September	2,056	300	189	1,567	2,741	1,937	2,158	-1,354	213
October	2,312	320	198	1,794	2,880	2,021	2,287	-1,429	366
November	2,431	335	178	1,919	2,975	2,011	2,471	-1,506	412
December	2,970	396	206	2,368	3,361	2,066	2,935	-1,639	729

^a Nonresidents' deposits redeposited by the banking institutions with the Bank of Israel.

^b Includes deposits of foreign banks and Israeli currency deposits of the International Monetary Fund.

^c Loans to and deposits with foreign banks and overseas branches of Israeli banks, loans to nonresidents, foreign securities, and vault cash.

^d Includes deposits of new immigrants and temporary residents, less Patach deposits redeposited with the Bank of Israel.

^e Deposits of foreign banks and overseas branches of Israeli banks.

SOURCES: Balance sheet of the Bank of Israel; monthly balance sheet of the banking institutions.