

## Chapter 1

# *Developments in the Activity of the Banking System in Israel in 2007*

Continued expansion in the economy during 2007 led to a large growth in aggregate demand for bank and non-bank credit due to the income and substitutability effect, and to an increase in the supply of bank credit, mainly because of the decrease in credit risk. As a result of these changes, outstanding bank credit to the public increased to a considerable extent and its price fell. These developments encompassed most credit segments, despite the continued contestability from non-bank credit.<sup>1</sup>

The positive trend in the global economy and in local economic activity and the local capital markets continued in 2007 for the sixth consecutive year. GDP uses increased considerably. Particularly notable was the expansion in gross domestic investment—the largest increase for 16 years. The expansion in investment came against the background of high utilization of existing capital stocks following several years of buoyant economic activity. The high level of investment was translated into a large growth in demand for credit<sup>2</sup> and for other sources of finance in all principal industries and especially in the burgeoning human-capital intensive industries. As in previous years, most of this demand was directed at non-bank entities although a substantial proportion was directed at the banking system as well, leading to a large growth in outstanding bank credit. A notable increase was recorded in credit in the unindexed segment. This was due to the lack of alternatives for unindexed non-bank credit for the short

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<sup>1</sup> A study conducted by the Banking Supervision Department's Research Unit at the Bank of Israel found that demand elasticity for bank credit relative to GDP at the overall industry level is 1.5. The rate of increase in outstanding credit during 2007 conforms to this finding: Credit expanded by 8.7 percent while the economy grew by 6.1 percent. See D. Ruthenberg and Y. Hecht (2006), "The Relationship Between Business Cycles in the Economy and the Volume and Quality of Bank Credit Against the Background of the Basel II Agreement – the Israeli Experience." Bank of Israel, Banking Supervision Department, Research Unit, Discussion Paper Series 06.01.

<sup>2</sup> The rates of change presented in this chapter refer to the entire system (the five large groups, 3 independent banks and excluding the negligible activity of foreign banks). See Table 1.3 and Figure 1.7 for further details. Outstanding credit and the rates of change in it that are reported and analyzed in this chapter refer to balance-sheet credit to the public, including the analysis of off-balance-sheet activity where the balances represent credit risk (Table 1.6 and Table 1.7). See Section 4c in this chapter.

and medium terms. Apart from the growth in business sector demand for credit, the high level of activity in the economy and the increase in households' income and financial wealth led to an expansion in private consumption and with it, a growth in demand for consumer credit and housing loans. Unlike the diverse forms of credit available to the business sector (bank credit and non-bank credit), the majority of consumer credit derived from the banking system. In addition, credit from the banking system has a relative advantage over non-bank sources as regards its accessibility for small and medium-sized businesses.

To conclude, the rate of growth in outstanding credit to both businesses and households during the period reviewed was the highest since 2001.

Growing signs of a cyclical slowdown in the global economy became apparent during the initial months of 2008 due to the implications of the financial crisis,<sup>3</sup> which is expected to hold down the economy's growth rate. If the less optimistic scenarios materialize, the business sector's ability to raise sources of finance outside of the banking system is likely to be impaired in 2008. Such a development will increase the bank's share in the supply of credit during 2008.<sup>4</sup>

Credit prices and credit margins declined during the year, principally in CPI-indexed credit. This decrease derived from both supply factors and demand factors. The principal factor on the supply side was the decrease in firms' risks due to the continued buoyant level of activity in the economy, while the demand side was notable for competition for the supply of credit by non-bank entities (the substitutability effect).<sup>5</sup>

The disintermediation process continued in 2007. The process was apparent with respect to the public's liabilities and assets: (1) On the public's liabilities side, the banks' share of total credit and credit substitutes declined as stated, most notably in favor of the firms that issued bonds on the Tel Aviv Stock Exchange—despite the large growth in outstanding bank credit. (2) On the public's financial asset side, the decline in the proportion of deposits to other components of the public's financial assets portfolio continued. In our estimation, the decrease in bank deposits derived from a change in the public's preferences, due to the tendency to hold a financial asset portfolio with higher levels of yield and risks and as a result of the low interest rates which the banks offered on short-term deposits. We expect contestability to increase in 2008, especially in the household segment.

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<sup>3</sup> See Chapter 2 in this survey.

<sup>4</sup> For further details on this subject, see M. Zilberberg and D. Ruthenberg (2008), "Characteristics of Business Firms with Indebtedness to the Banks which Issued Bonds on the Tel Aviv Stock Exchange during Recent Years," Bank of Israel, Banking Supervision Department, Research Unit, Discussion Paper 08.01.

<sup>5</sup> For further details see Chapter 2 in this survey and especially Table 2.3.

This is because a legislative change permitting non-bank entities to issue liquid mutual funds with a short duration went into effect at the beginning of 2008.

The Israeli banking system increased its activity abroad during recent years because of a reduction in part of their local activity and the desire to diversify their sources of profit. This was mainly done by purchasing local banks in the emerging markets.

## 1. THE BACKGROUND—MACROECONOMIC DEVELOPMENTS WORLD WIDE AND IN ISRAEL

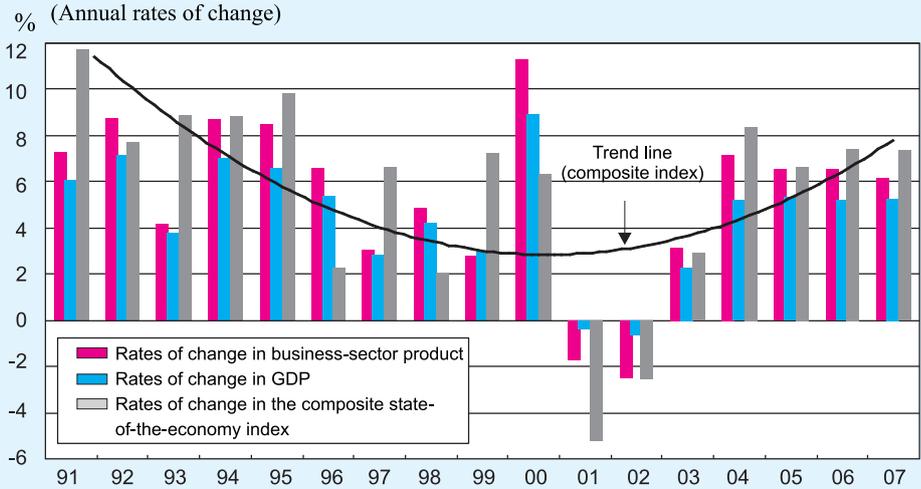
In line with the cyclical expansion that began in 2003 following the recession years of 2001 and 2002, a continued growth was recorded in economic activity in 2007. Local economic activity in 2007 appears to have been directly affected by the continued improvement in the global economy. The annual global growth rate amounted to 2.2 percent in the USA in 2007, 3.1 percent in the eurozone, and 3.5 percent in the OECD countries. These growth rates were reflected by a large expansion in demand for Israeli exports and imports of goods and services to Israel—by 8.4 percent and 12.3 percent respectively. A substantial increase in domestic demand was recorded: from the retail sector where private consumption rose by the high rate of 6.6 percent; and from the firms' sector, with gross domestic investment expanding by the high rate of 13.8 percent. A particularly large growth in investment was recorded in the manufacturing, construction equipment, transportation and communication industries. As a result, gross domestic product and business sector product rose by 5.3 percent and 6.1 percent respectively, and the Composite Index went up by 7.3 percent (Figure 1.1).

The rapid growth typical of the Israeli economy during recent years continued in 2007 and actually strengthened in the fourth quarter. In that quarter, GDP and business sector product rose by 6.1 percent and 7.7 percent annualized respectively, compared with 5.3 percent and 6.1 percent respectively in the whole of 2007. The growth in the fourth quarter of the year mainly reflected the upsurge in exports, while the rate of increase in merchandise imports slowed.

The high growth rates in the economy during 2007 were apparent in the labor market: The unemployment rate fell consistently during the year, continuing the trend that began at the end of 2003, and reached 6.7 percent at the end of 2007, the lowest level for nearly 12 years—compared with 7.8 percent at the end of 2006. The average real wage per employee post remained largely unchanged in 2007 and amounted to NIS 7,650 at the end of the year, slightly more than at the end of 2006 (Figure 1.2).<sup>6</sup>

<sup>6</sup> See Chapter 2 of the 2007 Bank of Israel Report for further details of macroeconomic developments in Israel in 2007.

**Figure 1.1**  
**Annual Changes in GDP, Business-Sector Product and the Composite State-of-the-Economy Index, 1991-2007**  
 (Annual rates of change)

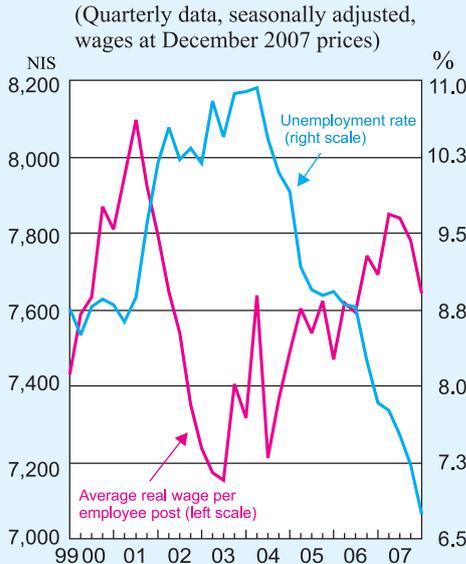


SOURCE: Based on data from the Central Bureau of Statistics.

The improvement in the macroeconomic environment in which the Israeli banking system operated was accompanied by buoyant activity in the capital market: 2007 was the sixth consecutive year when share prices rose. The Tel Aviv 100 Index went up by the high rate of 21 percent in real terms (Figure 1.3). Due to the financial crisis and forecasts of a considerably slower rate of economic growth in 2008 however, this index plummeted by 14 percent in real terms during the first four months of 2008.

The capital market's high level of liquidity and trading turnover derives inter alia from the high level of involvement by foreign investors and financial institutions (pension funds, provident funds and the insurance companies) in the market: Daily turnover in shares and corporate bonds surged in 2007, by approximately 50 percent and 150 percent respectively

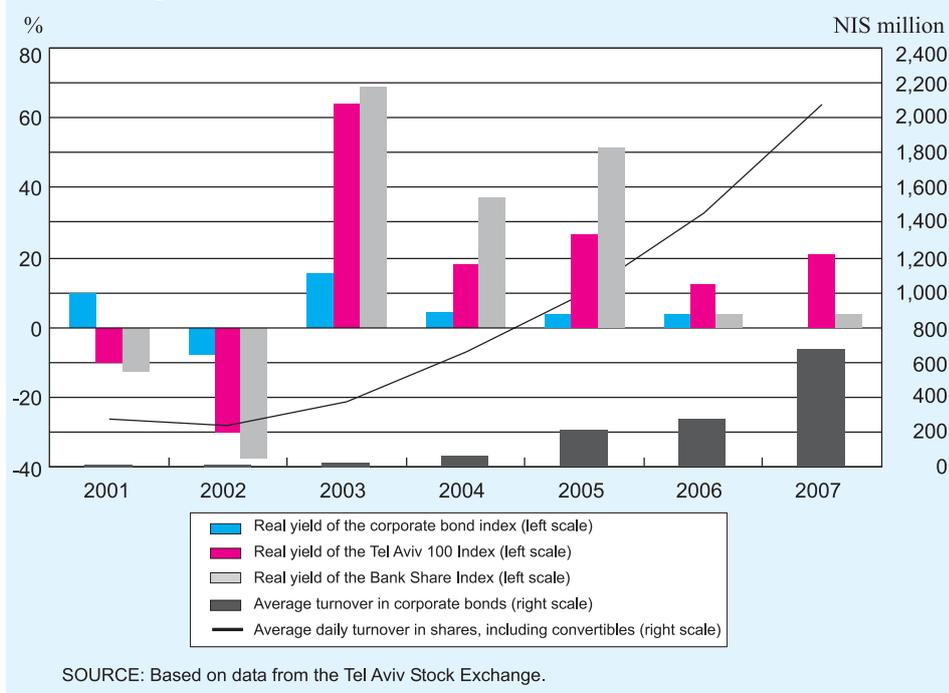
**Figure 1.2**  
**Major Developments in the Labor Market - Unemployment and Average Real Wage per Employee Post, December 1999 to December 2007**  
 (Quarterly data, seasonally adjusted, wages at December 2007 prices)



SOURCE: Based on data from the Central Bureau of Statistics.

compared with 2006 and amounted to a daily average of NIS 2.1 billion and NIS 0.7 billion respectively. The large growth in corporate bond turnover is attributed to two main factors: (1) the decline in the budget deficit led to reduced domestic borrowing, as a result of which institutional investors diverted their money to private sector issues; (2) a continued growth in business sector issues and placements, which reached NIS 73 billion in 2007 compared with only NIS 43 billion in 2006 (Figure 1.4). This development was uniform over the year. Corporate bond issues, which became the principal substitute for bank credit during recent years, were centered in the first half of the year. As a result of the shocks in the financial markets, this margin increased and the volume of issues decreased considerably. Accordingly, NIS 28 billion were raised from 133 issues in the local capital markets during the first half of 2007, while in the second half issue volume totaled only NIS 19 billion. The decrease continued apace in the first quarter of 2008: Only 16 issues, amounting NIS 8 billion, were recorded during the months January-March 2008.<sup>7</sup>

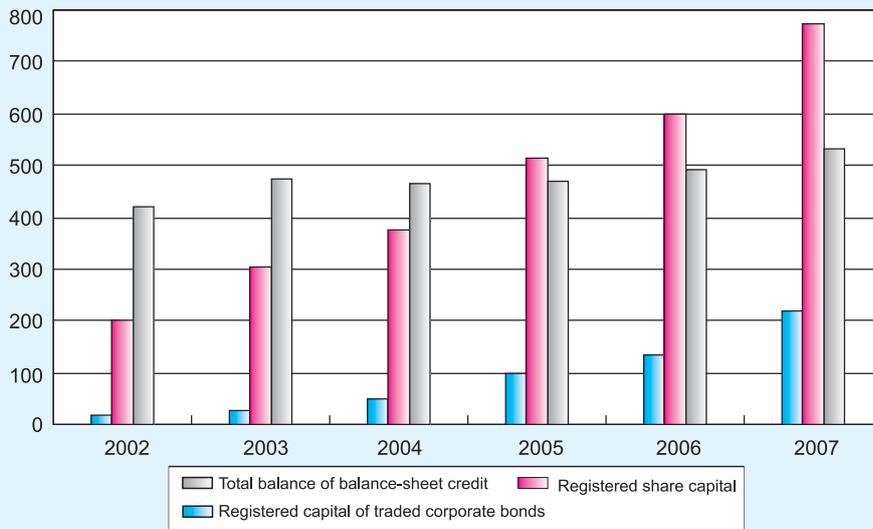
**Figure 1.3**  
Real Annual Yield of the Tel Aviv 100 Index, the Bank Share Index, the Corporate Bond Index and Average Daily Turnover in Shares and Corporate Bonds, 2001-07



<sup>7</sup> According to a recent study conducted by the Banking Supervision Department's Research Unit (Footnote 4), worldwide experience shows that in a period of slowdown in economic activity, only particularly good business firms will continue to issue, while other firms will increase their demand for bank credit.

**Figure 1.4**  
**Registered Capital for Trading of Corporate Bonds and Shares Traded on the Tel Aviv Stock Exchange, and Balance of Bank Credit to the Public,<sup>a</sup> 2002-07**

NIS billion



<sup>a</sup> The balance of balance-sheet credit for 2003 and 2004 includes Mishkan and Tefahot banks.

SOURCE: Based on data of the Tel Aviv Stock Exchange and published financial statements.

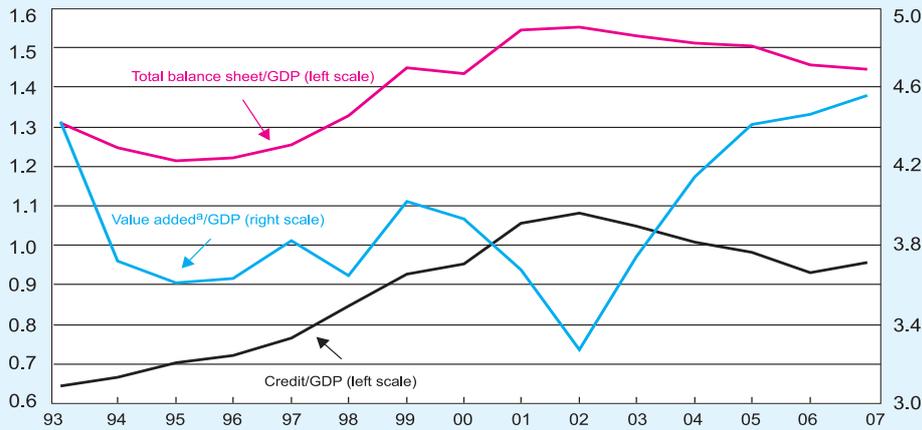
## 2. PRINCIPAL DEVELOPMENTS IN THE INDICES OF BANKING ACTIVITY

The banking activity index, which is expressed by the ratio of added value<sup>8</sup> to GDP, continued to rise and was similar to the average ratio in the developed countries (Figure 1.6). The rise in this ratio began at the start of the present real cycle in 2003 (Figure 1.5) and is similar to the average ratio in the developed countries (Figure 1.1).

Other indices of banking activity are the ratio between the banking system's aggregate balance sheet and GDP, and the ratio between aggregate bank credit and GDP. The disintermediation process is apparent in both these ratios, which fell between 2003 and 2006 as a result of the rapid development of the non-bank credit market. The decline in the balance sheet/GDP ratio ceased in 2007 when the 5.5 percent increase in the aggregate balance sheet was similar to the rate of increase in GDP. The ratio between aggregate bank credit and GDP rose slightly in 2007, for the first time since 2002, and amounted to 3.7 percent at the end of the year. The rise in the ratio derived from an 8.7 percent increase in bank credit, which exceeded the GDP growth rate. However, the value of this ratio is lower than the average for countries similar to Israel (Figure 1.6a).

<sup>8</sup> Added value is the sum of total ordinary before-tax net income, salary and related expenses and other operating expenses.

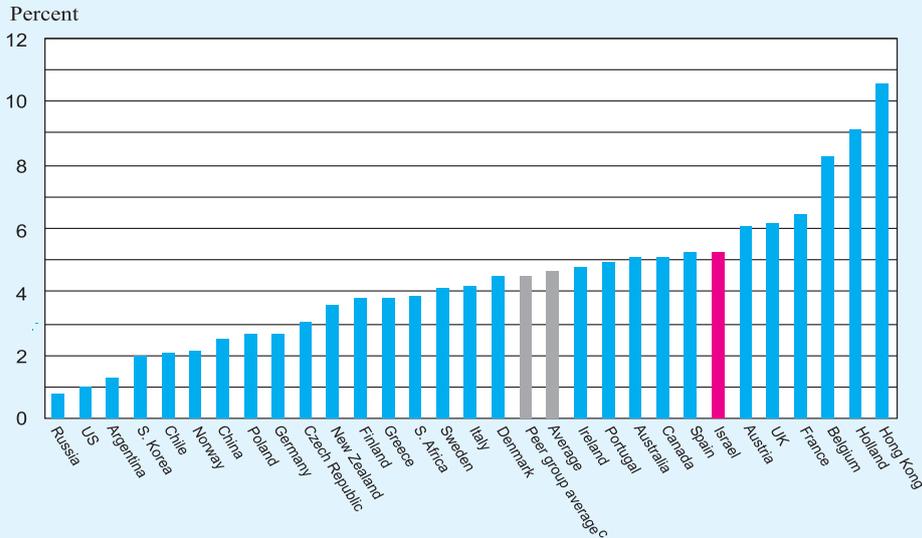
**Figure 1.5**  
**Indices of Banking Activity of the Five Major Banking Groups Relative to GDP, 1993-2007**  
 (Percent)



<sup>a</sup> Value added is the sum of net ordinary before-tax income, salaries and related expenses, general expenses, maintenance and depreciation on buildings and equipment.

SOURCE: Based on published financial statements and data from the Central Bureau of Statistics.

**Figure 1.6**  
**Value Added<sup>a</sup> as Share of GDP 2006, International Comparison<sup>b</sup>**



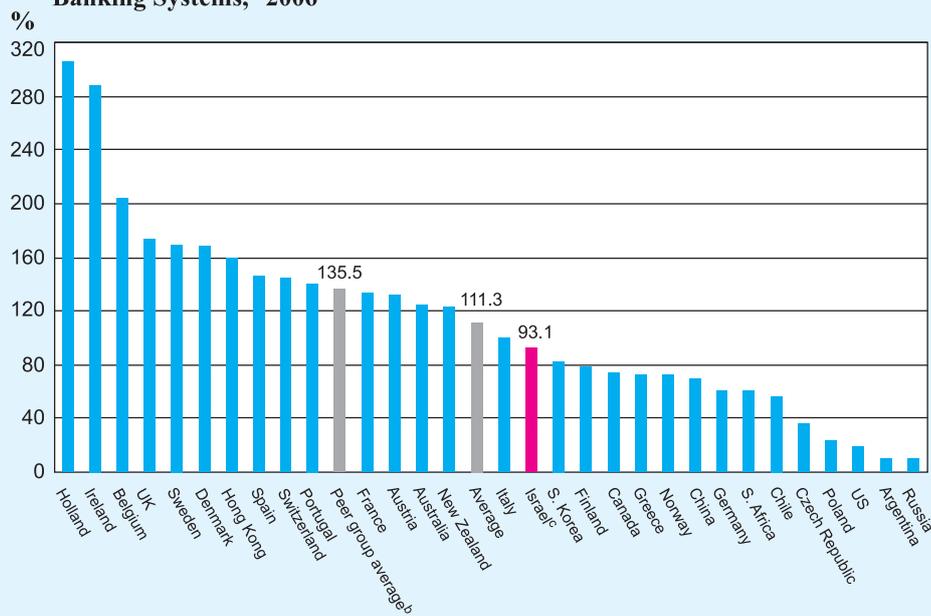
<sup>a</sup> Value added is the sum of net ordinary before-tax income, salaries and related expenses, general expenses, maintenance and depreciation on buildings and equipment.

<sup>b</sup> In each country the optimal number of banking groups was chosen, as a function of the structure and size of the banking sector. In general, values were based on the 10 largest banking groups, except for: the US, which was based on the 50 largest banking groups; Chile, Portugal, and South Korea, on the seven largest banking groups; Israel, South Africa, Finland, Belgium and the Czech Republic, on the five largest banking groups; and New Zealand, on the four largest banking groups.

<sup>c</sup> Israel's peer group consists of eight similar countries in terms of size of GDP and banking system: Belgium, Denmark, Finland, Greece, Ireland, Norway, Portugal, and South Africa.

SOURCE: Based on data from Bankscope, and the IFS database of the International Monetary Fund.

**Figure 1.6a**  
**Balance-Sheet Credit to the Public as Share of GDP in Selected**  
**Banking Systems,<sup>a</sup> 2006**



<sup>a</sup> In each country the largest ten banking groups were chosen, except for the US, for which the largest fifty groups were included, and South Africa, Israel, New Zealand, Finland and the Czech Republic, for which the largest five groups were included.

<sup>b</sup> Israel's peer group consists of eight similar countries in terms of size of GDP and banking system: Belgium, Denmark, Finland, Greece, Ireland, Norway, Portugal and South Africa.

<sup>c</sup> For Israel the share is calculated from published financial statements and data from the Bank of Israel Research Department.

SOURCE: Based on Bankscope and IMF data.

### 3. STRUCTURE OF THE BANKING SYSTEM IN ISRAEL

Economic forces and regulatory practices led to major changes in the Israeli banking system during recent years. The system itself is currently subject to a process of mergers between financial institutions, mainly involving acquisitions of small banks by large and medium-sized banks and mergers of mortgage banks within their parent banks. This phenomenon, which is far more widespread abroad, is intended to exploit economies of scale and diversification.<sup>9</sup> With respect to regulatory practice, the most prominent reform in recent years was the full implementation of the recommendations of the Bachar

<sup>9</sup> For terms see: D. Ruthenberg (2000), "Banking Management in Israel: Management of Assets, Liabilities and Risks", Keter Publishing House, p. 345. For further details on the subject, see D. Ruthenberg (1994), "Optimal Structure of the Israeli Banking System – Theory and Practice", Bank of Israel, Banking Supervision Department, Banking Issue 12, pp. 49-79. Y. Landskroner, D. Ruthenberg and D. Zaken (2005). "Diversification and Performance in Banking: the Israeli Case," Journal of Financial Services Research 27, 1, 27-49.

Committee, which were embodied in legislation in 2005. These recommendations and the resulting legislation were intended to deal with the issue of concentration in the Israeli financial system and the conflicts of interest within it.

We will now describe developments in the banking system during recent years, and will examine the concentration and the competition in it on the basis of a number of widely used indices.

#### **a. Structure of the system and the services provided**

As stated, the Israeli banking system underwent a series of mergers during recent years whereby small banks were purchased by large and medium-size banks in order to exploit economies of scale and diversification. The majority of the mortgage banks were merged within their parent companies: Bank Mishkan was merged within the Bank Hapoalim group, Bank Tefahot was merged within the Bank Mizrahi group, and the First International Mortgage Bank was merged within the First International Bank. In the past two years the ownership of the specialized banks was replaced: Bank Massad, Bank Yahav and Bank Otzar Hahayal were removed from the control of the Bank Hapoalim group and were acquired by medium-sized banks.

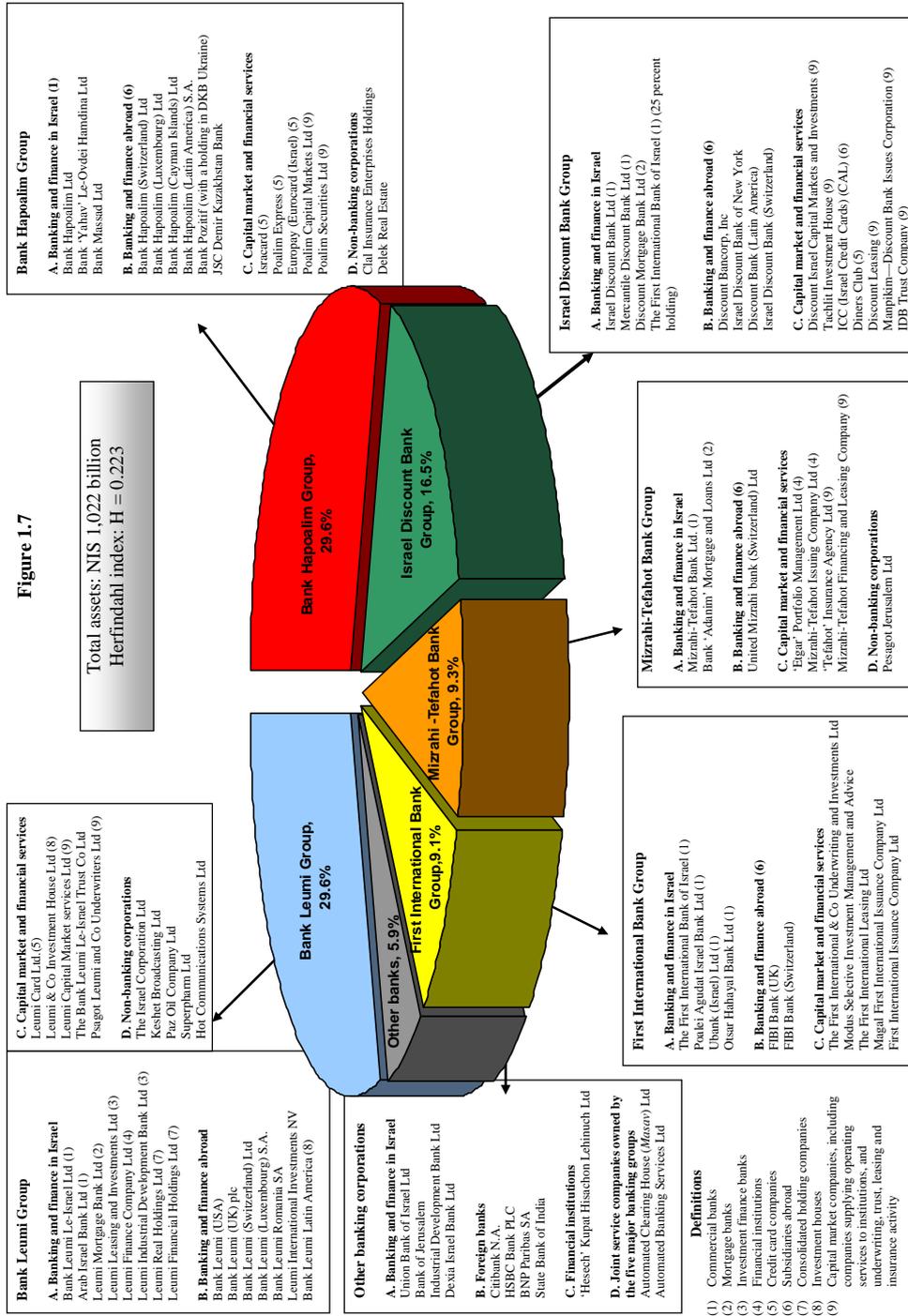
Israel currently has 26 banking institutions compared with 39 at the end of 2003 (commercial banks, mortgage banks, foreign banks, financial institutions and joint service companies). These banks are controlled via five banking groups, which from the aspect of asset volume account for 94 percent of system activity, as well as three independent banks and four branches of foreign banks. A new branch of BMP Paribas Bank was opened in Israel at the end of 2006 and a new branch of the State Bank of India was opened in March 2007. These two branches came in addition to two existing branches of foreign banks that were already operating in Israel—Citibank and HSBC (Figure 1.7; Table 1.1).

Apart from classical banking intermediation activity, via subsidiaries the large banking corporations engage in complementary areas to commercial banking activity. They are thereby able to engage in universal banking: credit card activity; capital market activity (which has decreased greatly in recent years)—brokerage services in securities and other financial assets on behalf of their customers; custodial services for securities; portfolio management for customers; and securities underwriting and issues. In the past, the bank held a large number of non-financial corporations (equity-basis investees) and equity holdings in insurance companies.<sup>10</sup> During recent years however, these investments have decreased and currently account for only 5 percent of the banking system's equity capital. Investment restrictions were prescribed for underwriting activity in 2008, as well as restrictions on holding ratios which prevent the banks from controlling underwriting companies. For many years now, the local banks have held banking subsidiaries abroad, principally in major financial centers. These subsidiaries

<sup>10</sup> The ownership of non-financial companies is restricted to 20 percent of the banking corporation's capital and 20 percent of the means of control in a purchased company, without the ability to manage such a company.

Figure 1.7

Total assets: NIS 1,022 billion  
Herfindahl index: H = 0.223



found it very difficult to compete with large local banks, and their profitability was low. The proportion of credit to the public at these banks was significantly lower than at local banks, and most of their activity consisted of private banking. The performance of these banks is poor, as stated, due to the high entry barriers resulting from the presence of large foreign banks alongside local banks with a long tradition of activity. In view of the Israeli banks' difficulty in achieving a good performance, their presence in these centers has sometimes been intended for reputation purposes only. In recent years however, as a result of the decrease in the share of activity of the banks in Israel and the banks' desire to diversify their sources of profit by exploiting their expertise and advanced technologies, the Israeli banking system has expanded its activity abroad. This has been done by purchasing local banks in the emerging markets, on the assumption that these banking subsidiaries will find it easier to compete with the local banks in those markets. The expansion of activity abroad may partly derive from an attempt by the banks' management to compensate for the large drop in their income resulting from the sale of their holdings in companies operating in the local capital market.

The Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Capital Market in Israel ("the Bachar Law"), which was enacted in August 2005, led to a change in the composition of the banking system's activities. As required under this law, the banks had to sell their entire holdings in provident fund and mutual fund management companies, and were thereby unable to utilize economies of diversification.<sup>11</sup> A study conducted at the Banking Supervision Department's Research Unit<sup>12</sup> found that risk-adjusted return on capital (RAROC) was higher at banks that succeeded in diversifying their activities. This present review provides further support for the positive relationship between diversification and yield.<sup>13</sup>

## **b. Concentration and competition in the banking system**

The extent of competition in the Israeli banking system, the changes have occurred in it during recent years and its status compared with the competition in other banking system worldwide are examined by means of two approaches: the Indirect Estimate Approach, which is also known as the "structure" approach,<sup>14</sup> and the Direct Estimate Approach, which is also called "contestability". Under the structure approach, where an emphasis is placed on the relationship between the structure of the system, its conduct and its performance, the concentration of the banking system fell slightly after rising persistently since 1997. Concentration is measured here by means of two indices that

<sup>11</sup> For further details on the subject see the Supervisor of Banks' Annual Survey for 2005.

<sup>12</sup> Y. Landskroner, D. Ruthenberg and D. Zaken (2005), "Diversification and performance in banking: The Israeli case," *Journal of Financial Services Research*, 27 1 27-49.

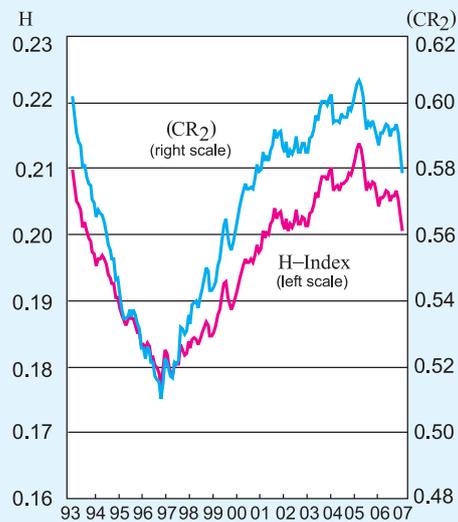
<sup>13</sup> See Table 3.9 below.

<sup>14</sup> For further details see David Ruthenberg (2005), "Competition in the Banking Industry: Theoretical Aspects and Empirical Evidence from Israel and Abroad," Bank of Israel, Banking Supervision Department Research Unit. Discussion Paper Series 05.02.

are employed for measuring concentration in the banking system: One index, the Herfindahl, Hirschman Index (the H index), is calculated here for unindexed bank credit, which currently accounts for 50 percent of the commercial banks' outstanding credit (Table A.1.4). The other approach, CR<sub>2</sub>, measures the market segment of the two largest banks (Hapoalim and Leumi) in aggregate unindexed local currency credit. Concentration according to the H index amounted to 0.20 at the end of 2007, compared with 0.204 at the end of 2006 and 0.212 at the end of 2005 (Figure 1.8). Since the number of commercial banks operating in the unindexed segment remained unchanged in the past two years, the decrease in the system's concentration must thereby derive from a greater diversification of credit activity among the different banks. However, an international comparison of overall banking activity shows that the concentration in the Israeli banking system is higher than the average in its peer group.<sup>15</sup> A similar picture is obtained from the CR<sub>2</sub> index, which amounted to 58 percent at the end of 2007, 59 percent at the end of 2006 and 60 percent at the end of 2005 (Figure 1.8).

Another index used for estimating competition in the industry is the market power which the banks exert over their customers. Market power is calculated as the relative deviation of the price of the banking product (credit) from its marginal cost, which is usually the Bank of Israel interest rate (Figure 1.9). This index is calculated here on unindexed local currency credit as best representing financial intermediation, with a distinction between the bank's activity with households and their activity with business firms. The data show that the banks' marketing power over households is greater than that which they exert over business firms. A similar phenomenon, in terms of intensity and direction, can be found in European countries. It can be assumed that the difference in marketing power between the two populations derives from households' low bargaining ability with the banks compared with the bargaining power of firms. This is because

**Figure 1.8**  
The Herfindahl-Hirschman (H) Index<sup>a</sup> and Market Share Index for the Largest Two Banks<sup>b</sup> (CR<sub>2</sub>) Calculated from Unindexed Local Currency Credit, 2003-07



$$^a \text{ The H-Index is defined as } H = \sum_{i=1}^n \left( \frac{y_i}{Y} \right)^2,$$

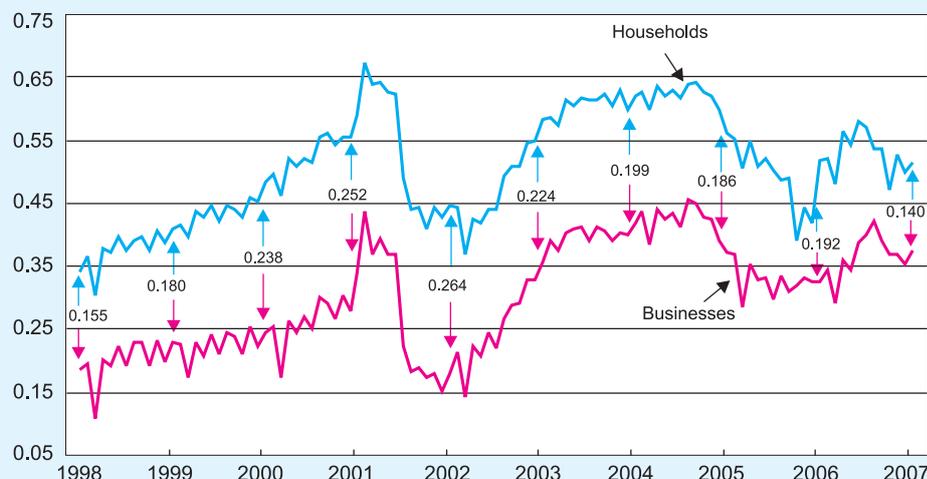
where  $y_i$  is the output of bank  $i$  (unindexed local currency Credit), and  $Y$  is the output of the banking industry.

<sup>b</sup> CR<sub>2</sub> is the market share of the largest two banking groups.

SOURCE: Based on published financial statements and reports to the Supervisor of Banks.

<sup>15</sup> The peer group for Israel contains nine countries that are similar to it in terms of size of economy and the extent of banking system concentration: Belgium, Denmark, Finland, Greece, Ireland, Norway, New Zealand, Portugal and South Africa.

**Figure 1.9**  
**The Market Power (M) Index<sup>a</sup> of the Seven Major Commercial Banks,<sup>b</sup>**  
**Businesses vis-à-vis Households in the Unindexed Local Currency Segment,**  
**December 1998 to December 2007**



<sup>a</sup> The M-Index is defined as  $(R_L - R_M) / R_L$ , where  $R_L$  is the rate of interest on unindexed local currency credit (including income from credit management fees), and  $R_M$  is the inter-bank interest rate.

<sup>b</sup> Hapoalim, Leumi, Discount, First International, Mizrahi-Tefahot, Mercantile Discount, and Union.

SOURCE: Based on banks' reports to the Supervisor of Banks.

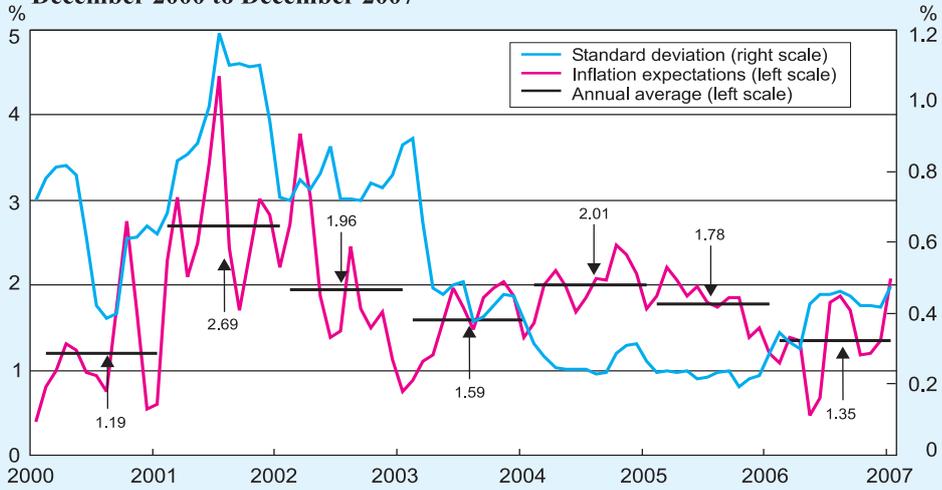
firms usually have access to more numerous credit substitutes, and their costs of moving between banks are lower because they manage activity with more banks. While the marketing power which the banks exerted over households remained unchanged during 2007, their marketing power over business firms rose from 0.32 to 0.37. As a result, the difference between the marketing power exerted over the two sectors decreased slightly.<sup>16</sup>

Contestability to the banking system from non-bank entities on both the asset side and the liability side has increased continually since 2003. Contestability on the asset side, which is measured as the difference between the total financial assets which the public holds outside of the banking system and the public's deposits at the banks, increased in 2007 at a rate similar to that recorded in the last five years. On the liability side (bank credit to the public), contestability, which is measured as the difference between

<sup>16</sup> The marketing power which the banks exert over their customers – households and businesses – is affected by a number of factors: (1) the concentration in the banking system; (2) risk factors; (3) income factors; (4) substitutability factors. In 2007, the risk factor as measured by the rate of loan-loss provision fell more in the corporate segment than in the household segment (Table 3.5 below). Moreover, assuming that the relative concentration remained unchanged, it can be estimated that in 2007 the income factor had a greater affect on business firms than on households. For this reason, the banks' marketing power over business firms rose more than that over households. For further details see David Ruthenberg (2005), "Competition in the Banking Industry: Theoretical aspects and Empirical Evidence from Israel and Abroad", Bank of Israel, Banking Supervision Department, Research Unit, discussion paper series 05.02, Table 6.

credit substitutes and outstanding bank credit, was higher in 2007 than in 2005, and also higher than in 2003 when the economy recovered from the recession that had prevailed during the years 2001 and 2002 (Figure 1.11 and Table 1.5).

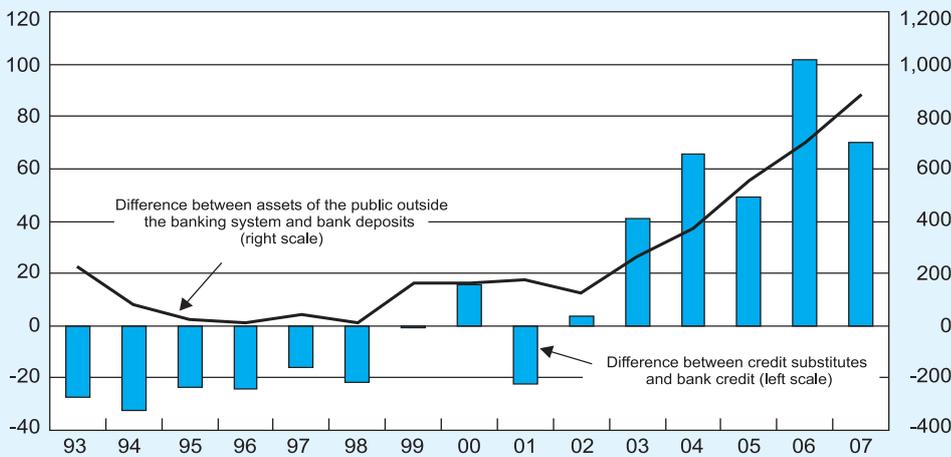
**Figure 1.10**  
**One-Year Inflation Expectations, Annual Average and Standard Deviation,<sup>a</sup>**  
**December 2000 to December 2007**



<sup>a</sup> The standard deviation at any point in time is calculated from the last twelve monthly observations.

SOURCE: Based on data from the Bank of Israel Monetary Department.

**Figure 1.11**  
**Contestability in the Credit and Deposit Markets, 1993-2007**  
**(NIS billion)**



SOURCE: Based on banks' reports to the Supervisor of Banks, the Annual Report of the Commissioner of the Capital Market, Insurance and Savings in the Ministry of Finance, and the Tel Aviv Stock Exchange.

#### 4. PRINCIPAL DEVELOPMENTS IN BALANCE SHEET AND OFF-BALANCE-SHEET ACTIVITY

##### a. General

The balance sheet of the Israeli banking system<sup>17</sup> expanded by 5.5 percent to approximately a trillion shekels at the end of 2007 (Table 1.2).

The classical balance-sheet activity of the banking system—the extension of credit to the public and the raising of deposits from the public—increased during the year reviewed. Concurrently, the banks continued to expand their securities portfolio in line with their desire to diversify their profit sources. Balance-sheet credit to the public, which accounts for 66 percent of the Israeli banking system's total assets, amounted to NIS 670 billion at the end of the year compared with NIS 616 billion at the end of 2006, an increase of 8.7 percent, which was high in comparison with previous years. Aggregate demand for bank credit in 2007 was heavily affected by the continued expansion in the economic activity of business firms, which in the first half of the year led to a growth in demand for non-bank credit as well. The continued downturn in unemployment and the rise in households' disposable income also contributed to the growth in demand for consumer credit. On the supply side, the banking system responded to contestability by non-bank entities by increasing the volume of bank credit. This trend was reflected by the extension of bank credit to industries, such as the construction and real estate industry, to which the banks had avoided supplying credit in recent years. The growth in the supply of bank credit resulted from a number of supportive factors: (1) an improvement in the payments record of borrowers in the system; (2) a decrease in the volume of problem loans (implying a decline in credit risk); (3) an improvement in business entities' level of liquidity; (4) an improvement in the performance of business firms (an increase in profits concurrent with a decrease in risk).

The distribution of credit by indexation segments shows that most of the increase was recorded in the unindexed segment, during the second half of the year. As stated, most of the growth in bank credit was recorded in the unindexed local currency segment, where contestability is lower than in the CPI-indexed and the foreign-currency indexed and denominated segments (Table 1.2). The proportion of unindexed credit at the commercial banks exceeded 50 percent for the first time at the end of 2007, and the proportion of this credit continued to rise at the beginning of 2008 (Table A.1.4). The growth in credit activity was accompanied by a moderate 3.7 percent increase in deposits of the public (Table 1.1). The increase derived from sustained growth in the economy and from a rise in individual's disposable income. This development was not uniform in its intensity in all segments of activity. Most of the growth in deposits of the public was recorded in the unindexed segment and was centered in the first half of the

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<sup>17</sup> As distinct from previous years, the following figure is based on overall banking system activity, excepting the relatively minor level of activity conducted by branches of foreign banks.

**Table 1.1**  
**Israel's Banking System**  
**Main Data from the Financial Statements of the Banking Institutions, December 2007**

|   | Number of branches <sup>a</sup> | Total assets (NIS billion) | Share of total banking system assets (%) | Balance of credit to the public <sup>b</sup> (NIS billion) | Share of total banking system credit (%) | Total deposits of the public (NIS billion) | Share of total banking system deposits (%) |
|---|---------------------------------|----------------------------|--|--|--|--|--|
| <b>Hapoalim group<sup>c</sup></b>                 |                                 |                            |  |  |  |  |  |
| Banking corporations                              | <b>295</b>                      | <b>303.0</b>               | <b>29.6</b>                              | <b>205.0</b>   | <b>30.5</b>                              | <b>231.8</b>                               | <b>29.2</b>                                |
| Bank Hapoalim                                     | 252                             | 272.0                      |  | 180.2  |  | 220.0                                      |  |
| Bank Yahav  | 27                              | 9.3                        |  | 2.4  |  | 8.7  |  |
| Bank Massad                                       | 16                              | 3.4                        |  | 1.9  |  | 3.1  |  |
| <b>Bank Leumi group<sup>d</sup></b>               |                                 |                            |  |  |  |  |  |
| Banking corporations                              | <b>249</b>                      | <b>302.2</b>               | <b>29.6</b>                              | <b>198.6</b>   | <b>29.5</b>                              | <b>238.0</b>                               | <b>30.0</b>                                |
| Bank Leumi Le-Israel                              | 214                             | 254.5                      |  | 133.7  |  | 208.4                                      |  |
| Arab Israel Bank                                  | 26                              | 4.2                        |  | 2.7  |  | 3.2  |  |
| Leumi Mortgage Bank                               | 9                               | 36.0                       |  | 35.8   |  | 7.6  |  |
| <b>Discount Bank group<sup>e</sup></b>            |                                 |                            |  |  |  |  |  |
| Banking corporations                              | <b>203</b>                      | <b>168.8</b>               | <b>16.5</b>                              | <b>101.9</b>   | <b>15.1</b>                              | <b>130.5</b>                               | <b>16.5</b>                                |
| Israel Discount Bank                              | 129                             | 114.7                      |  | 59.6   |  | 92.6                                       |  |
| Mercantile Discount Bank                          | 70                              | 18.9                       |  | 13.0   |  | 15.8                                       |  |
| Discount Mortgage Bank                            | 4                               | 11.5                       |  | 11.2   |  | 1.2  |  |
| <b>Mizrahi-Tefahot Bank group<sup>f</sup></b>     |                                 |                            |  |  |  |  |  |
| Banking corporations                              | <b>126</b>                      | <b>95.3</b>                | <b>9.3</b>                               | <b>74.3</b>  | <b>11.0</b>                              | <b>75.3</b>                                | <b>9.5</b>                                 |
| United Mizrahi Bank                               | 116                             | 94.1                       |  | 70.1   |  | 76.3                                       |  |
| Mortgage banks                                    | 10                              | 4.0                        |  | 3.9  |  | 1.6  |  |
| <b>First International Bank group<sup>g</sup></b> |                                 |                            |  |  |  |  |  |
| Banking corporations                              | <b>159</b>                      | <b>92.5</b>                | <b>9.1</b>                               | <b>55.6</b>  | <b>8.3</b>                               | <b>75.8</b>                                | <b>9.6</b>                                 |
| The First International Bank of Israel            | 88                              | 69.0                       |  | 41.3   |  | 55.4                                       |  |
| Bank Otsar Hahayal <sup>h</sup>                   | 46                              | 12.3                       |  | 8.5  |  | 9.9  |  |
| Poalei Agudat Israel Bank                         | 21                              | 2.9                        |  | 1.5  |  | 2.4  |  |
| UBank <sup>i</sup>                                | 4                               | 7.7                        |  | 2.4  |  | 6.5  |  |

(cont'd)

**Table 1.1 (Cont' d)**  
**Israel's Banking System**  
**Main Data from the Financial Statements of the Banking Institutions, December 2007**

|   | Number of branches <sup>a</sup> | Total assets   | Share of total banking system assets | Balance of credit to the public <sup>b</sup> | Share of total banking system credit | Total deposits of the public | Share of total banking system deposits |
|---|---------------------------------|----------------|--------------------------------------|--|--------------------------------------|------------------------------|--|
| <b>Union Bank</b>   | <b>34</b>                       | <b>31.6</b>    | <b>3.1</b>                           | <b>17.5</b>                                  | <b>2.6</b>                           | <b>26.7</b>                  | <b>3.4</b>                             |
| <b>Industrial Development Bank<sup>j</sup></b>                          | <b>1</b>                        | <b>6.5</b>     | <b>0.6</b>                           | <b>5.5</b>                                   | <b>0.8</b>                           | <b>0.1</b>                   | <b>0.0</b>                             |
| <b>Bank of Jerusalem</b>  | <b>15</b>                       | <b>9.0</b>     | <b>0.9</b>                           | <b>7.2</b>                                   | <b>1.1</b>                           | <b>7.0</b>                   | <b>0.9</b>                             |
| <b>Dexia Israel (Public Finance) (formerly Otzar Hashilton Hamkomi)</b> | <b>1</b>                        | <b>4.9</b>     | <b>0.5</b>                           | <b>3.7</b>                                   | <b>0.5</b>                           | <b>3.0</b>                   | <b>0.4</b>                             |
| <b>Foreign banks<sup>k</sup></b>  | <b>3</b>                        | <b>8.3</b>     | <b>0.8</b>                           | <b>3.7</b>                                   | <b>0.6</b>                           | <b>4.4</b>                   | <b>0.6</b>                             |
| Citibank  | 1                               | 4.6            |                                      | 1.2  |                                      | 1.9                          |  |
| HSBC  | 1                               | 3.0            |                                      | 2.1  |                                      | 2.1                          |  |
| BNP Paribas   | 1                               | 0.8            |                                      | 0.5  |                                      | 0.35                         |  |
| <b>Total</b>  | <b>1,086</b>                    | <b>1,022.1</b> | <b>100</b>                           | <b>673.0</b>                                 | <b>100</b>                           | <b>792.6</b>                 | <b>100</b>                             |

<sup>a</sup> Includes the branches where activity takes place.

<sup>b</sup> Credit given in Israel and abroad.

<sup>c</sup> This group also includes banking subsidiaries abroad: Bank Hapoalim (Switzerland), Bank Hapoalim (Luxembourg), Hapoalim (Latin America), and Bank Hapoalim (Cayman Islands), Bank Pozitif.

<sup>d</sup> This group also includes banking subsidiaries abroad: Bank Leumi USA, Bank Leumi (UK), Bank Leumi Switzerland, Bank Leumi Luxembourg, Bank Leumi Romania, and Leumi International Investments.

<sup>e</sup> This group also includes banking subsidiaries abroad: Disount Bankcorp (a banking holding company), Israel Discount Bank of New York, Discount Bank (Latin America), and Israel Discount Bank (Switzerland).

<sup>f</sup> The United Mizrahi Bank changed its name to Mizrahi-Tefahot Bank in November 2005.

<sup>g</sup> This group also includes banking subsidiaries abroad: FIBI Bank (UK) in London and FIBI Bank (Switzerland) in Zurich.

<sup>h</sup> On August 17, 2006, Bank Hapoalim completed the purchase of this bank.

<sup>i</sup> In December 2004 control of this bank was bought by the First International Bank. Until March 2005 the bank was called Investec (Israel) Bank.

<sup>j</sup> Scheduled to be closed on 31 July 2008.

<sup>k</sup> During 2007, the foreign banks BNP Paribas and State Bank of India (SBI) intend to begin operations in Israel.

SOURCE: Published financial statements and reports to the Supervisor of Banks.

year. The growth in unindexed local currency deposits concurrent with a decrease in the supply of CPI-indexed deposits during the first half of the year (Table 1.3) resulted, in our estimation, from a decrease in uncertainty over the level of inflation and in the implied volatility of inflation expectations (Figure 1.10). Another reason for the growth in the balance of unindexed local currency deposits was the increased activity in structured products, which combine a shekel deposit (usually unindexed) in which the principal is guaranteed at the end of the period of deposit, with an increment in respect of the increase in another index, if such an increase occurs. This investment instrument provides the customer with the opportunity for obtaining a relatively high yield against the risk of losing banking interest, without endangering the principal of the deposit. The deposit's yield is usually dependent on the following parameters: the exchange rate, interest rates and a predefined rate of the increase in a share or share basket index. The growth in structured product activity largely derived from the low interest rates that were offered on deposits of the public. This situation is expected to change in the near future because an amendment to the Joint Investments Law went into effect at the beginning of 2008. The amendment allows mutual fund managers to issue mutual funds with a short duration, which are thereby able to compete with liquid and short-term shekel deposits. Assuming that all other factors remain constant, this competition could have the effect of reducing the net interest margin in the unindexed segment.

#### **b. Principal developments in the banking system's deposits of the public**

Israeli residents' financial asset portfolio represents the public's potential supply of sources to the banking system. The portfolio is divided into three principal parts: The first part is tradable financial assets, which are usually managed via portfolio management companies and institutional investors. A smaller component is managed directly by the public. This component largely consists of shares, government bonds and corporate bonds, and non-marketable corporate bonds that are held only via institutional investors account for a minor element of it. The second, non-marketable part of the portfolio consists of deposits in the banking system. This part is notable for yields, market risks and commission fees that are significantly lower than those for the marketable portfolio. The first part of the asset portfolio consists of cash that is held by the public, and this is also non-tradable.

The expansion in the public's financial asset portfolio that began four years ago continued in 2007 and the portfolio totaled NIS 2.1 trillion, an increase of 13.2 percent compared with an increase of 11.8 percent in 2006 (Table A.1.3). As in previous years, the public's asset portfolio and the distribution of the portfolio were subject to two opposing effects: The first effect was the income effect, which led to an expansion in the portfolio due to the rapid growth in the economy. The second effect is the substitutability effect, which led to a change in the distribution of the portfolio between

the non-tradable part, which is deposited in the banking system, and the tradable part (principally shares and bonds). This disintermediation process is part of a global trend: Many parts of the world are notable for a persistent decline in the proportion of deposits and saving plans managed via the banking system to the public's total financial assets.<sup>18</sup> The disintermediation effect increased during the last three years due to the decline in bank interest rates and as a result of the relatively high yields expected in the money and capital markets compared with the lower effective yields offered by the banking system. Investors also expected that the sustained growth in the economy would be reflected in the profits of publicly-traded companies, and that these profits would be translated into dividend allocations in accordance with the liberal policy prevailing in the stock exchange during recent years. As a result of these developments, for the first time ever the proportion of the public's financial assets deposited with the banks in Israel fell to below 30 percent in 2007 (Figure 1.12 and Table 1.3). It should be realized however that the price effect also contributed to the increased proportion of marketable assets in the portfolio. This is because marketable assets are revaluated at market prices, which rose considerably during the year. The redistribution of the asset portfolio also resulted from a change in the public's preferences, in favor of marketable investments with a high yield expectancy but with a higher risk profile compared with deposits at the banks, which are notable for a lower yield and risk. As an example, for the first time in the present decade the proportion of shares of publicly-traded companies in the public's asset portfolio exceeded the proportion of unindexed local currency deposits in 2007: 20.3 percent compared with 17.3 percent. This development partly derived from the numerous reforms that were applied in the capital market and especially in the investment regulations of the provident funds and the pension funds. As a result of these reforms, the funds invested a larger proportion of their money in shares as opposed to government bonds. Despite these developments and the fierce competition for the public's sources which the banks faced, deposits of the public rose by 3.7 percent in 2007 as stated and totaled NIS 788 billion at the end of the year.

Developments in deposits of the public in the banking system by indexation segment show a large increase of nearly 10 percent in the unindexed local currency segment, and a decrease of 7 percent in the CPI-indexed segment. Most of the increase in unindexed local currency deposits was recorded in the first half of the year, apparently due to the large drop in inflation expectations to below the level of the government's inflation target (Figure 1.10). Mutually offsetting effects were apparent in the foreign-currency denominated and foreign-currency indexed segments: The income effect contributed to a growth in these deposits in line with the expansion of the asset portfolio, while the substitutability effect led to a reduction in their volume due to the shekel/foreign currency interest-rate differentials in favor of the shekel interest rates, and because the shekel strengthened against the majority of foreign currencies. The continued improvement in the Israeli economy's macro data concurrent with the expectation, which has since materialized, of an increase in the country's credit rating made it easier

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<sup>18</sup> IMF Global Financial Stability Report: Market Development and Issues – April 2005.

**Table 1.2**  
**The Balance Sheet of Israel's Banking System, a 2004-07**

|   | At current prices <sup>b</sup> |                |                |                  | Distribution |              |              | Average balance at current prices |                | Annual rate of change in the balance at the end of year from 2006 to 2007 (percent) |
|---|--------------------------------|----------------|----------------|------------------|--------------|--------------|--------------|-----------------------------------|----------------|---|
|   | 2004                           | 2005           | 2006           | 2007             | 2005         | 2006         | 2007         | 2006                              | 2007           |   |
| <b>Assets</b>                                     |                                |                |                |                  |              |              |              |                                   |                |   |
| Cash and Deposits in banks                        | 106,231                        | 122,270        | 138,889        | 123,451          | 3.3          | 14.5         | 12.2         | 129,758                           | 135,423        | -11.1   |
| of which: Cash <sup>e</sup>                       | 32,742                         | 24,865         | 21,631         | 23,550           | 2.7          | 2.3          | 2.3          |                                   |                | 8.9   |
| Deposits in commercial banks                      | 68,229                         | 93,411         | 113,370        | 97,063           | 10.2         | 11.8         | 9.6          |                                   |                | -14.4   |
| <b>Securities</b>                                 | <b>138,180</b>                 | <b>152,906</b> | <b>164,023</b> | <b>172,209</b>   | <b>16.6</b>  | <b>17.1</b>  | <b>17.0</b>  | <b>160,578</b>                    | <b>169,866</b> | <b>5.0</b>  |
| Credit to the public <sup>d,e</sup>               | 565,748                        | 603,592        | 615,883        | 669,271          | 65.6         | 64.1         | 66.0         | 608,675                           | 643,847        | 8.7   |
| of which: Unindexed local currency                | 191,286                        | 232,497        | 261,713        | 298,362          | 38.5         | 42.5         | 44.6         | 246,002                           | 279,250        | 14.0  |
| CPI-indexed local currency                        | 175,000                        | 181,889        | 176,722        | 186,724          | 30.1         | 28.7         | 27.9         | 178,782                           | 180,492        | 5.7   |
| In or indexed to foreign currency                 | 199,221                        | 188,296        | 176,350        | 182,562          | 31.2         | 28.6         | 27.3         | 182,928                           | 182,433        | 3.5   |
| of which: In dollars                              | 150,209                        | 144,909        | 126,473        | 123,255          | 24.0         | 20.5         | 18.4         | 134,760                           | 126,236        | -2.5  |
| Non-financial items                               | 241                            | 910            | 1,098          | 1,622            | 0.2          | 0.2          | 0.2          | 962                               | 1,673          | 47.7  |
| Credit to the government                          | 4,236                          | 3,389          | 3,247          | 2,299            | 0.4          | 0.3          | 0.2          | 3,027                             | 2,248          | -29.2   |
| Investment in subsidiary and affiliated companies | 4,027                          | 4,410          | 3,751          | 4,981            | 0.5          | 0.4          | 0.5          | 3,842                             | 4,675          | 32.8  |
| Buildings and equipment                           | 10,626                         | 11,187         | 12,099         | 12,706           | 1.2          | 1.3          | 1.3          | 11,701                            | 12,387         | 5.0   |
| Other assets                                      | 21,981                         | 21,995         | 22,606         | 26,591           | 2.4          | 2.4          | 2.6          | 23,435                            | 24,306         | 17.6  |
| <b>Total assets</b>                               | <b>851,029</b>                 | <b>919,748</b> | <b>960,499</b> | <b>1,013,797</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>941,015</b>                    | <b>995,229</b> | <b>5.5</b>  |

(cont'd)

**Table 1.2 (Cont'd)**  
**The Balance Sheet of Israel's Banking System,<sup>a</sup> 2004-07**

|                                      | At current prices <sup>b</sup> |                |                |                  |              | Distribution |              | Annual rate of change in the balance at the end of year from 2006 to 2007 (percent) |
|--------------------------------------|--------------------------------|----------------|----------------|------------------|--------------|--------------|--------------|---|
|                                      | 2004                           | 2005           | 2006           | 2007             | 2005         | 2006         | 2007         |   |
|                                      | (NIS million)                  |                |                |                  |              | (percent)    |              |   |
| <b>Liabilities and capital</b>       |                                |                |                |                  |              |              |              |   |
| Deposits of the public               | 692,783                        | 727,453        | 759,701        | 788,144          | 79.1         | 79.1         | 77.7         | 3.7   |
| of which: Unindexed local currency   | 283,331                        | 297,092        | 324,410        | 356,217          | 40.8         | 42.7         | 45.2         | 9.8   |
| CPI-indexed local currency           | 121,564                        | 112,509        | 104,812        | 97,475           | 15.5         | 13.8         | 12.4         | -7.0  |
| In or indexed to foreign currency    | 287,441                        | 316,678        | 328,891        | 332,324          | 43.5         | 43.3         | 42.2         | 1.0   |
| of which: In dollars                 | 220,100                        | 246,278        | 253,997        | 246,000          | 33.9         | 33.4         | 31.2         | -3.1  |
| Deposits from banks                  | 23,475                         | 22,508         | 26,180         | 26,744           | 2.4          | 2.7          | 2.6          | 2.2   |
| Government deposits                  | 15,693                         | 13,900         | 12,368         | 10,214           | 1.5          | 1.3          | 1.0          | -17.4   |
| Bonds and subordinated notes         | 41,153                         | 53,375         | 51,554         | 59,723           | 5.8          | 5.4          | 5.9          | 15.8  |
| Other liabilities                    | 29,496                         | 51,548         | 53,210         | 58,718           | 5.6          | 5.5          | 5.8          | 10.4  |
| <b>Total liabilities</b>             | <b>802,599</b>                 | <b>868,784</b> | <b>903,013</b> | <b>951,057</b>   | <b>94.5</b>  | <b>94.0</b>  | <b>93.8</b>  | <b>5.3</b>  |
| Minority interests                   | 2,027                          | 1,322          | 1,549          | 1,532            | 0.1          | 0.2          | 0.2          | -1.1  |
| Equity                               | 46,093                         | 49,643         | 55,937         | 61,208           | 5.4          | 5.8          | 6.0          | 9.4   |
| <b>Total liabilities and capital</b> | <b>851,029</b>                 | <b>919,748</b> | <b>960,499</b> | <b>1,013,797</b> | <b>100.0</b> | <b>100.0</b> | <b>100.0</b> | <b>5.5</b>  |

<sup>a</sup>The joint aggregate of consolidated and ordinary commercial corporations, including: the five major banking groups (Leumi, Hapoalim, Discount, First International, and Mizrahi-Tefahot), Bank of Jerusalem, Union Bank, Industrial Development Bank, and Otzar Hashilton Hamkommi.

<sup>b</sup>In accordance with Accounting Standards 12 and 17 of the Israel Accounting Standards Board, inflation adjustment of the financial statement ceased on 1 January 2004; data for 2004 and thereafter are shown in current terms.

<sup>c</sup>Including deposits with the central bank.

<sup>d</sup>Excluding non-financial items.

<sup>e</sup>From 2006 and in accordance with directives from the Supervisor of Banks, liabilities in respect of credit cards, which were hereto registered as guarantees (off-balance sheet item), will be recorded as part of the balance-sheet credit to the public. The 2005 data were adjusted accordingly, though data for 2004 do not include the liabilities in respect of credit cards.

SOURCE: Published financial statements.

**Figure 1.12**  
**Proportion of the Public's Assets in and outside the Banking System,**  
**1993-2007<sup>a</sup>**



<sup>a</sup> Due to structural changes in the capital market, in 2005 assets held in and outside of the banking system were reclassified.

SOURCE: Based on reports to the Supervisor of Banks, and data from the Bank of Israel Monetary Department.

to raise deposits from nonresident customers. Total deposits of nonresidents increased by 6 percent in real terms to a level of \$ 23.2 billion at the end of 2007 compared with \$21.9 billion at the end of 2006 (Table A.1.3). As a result of these developments, the banking system increased its deposits at foreign banks abroad while a small part of the growth in foreign-currency deposits was placed with subsidiaries abroad. In addition, the Israeli banks invested large amounts in their securities portfolios abroad, including in MBF and SIV assets (mainly by Bank Hapoalim).

### **c. Principal developments in the banking system's credit portfolio**

The distribution of credit to the business sector in 2007 again shows that a very large proportion of credit requirements was supplied from outside of the banking system, although to a lesser extent than in previous years. The business sector raised a total of NIS 137 billion in 2007, of which NIS 34 billion or 25 percent came from the banks. This ratio was higher than in 2006, when only 4 percent of the business sector's credit requirements were supplied by the banks (Figure 1.13 and Table 1.5).

The substantial increase in the economy's credit requirements compared with previous years resulted from the business sector's need to expand its investments. This is because at the beginning of the present rising business cycle, the factors of production

**Table 1.3**  
**The Public's<sup>a</sup> Assets Portfolio in Banks and not in Banks, 2003-07**

| Financial Assets  | Balances    |         |         |         |         |       |       | Composition |       |       | Rate of change        |                       |
|---|-------------|---------|---------|---------|---------|-------|-------|-------------|-------|-------|-----------------------|-----------------------|
|   | 2003        | 2004    | 2005    | 2006    | 2007    | 2003  | 2004  | 2005        | 2006  | 2007  | 2006 relative to 2005 | 2007 relative to 2006 |
|   | NIS billion |         |         |         |         |       |       | (percent)   |       |       | (percent)             |                       |
| <b>1. The public's assets in banks<sup>b</sup></b>  | 523.6       | 526.2   | 553.5   | 581.4   | 611.8   | 39.9  | 36.9  | 33.3        | 31.3  | 29.0  | 5.1                   | 5.2                   |
| Unindexed local-currency deposits <sup>c</sup>  | 278.0       | 291.0   | 305.3   | 333.3   | 365.0   | 21.2  | 20.4  | 18.4        | 17.9  | 17.3  | 9.2                   | 9.5                   |
| Deposits in and indexed to foreign currency <sup>d</sup>  | 91.9        | 100.7   | 119.0   | 127.4   | 140.2   | 7.0   | 7.1   | 7.2         | 6.8   | 6.7   | 7.0                   | 10.1                  |
| Indexed deposits <sup>e</sup>   | 153.7       | 134.5   | 129.2   | 120.8   | 106.6   | 11.7  | 9.4   | 7.8         | 6.5   | 5.1   | -6.5                  | -11.8                 |
| <i>of which:</i> Bank deposits of provident and pension funds and insurance companies <sup>f</sup>            | 60.8        | 62.8    | 56.5    | 56.3    | 58.7    | 4.6   | 4.4   | 3.4         | 3.0   | 2.8   | -0.2                  | 4.2                   |
| <b>2. The public's tradable assets</b>  | 409.5       | 485.5   | 602.9   | 725.3   | 879.7   | 31.2  | 34.1  | 36.2        | 39.0  | 41.8  | 20.3                  | 21.3                  |
| Shares <sup>g</sup>   | 163.1       | 194.3   | 256.4   | 327.9   | 426.7   | 12.4  | 13.6  | 15.4        | 17.6  | 20.3  | 27.9                  | 30.1                  |
| Traded bonds and <i>makam</i> <sup>h</sup>  | 138.2       | 175.4   | 210.6   | 244.8   | 299.9   | 10.5  | 12.3  | 12.7        | 13.2  | 14.2  | 16.2                  | 22.5                  |
| Residents' investments abroad   | 108.0       | 115.8   | 135.9   | 152.6   | 153.1   | 8.2   | 8.1   | 8.2         | 8.2   | 7.3   | 12.3                  | 0.3                   |
| <b>3. Cash held by the public</b>   | 16.2        | 17.8    | 20.9    | 21.6    | 24.7    | 1.2   | 1.2   | 1.3         | 1.2   | 1.2   | 3.3                   | 14.4                  |
| <b>4. Assets of provident and pension funds and insurance companies (excluding bank deposits)<sup>i</sup></b> | 363.6       | 395.8   | 486.1   | 532.0   | 589.9   | 27.7  | 27.8  | 29.2        | 28.6  | 28.0  | 9.4                   | 10.9                  |
| <b>Total assets of the public: 1+2+3+4</b>  | 1,312.9     | 1,425.3 | 1,663.4 | 1,860.3 | 2,106.1 | 100.0 | 100.0 | 100.0       | 100.0 | 100.0 | 11.8                  | 13.2                  |

<sup>a</sup> The public does not include the government, the Bank of Israel, the commercial banks or the mortgage banks.

<sup>b</sup> Including commercial and mortgage banks.

<sup>c</sup> Including unindexed earmarked deposits.

<sup>d</sup> Including time deposits, unrestricted resident deposits, unrestricted resident restitution deposits, residents' foreign currency deposits and non-resident deposits of residents of Israel.

<sup>e</sup> Including savings plans and deposits approved for the granting of loans of related companies and others.

<sup>f</sup> Of total bank deposits.

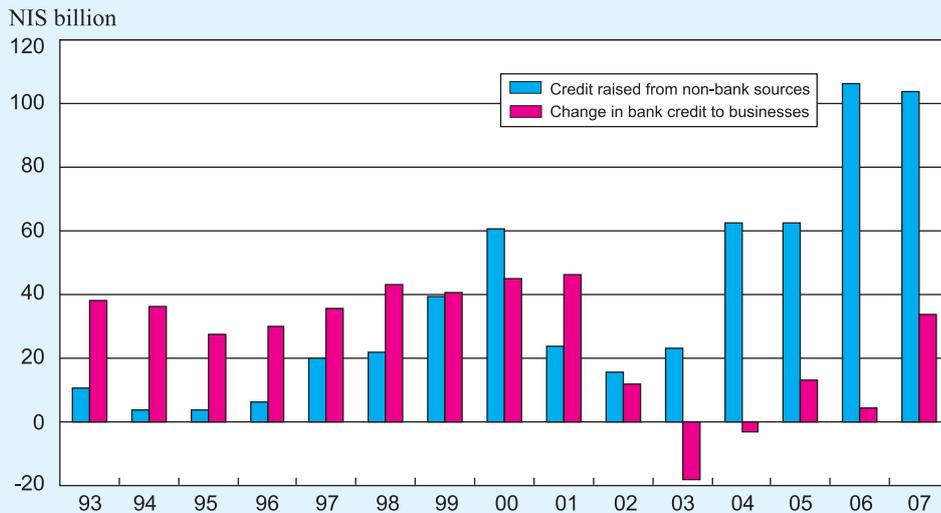
<sup>g</sup> Shares held by the public not including the holdings of nonresidents and the government.

<sup>h</sup> Including government bonds (indexed and unindexed) and corporate bonds.

<sup>i</sup> Includes provident and compensation funds, advanced study funds, pensions and life insurance funds in the "guaranteed return" and "participating in profits" programs.

SOURCE: Based on reports to the Bank of Israel and data of the Monetary Department.

**Figure 1.13**  
**Credit from Non-Bank Sources Compared to Change in**  
**Bank Credit to Businesses,<sup>a</sup> 1993-2007**



<sup>a</sup> Business credit given throughout the year excluding credit to individuals.

<sup>b</sup> Due to structural changes in the capital market, in 2005 assets held in and outside of the banking system were reclassified.

<sup>c</sup> The considerable increase in non-bank credit in 2006 was a result, inter alia, of Teva's raising of NIS 24 billion to finance its merger with the American pharmaceutical firm IVAX.

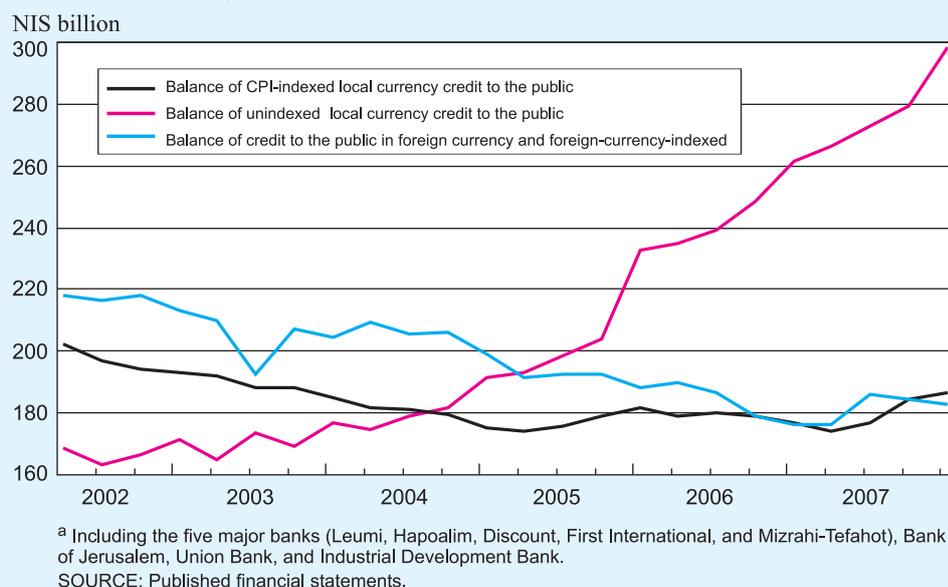
SOURCE: Based on reports to the Supervisor of Banks; Annual Reports of the Supervisor of Capital Markets Insurance and Savings in the Ministry of Finance; Bank of Israel data; and data from the Tel Aviv Stock Exchange.

available to the economy were limited as a result of the previous recession. Although investment in the principal industries rose only slightly at the beginning of the cycle, in 2006 investment increased considerably and to an even greater extent in 2007. These developments greatly increased the business sector's aggregate demand for sources of credit and as stated, the banking system's share in the supply of sources for these credit requirements increased. Most of the increase was recorded in the second half of the year, when the business sector experienced growing difficulties in raising non-bank credit as a result of the shocks in the local and international financial markets. We believe this trend will become more notable in 2008 if the unfavorable terms for raising debt and capital from the capital markets prevailing in the first quarter of 2008 continue.<sup>19</sup>

Outstanding credit to the public in the unindexed local currency segment expanded (credit to the business sector, and credit to the retail segment and households). In the CPI-indexed segment, where contestability to the banking system is most apparent,

<sup>19</sup> Worldwide experience shows that in a period of slowdown in economic activity, only particularly good business firms will continue to issue, while other firms will increase their demand for bank credit.

**Figure 1.14**  
**Quarterly Development of Balance of Credit from the Banking System<sup>a</sup>**  
**to the Public, by Indexation, 2002-07**



a slight increase in credit was recorded (Figure 1.14) while no major changes were recorded in the foreign-currency segment.

Unlike in previous years, outstanding credit increased in all principal industries in 2007 as a result of the large growth in investment. Accordingly, credit expanded to industries to which the banking system had avoided exposure in previous years, such as construction and real estate, hotels and food and accommodation services. The main reason for this development was the rapid growth in product in all the principal industries—in industries whose output is mainly directed at the local market, which have benefited from the rapid expansion in private consumption, as well as in export-oriented industries, mainly manufacturing, hotels and food services (Table 1.4). The product of the construction industry rose as well.

The product of non-residential construction (buildings, roadworks and defense construction) surged by 12 percent concurrent with a moderate 3 percent increase in housing construction.<sup>20</sup> The expansion in the industry is mainly attributed to increased construction of public buildings at the initiative of the public sector, the paving of roads and the construction of industrial buildings resulting from the rapid expansion in the productive sectors of the economy. The growth in the industry was financed from non-bank sources, as well as from the banking system. Balance-sheet bank credit to the

<sup>20</sup> For further details see the Bank of Israel report for 2007, Chapter 2, pp 36-63.

**Table 1.4**  
**Ratio of Credit<sup>a</sup> to Output, by Industry, 1998-2007**

| Sector                               | 1998        | 1999        | 2000        | 2001        | 2002        | 2003        | 2004        | 2005        | 2006        | 2007        |
|--------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Agriculture                          | 1.25        | 1.46        | 1.41        | 0.77        | 0.71        | 0.69        | 0.67        | 0.54        | 0.59        | 0.62        |
| Manufacturing                        | 1.04        | 1.27        | 1.20        | 1.55        | 1.59        | 1.53        | 1.38        | 1.39        | 1.32        | 1.38        |
| Construction and real estate         | 3.07        | 3.66        | 4.13        | 4.53        | 4.39        | 4.17        | 4.04        | 3.92        | 3.59        | 3.75        |
| Construction                         | 3.08        | 3.63        | 4.09        | 4.35        | 4.06        | 3.62        | 3.57        | 3.50        | 3.23        | 3.12        |
| Real estate                          | 3.00        | 3.75        | 4.26        | 5.18        | 5.54        | 6.25        | 5.62        | 5.29        | 4.74        | 5.64        |
| Water and electricity                | 0.61        | 0.77        | 0.85        | 1.01        | 1.01        | 0.75        | 0.75        | 0.69        | 0.73        | 0.69        |
| Trade and services                   | 0.75        | 0.96        | 0.96        | 1.03        | 1.05        | 1.02        | 1.04        | 1.04        | 0.99        | 1.07        |
| Trade                                | 1.08        | 1.19        | 1.27        | 1.36        | 1.40        | 1.27        | 1.24        | 1.22        | 1.11        | 1.12        |
| Services                             | 0.62        | 0.85        | 0.85        | 0.90        | 0.92        | 0.92        | 0.96        | 0.97        | 0.95        | 1.05        |
| Hotels and catering                  | 1.60        | 1.84        | 1.74        | 2.39        | 2.44        | 2.38        | 2.15        | 1.84        | 1.66        | 1.57        |
| Financial services                   | 1.17        | 2.40        | 2.55        | 2.77        | 2.45        | 2.58        | 2.52        | 2.68        | 2.85        | 3.21        |
| Communications and computer services | 0.88        | 1.14        | 1.38        | 1.45        | 1.17        | 0.90        | 0.74        | 0.67        | 0.57        | 0.49        |
| Transport and storage                | 0.49        | 0.82        | 0.80        | 0.84        | 0.91        | 0.83        | 0.80        | 0.80        | 0.74        | 0.69        |
| <b>Total</b>                         | <b>1.15</b> | <b>1.38</b> | <b>1.36</b> | <b>1.50</b> | <b>1.59</b> | <b>1.43</b> | <b>1.36</b> | <b>1.31</b> | <b>1.25</b> | <b>1.34</b> |

<sup>a</sup> Credit is calculated for lending activity in Israel only and includes balance-sheet credit (credit to the public, investment in bonds and other assets in respect of derivatives) and off-balance-sheet credit risk weighted by conversion coefficients for balance-sheet credit (guarantees and other liabilities on behalf of customers, and futures transactions).

SOURCE: Based on reports to the Supervisor of Banks, the Central Bureau of Statistics, and other Bank of Israel data.

construction industry amounted to NIS 110 billion in 2007, an increase of 12 percent. As a result, the ratio of credit to product in the construction and real estate industry rose slightly (Table 1.4). Despite the increase in this ratio, the sector-specific risk of the construction industry has decreased over the years due to an improvement in the profitability of the firms operating in the industry. The rebound in the construction industry has not included housing construction, where output has remained at a level similar to the average for recent years. Housing construction may react to the upsurge in activity with some element of delay, because of the shortage of land available for construction and the considerable time necessary for redesignating the use of land. It is also possible that the demand surplus for apartments resulting from the rise in the standard of living, the increase in the population and from nonresidents' investments will be translated into a rise in housing prices in demand centers, and the industry will react to this demand with a lag of several years. Despite the only moderate 3 percent growth in housing construction, outstanding loans which the banking system supplies to households expanded by the higher rate of 9 percent during the year (Table 3.5). The difference results from the following developments: (1) During recent years and especially in 2007, most of the transactions in the residential apartment market were in second-hand apartments. (2) The price increases that were recorded, principally in demand areas, made it necessary for certain apartment buyers to take new loans. (3) The downtrend in loans for eligible persons under Housing Ministry criteria, whereby loans are taken from the banking system, continued.

Another industry that was a focus of attention in the past despite its negligible proportion in the banking system's credit portfolio is the tourism industry. During the recession years very high ratios of problem loans were recorded in this industry, whose output is highly sensitive to the security situation. This industry is built around long-term finance and relies mainly on the banking system.

The product of the tourism and accommodation services industry rose by 5.4 percent in 2007, reflecting an impressive growth in the industry's revenue and a large increase in the number of tourists' overnight stays at hotels. This came in the wake of a major slump in the third quarter of 2006 that resulted from the Second Lebanon War. Although consumption of tourism services rose in the center and the south of the country during the summer months of 2006, an immediate impact was apparent in the extent of foreign tourism, and the number of hotel stays fell by 30 percent in the third quarter of 2006. The industry appears to have fully recovered from the slump in activity during 2007. Outstanding credit to the industry expanded by 10 percent to NIS 6.5 billion in 2007. The existing stock of hotel rooms and the gradual increase in the number of hotel stays by tourists do not currently appear to be an incentive for extensive investment in the industry. The ratio of credit to product in the hotels and accommodation services industry fell to some extent, mainly due to the large growth in the industry's product. This ratio reverted to the level of the end of the previous decade, when activity in the industry was vibrant and the levels of risk were low. The decline in the credit-product ratio coincided with the rebound in the industry that began in 2003, and which ceased only in the third

**Table 1.5**  
**Changes in Bank Credit to the Business Sector and its Principal Non-Bank Substitutes, 1997-2007**

|      | (NIS million, at current prices) <sup>a</sup>      |                                     |   |                        |                                    |   |                       | Difference between changes in bank credit and its substitutes |   |
|------|--|-------------------------------------|---|------------------------|------------------------------------|---|-----------------------|---|---|
|      | Overall changes in bank credit and its substitutes | Changes in bank credit <sup>b</sup> | Overall funds from non-bank substitutes | Share issues in Israel | Capital raised abroad <sup>d</sup> | Changes in direct credit from abroad <sup>e</sup> | Venture capital funds |   | Changes in credit from institutional investors <sup>f</sup> |
| 1997 | 37,908   | 19,751                              | 18,157                                  | 8,256                  | 6,895                              | 3,160   | 1,730                 | -3,430  | 1,594   |
| 1998 | 64,990   | 43,177                              | 21,813                                  | 7,895                  | 4,562                              | 6,736   | 2,448                 | -2,377  | 21,364  |
| 1999 | 79,813   | 40,355                              | 39,458                                  | 5,659                  | 17,802                             | 6,728   | 4,462                 | 3,126   | 897   |
| 2000 | 106,129  | 45,254                              | 60,875                                  | 14,212                 | 19,267                             | 9,451   | 13,351                | 4,301   | -15,621   |
| 2001 | 69,914   | 46,083                              | 23,831                                  | 5,833                  | 7,322                              | -250  | 8,708                 | 2,129   | 22,252  |
| 2002 | 27,137   | 11,811                              | 15,326                                  | 5,555                  | 1,061                              | -104  | 5,289                 | 555   | -3,515  |
| 2003 | 5,080  | -17,839                             | 22,919                                  | 3,148                  | 3,855                              | 2,634   | 4,427                 | 6,062   | -40,758   |
| 2004 | 59,266   | -3,191                              | 62,457                                  | 8,251                  | 11,341                             | 13,219  | 6,268                 | 0,826   | -65,648   |
| 2005 | 75,725   | 13,370                              | 62,355                                  | 14,169                 | 4,874                              | 11,759  | 6,154                 | 4,404   | -48,986   |
| 2006 | 110,562  | 4,570                               | 105,992                                 | 19,065                 | 33,306 <sup>g</sup>                | 18,394  | 6,853                 | 17,133  | -101,422  |
| 2007 | 137,476  | 33,715                              | 103,761                                 | 19,634                 | 1,332                              | 8,429   | 7,059                 | 30,974  | -70,046   |

<sup>a</sup> In accordance with Accounting Standards 12 and 17 of the Israel Accounting Standards Board, inflation adjustment of the financial statement ceased on 1 January 2004; data for 2004 and thereafter are shown in current terms.

<sup>b</sup> Credit to the public from the commercial banks (on a consolidated basis). Does not include credit to individuals and credit to borrowers for activity abroad. It is assumed that the change in credit balances reflects the flow of new credit granted.

<sup>c</sup> Corporate bond issues and allocations by Tel Aviv Stock Exchange companies. From 2001 all bond issues that are not credit substitutes (financial issues, banking corporations' Tier 2 capital, financial exchange traded funds (ETFs), etc.), so that this refers to real issues.

<sup>d</sup> Including issues of bonds and shares abroad, after offsetting early redemption of bonds and share buy-backs.

<sup>e</sup> Defined as credit to the public or to the government given by banks abroad, and non-tradable (excluding commercial credit). This series was updated retroactively due to a new categorization of the data.

<sup>f</sup> From 2005 this item includes non-negotiable bonds issued to institutional investors.

<sup>g</sup> Of which some NIS 24 billion was raised by Teva to finance its merger with the American pharmaceuticals company IVAX.

SOURCE: Based on reports to the Supervisor of Banks.

quarter of 2006. It should be remembered however that unlike foreign tourism, internal tourism is not affected at the aggregate level by security-related developments. This is due to the rise in the local standard of living and to the persistent upturn in internal tourism since the beginning of the present business cycle. The proportion of problem loans to total credit to the industry continued to fall in 2007, although it is still the highest among the principal industries (Table 3.5, Figure 3.7). Concurrent with the continued expansion of bank credit to the business sector, the growth in the volume of bank credit to the household sector was maintained in 2007. Credit to private individuals rose by the high rate of 10 percent, most of it in the first three quarters of the year and included an 8 percent expansion in housing loans.

The rapid expansion in credit to the household segment occurred against the background of macroeconomic developments that favorably affected borrowers' repayment ability, which greatly increased the supply of bank credit to that segment. On the demand side as well, households' demand for credit increased as a result of the continued improvement in the labor market (Figure 1.2) as the average real wage stabilized at a high level. Apart from this development, unemployment rates among educated persons, including those with a partial high-school education, fell heavily. Moreover, the number of persons employed in the human-capital intensive industries increased and their salaries rose. Concurrent with the favorable developments in the labor market, the reduction in tax rates and the large increase in households' financial wealth contributed to a growth in households' aggregate demand for bank credit. Most of this incremental demand was directed towards an expansion in local private consumption, which surged by 7.2 percent in the year reviewed as previously mentioned. Complementing these demand factors was the increasing abundance of non-bank credit substitutes in the business sector, as well as the low risk and relatively high profitability associated with the retail segment. All these factors prompted the banks to increase the supply of credit and the services provided to that segment. This growth in activity was accompanied by media advertising campaigns, which were aimed at competing for households' credit requirements.

#### **d. Principal developments in off-balance-sheet activity**

Credit risk in respect of customers' liabilities to the banks is an integral part of off-balance-sheet activity, and is apparent in two main areas:

*(1) Transactions in off-balance-sheet financial instruments in which the nominal amount represents credit risk*

This activity includes letters of credit, guarantees<sup>21</sup> and liabilities for the granting of credit that has been approved and not yet granted.<sup>22</sup> Transactions associated with this

<sup>21</sup> Guarantees for securing credit, guarantees for apartment buyers, and other guarantees and other liabilities at customers' expense.

<sup>22</sup> Unutilized credit card credit lines, unutilized balances of current loan accounts, irrevocable liabilities for the granting of credit that has been approved and not yet granted, and irrevocable liabilities for the issue of guarantees.

**Table 1.6**  
**Distribution of Off-Balance-Sheet Financial Instruments, the Five Major Banking Groups, 2005-07**

|   | End-of-year balances<br>(NIS billion) |            | Rate of change (relative<br>to the previous period)<br>(percent) |             | Distribution<br>(percent) |            |
|---|---------------------------------------|------------|--|-------------|---------------------------|------------|
|   | 2005                                  | 2006       | 2006   | 2007        | 2005                      | 2007       |
| Documentary credit  | 6                                     | 6          | -2.0   | 1.6         | 2.2                       | 1.9        |
| Credit guarantees   | 20                                    | 22         | 8.2  | 27.6        | 7.0                       | 6.7        |
| Guarantees for home buyers  | 20                                    | 20         | 0.0  | 19.4        | 7.1                       | 6.3        |
| Other guarantees and liabilities  | 27                                    | 33         | 19.9   | 9.2         | 9.6                       | 10.2       |
| Non-recurring commitments for approved credit that has not yet been<br>extended | 70                                    | 79         | 13.5   | -1.3        | 24.6                      | 24.6       |
| Commitments to issue guarantees   | 16                                    | 19         | 17.8   | -6.1        | 5.6                       | 5.8        |
| Overdraft facilities and other credit facilities to the public not yet utilized | 84                                    | 99         | 18.1   | 35.4        | 29.6                      | 30.8       |
| Credit card facilities not yet utilized   | 41                                    | 44         | 8.6  | 26.8        | 14.3                      | 13.7       |
| <b>Total</b>  | <b>284</b>                            | <b>322</b> | <b>13.4</b>  | <b>17.9</b> | <b>100</b>                | <b>100</b> |

SOURCE: Published financial reports.

activity largely consist of current loan accounts and other credit lines to the public that have yet to be utilized, as well as irrevocable liabilities for the granting of credit that has been approved and not yet granted, which account for 35 percent and 21 percent of overall activity respectively (Table 1.6). Other transactions in off-balance-sheet financial instruments in which the nominal sum represents credit risk among the five large banking groups amounted to NIS 379 billion at the end of 2007, 18 percent more than at the end of 2006. The expansion was centered among current loan accounts and other unutilized credit lines, and conformed to the expansion in balance-sheet bank credit in 2007 as described in Section 4.c above.

*(2) Activity in derivative financial instruments*

In accordance with their exposure to base risks, contracts relating to derivative instruments are divided into four groups: interest-rate contracts,<sup>23</sup> foreign-currency contracts, contracts in respect of shares, and commodity and other contracts. The instruments are used for several purposes: (1) hedging derivatives;<sup>24</sup> (2) ALM derivatives;<sup>25</sup> (3) other derivatives;<sup>26</sup> (4) credit directives<sup>27</sup> and foreign-currency swaps. Activity in derivative instruments expanded considerably in 2007, and totaled NIS 1.36 billion at the end of the year compared with NIS 1.10 billion at the end of 2006. The expansion encompassed all types of contracts and all of the banking groups (Table 1.7). The banks' growing use of derivative financial instruments resulted from the increased sophistication of the financial markets and from the large rise in uncertainty with respect to the different market risk factors. The implied volatility of inflation expectations rose persistently in the course of the year (Figure 3.10), as did the implied volatility of shekel-dollar options.<sup>28</sup> The underlying interest-rate trend in the economy was not uniform in the

<sup>23</sup> Contracts for the purchase/sale of CPI-indexed local currency in return for unindexed local currency, or other interest-rate contracts.

<sup>24</sup> A derivative which the bank's management designates as suitable for hedging purposes. This is when the nature of the hedging instrument's risk exposure is identical to the nature of the hedged item's risk exposure. The hedged item must be specifically identified. At the commencement of the hedging activity, formal documentation is made of the hedging ratios and the objective and risk management strategy of the banking corporations when creating the hedge, including identification of the hedging instruments, the hedged item, the nature of the risk hedged, and the manner of assessing the effectiveness of the hedging instrument, offsetting the exposure to changes in the fair value of the hedged item which can be attributed to the risk hedged. The manner in which the banking corporation plans to assess the effectiveness of the hedging instrument must be based on reasonable assumptions.

<sup>25</sup> A derivative which the bank's management regard as a hedging instrument, but which does not conform to the hedging terms specified in this statement of opinion.

<sup>26</sup> A derivative that is not a hedging instrument and that is not ALM.

<sup>27</sup> A contract transferring credit risks from the buyer to the vendor. Credit derivatives are of various forms: options for protecting against credit default, a note for the partial coverage of credit risk, and a SWAP for full coverage of the risks.

<sup>28</sup> An index for measuring uncertainty regarding the exchange rate in the future.

**Table 1.7**  
**Distribution of Balances of Financial Derivatives, the Five Major Banking Groups,**  
**December 2006 and December 2007**

(NIS billion)<sup>a</sup>

|                     | 2006                    |                         |                    | 2007                    |                         |                    |              |
|---------------------|-------------------------|-------------------------|--------------------|-------------------------|-------------------------|--------------------|--------------|
|                     | Interest rate contracts | Exchange rate contracts | Other <sup>b</sup> | Interest rate contracts | Exchange rate contracts | Other <sup>b</sup> |              |
| Hapoalim            | 186                     | 247                     | 40                 | 205                     | 250                     | 59                 |              |
| Leumi               | 63                      | 135                     | 34                 | 121                     | 192                     | 26                 |              |
| Discount            | 26                      | 58                      | 17                 | 59                      | 70                      | 13                 |              |
| Mizrahi-Tefahot     | 31                      | 80                      | 27                 | 48                      | 92                      | 38                 |              |
| First International | 8                       | 87                      | 57                 | 9                       | 99                      | 74                 |              |
| <b>Total</b>        | <b>314</b>              | <b>607</b>              | <b>175</b>         | <b>442</b>              | <b>704</b>              | <b>210</b>         |              |
|                     |                         |                         |                    | <b>Total</b>            |                         |                    | <b>1,356</b> |

<sup>a</sup> In terms of notional principal, at current prices.

<sup>b</sup> Contracts based on shares, commodities and others.

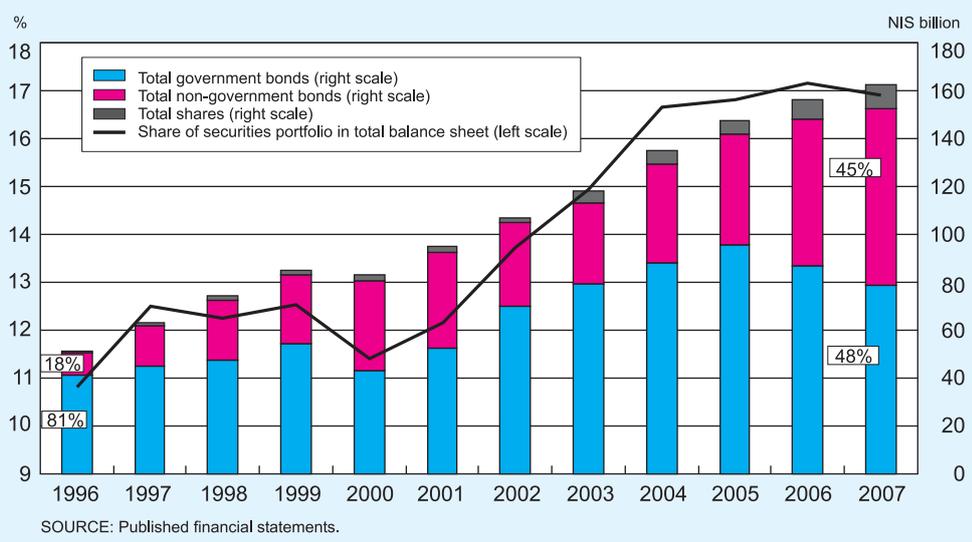
SOURCE: Published financial reports.

course of the year: after continuing to fall in the first half of the year, the trend rose in the second half and was subsequently stable.

### 5. THE BANKING SYSTEM'S ACTIVITY IN SECURITIES

The banks expanded their nostro securities portfolio in Israel and abroad persistently during recent years. This is in line with the banks' tendency of diversifying their profit sources, and also resulted from the relative weakness in demand for bank credit due to the vibrant activity in the credit substitute market. The aggregate securities portfolio of the five large banking groups amounted to NIS 163 billion in December 2007, 20 percent of which consisted of deposits of the public, and its proportion to the balance sheet reached 17 percent at the end of 2007. This portfolio has expanded rapidly in recent years. As an example, 11 years ago it amounted to only NIS 51 billion, and its proportion to the balance sheet was only 11 percent (Figure 1.15 and Table 1.8).

**Figure 1.15**  
**The Size and Composition of the Securities Portfolio of the Five Major Banking Groups, 1996-2007**



Concurrent with these developments, it should be remembered that the banks' natural tendency is to direct this money to the government bond market, which serves as a liquid channel of investment notable for relatively low credit risks. Part of the expansion in the securities portfolio began several years ago following a change in the Short-Term Loan Law and in the management of the Bank of Israel's monetary policy—the removal of the *makam* ceiling (*makam*—short-term bills issued by the Bank of Israel), which led to a decrease in the commercial banks' deposits with the Bank of Israel and an increase in their holdings of unindexed government bonds. Although this development did not change their portfolio's yield and risk profiles, the banks' management did change the structure of the portfolio in order to diversify their investments and as a result of the large decrease in issues of government bonds in the CPI-indexed segment and the foreign-currency segment. Developments in the fixed-income markets during recent years deepened these markets from the aspect of the larger number of bond series traded in them, concurrent with a persistent growth in trading in these series. The increase in the terms to maturity of government bonds encouraged the issue of long-term corporate bonds by publicly-traded companies. These developments prompted the banks to direct a growing proportion of their investments to non-government marketable securities, such as corporate bonds traded on the Tel Aviv Stock Exchange or assets that are traded abroad, from investment in the bonds of the highest-rated countries such as the USA, to complex securities with a higher risk profile. However, the different banking groups were clearly notable for the difference in their investment policy. The differing preferences of the groups' management were reflected by the manner in which they selected the point on the yield-risk curve. As an example, the Bank Hapoalim and Bank Leumi groups hold two thirds of their securities portfolios, which are each assessed at NIS 50 billion, in non-government securities. At the other end of the scale is Bank Discount, which allocates only 20 percent of its portfolio (which amounts to NIS 37 billion) to non-government securities.

This change in the composition of the banks' investment portfolio exposed the banking system to market risks and credit risks. Since the banks in Israel are subject to supervisory restrictions that prevent them from investing in marketable shares, the above-mentioned change was reflected entirely by a decrease in the proportion of government bonds and an increase in the proportion of corporate bonds (Table 1.2).

Today, 45 percent of the banks' securities portfolios are invested in non-government bonds,<sup>29</sup> compared with only 18 percent in 1996. At the same time, the proportion of government bonds fell from 81 percent in 1996 to only 48 percent in 2007. Although

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<sup>29</sup> The banks also have holdings of marketable and non-marketable shares, most of which are shares held against credit rather than resulting from the realization of collateral. These holdings do not reflect strategic purchases for the purpose of diversifying profit sources.

the changes have inevitably increased yield expectancy,<sup>30</sup> the level of risk in the banks' investment portfolios has increased as well.

## 6. THE BANKING GROUPS' PRINCIPAL ACTIVITIES VIA SUBSIDIARIES

### a. General

Apart from classical financial intermediation and the other banking activities which the banks offer directly and which were described in the previous parts of this chapter, the banks in Israel operate via subsidiaries in several areas: commercial banking in Israel; the holding of companies specializing in capital market activity, leasing and the extension of mortgages;<sup>31</sup> the extension of consumer credit to households via credit card companies that are owned by the major banking groups; banking activity abroad via banking subsidiaries, branches and representative offices. The contribution of these areas of activity to the parent companies' profits is considerable and enables them to diversify their sources of profit. At the same time, these areas of activity enable the subsidiaries to specialize in unique population groups, which are not necessarily the same as the customers of the commercial banks at the head of the groups. The commercial banks' exploitation of economies of diversification became highly important in recent years due to the supervisory restrictions imposed on them as a result of the application of the recommendations of the Bachar Committee.<sup>32</sup> These diversified activities continued to produce high yields in 2007, in relative terms and in comparison with other profit centers. A long-term examination of these yields by means of the RAROC Index and the Sharp Index (Table 1.9 and Table 3.9) shows that high profit centers are involved relative to classical banking activity only: an annual 10-year average of 1.9 compared with 0.6 (Table 1.9). Credit card activity by the subsidiaries has increased persistently for several years now. This area of activity contributed NIS 386 million to the group's net profit in 2007—all of it from the three largest banks' holdings in the three credit card companies controlled by them. The growth in credit card activity—which led to a relatively high Sharp Index of 0.94—resulted from the expansion in private consumption in 2007, which led to a growth in demand for consumer credit.

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<sup>30</sup> Concurrent with these changes, the classification of the banks' nostro securities portfolios was changed in a manner that affects the recording of profit or loss from their holdings. See section b. below for more details.

<sup>31</sup> As a result of mergers within the parent companies, the importance of mortgage banks operating as separate subsidiaries of the large banks is declining continually. See Section 3 of this chapter "Structure of the Banking System in Israel" on this subject.

<sup>32</sup> For further details on this subject see Section 3 of this chapter: "Structure of the Banking System in Israel."

**Table 1.8**  
**The Securities Portfolios of the Major Banking Groups, 2006-07**

|                                     | Hapoalim                 |                        |                          |                        |                          |                        | Leumi                    |                        |                          |                        |                          |                        | Discount                 |                        |                          |                        |       |       |       |
|-------------------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|-------|-------|-------|
|                                     | 2006                     |                        | 2007                     |                        | 2006                     |                        | 2007                     |                        | 2006                     |                        | 2007                     |                        | 2006                     |                        | 2007                     |                        |       |       |       |
|                                     | Fair value (NIS million) | Distribution (percent) |       |       |       |
| Bonds held to maturity              | 111                      | 0.25                   | 20                       | 0.04                   | 2,441                    | 5.26                   | 1,476                    | 3.13                   | 4,750                    | 12.22                  | 3,043                    | 8.16                   | 2,996                    | 6.74                   | 2,443                    | 4.84                   | 0.10  | 311   | 0.83  |
| Other bonds                         | <b>3,107</b>             | <b>6.99</b>            | <b>2,463</b>             | <b>4.88</b>            | <b>2,566</b>             | <b>5.53</b>            | <b>1,599</b>             | <b>3.39</b>            | <b>4,790</b>             | <b>12.32</b>           | <b>3,354</b>             | <b>9.00</b>            |                          |                        |                          |                        |       |       |       |
| Securities available for sale       | 14,015                   | 31.53                  | 13,562                   | 26.89                  | 16,963                   | 36.55                  | 10,103                   | 21.41                  | 25,516                   | 65.63                  | 24,284                   | 65.13                  | 22,559                   | 50.74                  | 29,237                   | 57.97                  | 48.72 | 4,316 | 13.01 |
| Total bonds available for sale      | 36,574                   | 82.27                  | 42,799                   | 84.87                  | 32,651                   | 70.35                  | 33,092                   | 70.13                  | 29,832                   | 76.73                  | 29,134                   | 78.13                  | 1,827                    | 4.11                   | 1,876                    | 3.72                   | 9.40  | 1,193 | 3.07  |
| Total securities available for sale | <b>38,401</b>            | <b>86.38</b>           | <b>44,675</b>            | <b>88.59</b>           | <b>36,850</b>            | <b>79.40</b>           | <b>37,528</b>            | <b>79.53</b>           | <b>31,025</b>            | <b>79.80</b>           | <b>30,894</b>            | <b>82.85</b>           |                          |                        |                          |                        |       |       |       |
| Tradable securities                 | 2,853                    | 6.42                   | 3,213                    | 6.37                   | 4,880                    | 10.51                  | 5,208                    | 11.04                  | 2,580                    | 6.64                   | 2,418                    | 6.48                   | 59                       | 0.13                   | 50                       | 0.10                   | 4.10  | 471   | 1.21  |
| Other bonds                         | 2,912                    | 6.55                   | 3,263                    | 6.47                   | 6,964                    | 15.00                  | 7,141                    | 15.13                  | 3,051                    | 7.85                   | 3,026                    | 8.12                   | 36                       | 0.08                   | 30                       | 0.06                   | 1.95  | 14    | 0.04  |
| Total tradable securities           | <b>2,948</b>             | <b>6.63</b>            | <b>3,293</b>             | <b>7.41</b>            | <b>6,997</b>             | <b>15.08</b>           | <b>8,060</b>             | <b>17.08</b>           | <b>3,065</b>             | <b>7.88</b>            | <b>3,039</b>             | <b>8.15</b>            |                          |                        |                          |                        |       |       |       |
| Total government bonds              | <b>16,979</b>            | <b>38</b>              | <b>16,795</b>            | <b>33</b>              | <b>24,284</b>            | <b>52</b>              | <b>16,787</b>            | <b>36</b>              | <b>32,846</b>            | <b>84</b>              | <b>29,745</b>            | <b>80</b>              |                          |                        |                          |                        |       |       |       |
| Total other bonds                   | <b>27,477</b>            | <b>62</b>              | <b>33,636</b>            | <b>67</b>              | <b>22,129</b>            | <b>48</b>              | <b>30,400</b>            | <b>64</b>              | <b>6,034</b>             | <b>16</b>              | <b>7,542</b>             | <b>20</b>              |                          |                        |                          |                        |       |       |       |
| Total securities                    | <b>44,456</b>            | <b>100</b>             | <b>50,431</b>            | <b>100</b>             | <b>46,413</b>            | <b>100</b>             | <b>47,187</b>            | <b>100</b>             | <b>38,880</b>            | <b>100</b>             | <b>37,287</b>            | <b>100</b>             |                          |                        |                          |                        |       |       |       |

(cont'd)

**Table 1.8 (Cont'd)**  
**The Securities Portfolios of the Major Banking Groups, 2006-07**

|  | Mizrahi-Tefahot          |                        |                          |                        |                          |                        | First International      |                        |                          |                        |                          |                        | Total of Five Banking Groups |                        |                          |                        |  |  |
|--|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|------------------------|------------------------------|------------------------|--------------------------|------------------------|--|--|
|  | 2006                     |                        | 2007                     |                        | 2006                     |                        | 2007                     |                        | 2006                     |                        | 2007                     |                        | 2006                         |                        | 2007                     |                        |  |  |
|  | Fair value (NIS million) | Distribution (percent) | Fair value (NIS million)     | Distribution (percent) | Fair value (NIS million) | Distribution (percent) |  |  |
| Bonds held to maturity                     | 0                        | 0.00                   | 0                        | 0.00                   | 0                        | 0.00                   | 0                        | 0.00                   | 0                        | 0.00                   | 0                        | 0.00                   | 7,302                        | 4.67                   | 4,539                    | 2.79                   |  |  |
| Other bonds                                | 153                      | 2.56                   | 0                        | 0.00                   | 1,032                    | 4.97                   | 1,227                    | 5.71                   | 4,346                    | 2.78                   | 4,104                    | 2.52                   |                              |                        |                          |                        |  |  |
| <b>Total bonds held to maturity</b>        | <b>153</b>               | <b>2.56</b>            | <b>0</b>                 | <b>0.00</b>            | <b>1,032</b>             | <b>4.97</b>            | <b>1,227</b>             | <b>5.71</b>            | <b>4,346</b>             | <b>2.78</b>            | <b>4,104</b>             | <b>2.52</b>            |                              |                        |                          |                        |  |  |
| Securities available for sale              | 3,074                    | 51.41                  | 4,079                    | 66.38                  | 7,844                    | 37.81                  | 9,789                    | 45.53                  | 67,412                   | 43.08                  | 61,817                   | 38.03                  |                              |                        |                          |                        |  |  |
| Government bonds                           | 2,318                    | 38.77                  | 1,587                    | 25.83                  | 8,538                    | 41.16                  | 8,153                    | 37.92                  | 53,419                   | 34.14                  | 66,816                   | 41.10                  |                              |                        |                          |                        |  |  |
| Other bonds                                | 5,392                    | 90.18                  | 5,666                    | 92.21                  | 16,382                   | 78.97                  | 17,942                   | 83.45                  | 120,831                  | 77.22                  | 128,633                  | 79.13                  |                              |                        |                          |                        |  |  |
| Total bonds available for sale             | 404                      | 6.76                   | 399                      | 6.49                   | 920                      | 4.44                   | 881                      | 4.10                   | 8,543                    | 5.46                   | 9,352                    | 5.75                   |                              |                        |                          |                        |  |  |
| Total shares available for sale            |                          |                        |                          |                        |                          |                        |                          |                        |                          |                        |                          |                        |                              |                        |                          |                        |  |  |
| <b>Total securities available for sale</b> | <b>5,796</b>             | <b>96.94</b>           | <b>6,065</b>             | <b>98.70</b>           | <b>17,302</b>            | <b>83.41</b>           | <b>18,823</b>            | <b>87.55</b>           | <b>129,374</b>           | <b>82.68</b>           | <b>137,985</b>           | <b>84.89</b>           |                              |                        |                          |                        |  |  |
| Tradable securities                        | 29                       | 0.49                   | 79                       | 1.29                   | 2,067                    | 9.96                   | 1,356                    | 6.31                   | 12,409                   | 7.93                   | 12,274                   | 7.55                   |                              |                        |                          |                        |  |  |
| Government bonds                           | 1                        | 0.02                   | 1                        | 0.02                   | 325                      | 1.57                   | 76                       | 0.35                   | 2,940                    | 1.88                   | 2,668                    | 1.64                   |                              |                        |                          |                        |  |  |
| Other bonds                                | 30                       | 0.50                   | 80                       | 1.30                   | 2,392                    | 11.53                  | 1,432                    | 6.66                   | 15,349                   | 9.81                   | 14,942                   | 9.19                   |                              |                        |                          |                        |  |  |
| Total tradable bonds                       | 0                        | 0.00                   | 0                        | 0.00                   | 18                       | 0.09                   | 18                       | 0.08                   | 101                      | 0.06                   | 980                      | 0.60                   |                              |                        |                          |                        |  |  |
| Total tradable shares                      |                          |                        |                          |                        |                          |                        |                          |                        |                          |                        |                          |                        |                              |                        |                          |                        |  |  |
| <b>Total tradable securities</b>           | <b>30</b>                | <b>0.50</b>            | <b>80</b>                | <b>1.30</b>            | <b>2,410</b>             | <b>11.62</b>           | <b>1,450</b>             | <b>6.74</b>            | <b>15,450</b>            | <b>9.87</b>            | <b>15,922</b>            | <b>9.80</b>            |                              |                        |                          |                        |  |  |
| Total government bonds                     | 3,103                    | 52                     | 4,158                    | 68                     | 9,911                    | 48                     | 11,145                   | 52                     | 87,123                   | 56                     | 78,630                   | 48                     |                              |                        |                          |                        |  |  |
| Total other bonds                          | 2,876                    | 48                     | 1,987                    | 32                     | 10,833                   | 52                     | 10,355                   | 48                     | 69,349                   | 44                     | 83,920                   | 52                     |                              |                        |                          |                        |  |  |
| <b>Total securities</b>                    | <b>5,979</b>             | <b>100</b>             | <b>6,145</b>             | <b>100</b>             | <b>20,744</b>            | <b>100</b>             | <b>21,500</b>            | <b>100</b>             | <b>156,472</b>           | <b>100</b>             | <b>162,550</b>           | <b>100</b>             |                              |                        |                          |                        |  |  |

SOURCE: Published financial reports.

**Table 1.9**  
**Investment and Contribution to Profit of Companies in which the Bank has a Holding and of the Bank Itself, the Five Major Banking Groups, 2006-07**

|  | Book value of investment at end of year |               |              |             |                |              |   |             |                |             |                         |             | Yield on investment in 1997-2007 |            |              |          |                       |                     |
|--|---|---------------|--------------|-------------|----------------|--------------|---|-------------|----------------|-------------|-------------------------|-------------|----------------------------------|------------|--------------|----------|-----------------------|---------------------|
|  | 2006                                    |               | 2007         |             | Rate of change |              | Contribution to net profit <sup>a</sup> |             | Rate of change |             | Investment distribution |             | Yield on investment              |            | Average      | St. dev. | Variance <sup>b</sup> | Sharpe <sup>c</sup> |
|  | 2005-                                   | 2006-         | 2005-        | 2006-       | 2005-          | 2006-        | 2005-                                   | 2006-       | 2005-          | 2006-       | 2005-                   | 2006-       | 2005-                            | 2006-      |              |          |                       |                     |
| <b>a. Major consolidated companies</b>                       |   |               |              |             |                |              |   |             |                |             |                         |             |                                  |            |              |          |                       |                     |
| Commercial banks   | 3,938                                   | 4,233         | 14.9         | 7.5         | 514            | 385          | -25.1                                   | 10.7        | 11.5           | 15.0        | 9.8                     | 10.5        | 2.9                              | 3.6        | 2.055        |          |                       |                     |
| Mortgage banks <sup>d</sup>                                  | 2,781                                   | 3,390         | -16.8        | 21.9        | 95             | 263          | 176.8                                   | 7.6         | 9.2            | 6.1         | 13.4                    | 8.1         | 3.7                              | 2.1        | 0.959        |          |                       |                     |
| Holdings, investments and others <sup>e</sup>                | 7,790                                   | 7,594         | 7.8          | -2.5        | 882            | 424          | -52                                     | 21.2        | 20.6           | 12.2        | 5.4                     | 6.4         | 3.6                              | 1.8        | 0.554        |          |                       |                     |
| Banking and financial companies abroad <sup>f</sup>          | 10,742                                  | 10,428        | 0.8          | -2.9        | -3             | -70          |   | 29.2        | 28.4           | 0.0         | -0.7                    | 8.8         | 7.4                              | 1.2        | 0.593        |          |                       |                     |
| Capital market (underwriting and management)                 | 2,344                                   | 1,162         | 128.7        | -50.4       | 1,247          | 710          | -43.1                                   | 6.4         | 3.2            | 121.7       | 30.3                    | 17.6        | 36.2                             | 0.5        | 0.364        |          |                       |                     |
| Credit cards   | 1,801                                   | 2,020         | 37.7         | 12.2        | 299            | 386          | 29.1                                    | 4.9         | 5.5            | 22.9        | 21.4                    | 12.8        | 8.8                              | 1.4        | 0.942        |          |                       |                     |
| Leasing  | 230                                     | 237           | 2.7          | 3.0         | 6              | 6            | 0.0                                     | 0.6         | 0.6            | 2.7         | 2.6                     | 2.1         | 1.4                              | 1.5        | -1.691       |          |                       |                     |
| <b>Total major consolidated companies</b>                    | <b>29,626</b>                           | <b>29,064</b> | <b>8.9</b>   | <b>-1.9</b> | <b>3,040</b>   | <b>2,104</b> | <b>-30.8</b>                            | <b>80.5</b> | <b>79.0</b>    | <b>11.2</b> | <b>7.1</b>              | <b>8.8</b>  | <b>2.2</b>                       | <b>3.9</b> | <b>1.940</b> |          |                       |                     |
| <b>b. Major companies included on an equity basis</b>        |   |               |              |             |                |              |   |             |                |             |                         |             |                                  |            |              |          |                       |                     |
| Commercial banks <sup>g</sup>                                | 1,254                                   | 1,451         | 34.8         | 15.7        | 133            | 26           | -80.5                                   | 3.4         | 3.9            | 14.3        | 2.1                     | 7.4         | 4.9                              | 1.5        | 0.603        |          |                       |                     |
| Non-financial companies and insurance <sup>h</sup>           | 400                                     | 360           | -75.4        | -10.0       | 147            | 52           | -64.6                                   | 1.1         | 1.0            | 9.0         | 13.0                    | 10.2        | 9.4                              | 1.1        | 0.606        |          |                       |                     |
| Holdings, investment, financial and other (including abroad) | 1,455                                   | 1,478         | 3.4          | 1.6         | 215            | 110          | -48.8                                   | 4.0         | 4.0            | 15.3        | 7.6                     | 10.5        | 2.9                              | 0.7        | 2.012        |          |                       |                     |
| <b>Total major companies included on an equity basis</b>     | <b>3,109</b>                            | <b>3,289</b>  | <b>-21.5</b> | <b>5.8</b>  | <b>495</b>     | <b>188</b>   | <b>-62.0</b>                            | <b>8.5</b>  | <b>8.9</b>     | <b>12.5</b> | <b>6.0</b>              | <b>10.5</b> | <b>2.9</b>                       | <b>1.1</b> | <b>2.012</b> |          |                       |                     |

(cont'd)

**Table 1.9 (cont'd)**  
**Investment and Contribution to Profit of Companies in which the Bank has a Holding and of the Bank Itself, the Five Major Banking Groups, 2006-07**

|  | Book value of investment at end of year |               | Rate of change |             | Contribution to net profit <sup>a</sup> |              | Rate of change |              | Investment distribution |             | Yield on investment |             | Yield on investment in 1997-2007 |            |                     |
|--|---|---------------|----------------|-------------|---|--------------|----------------|--------------|-------------------------|-------------|---------------------|-------------|----------------------------------|------------|---------------------|
|  | 2006                                    | 2007          | 2005-2006      | 2006-2007   | 2006                                    | 2007         | 2006           | 2007         | 2006                    | 2007        | 2006                | 2007        | Average                          | St. dev.   | Sharpe <sup>c</sup> |
| <b>Total major companies in which the banks have a holding</b> | <b>32,735</b>                           | <b>32,353</b> | <b>5.0</b>     | <b>-1.2</b> | <b>3,535</b>                            | <b>2,292</b> | <b>-35.2</b>   | <b>89.0</b>  | <b>88.0</b>             | <b>11.3</b> | <b>7.0</b>          | <b>10.5</b> | <b>2.9</b>                       | <b>3.1</b> | <b>2.012</b>        |
| Non-major companies <sup>i</sup>                               | 4,048                                   | 5,890         | 51.0           | 45.5        | 164                                     | 369          | 125.0          | 11.0         | 16.0                    | 6.1         | 9.1                 |             |                                  |            |                     |
| <b>Total companies in which the banks have a holding</b>       | <b>36,783</b>                           | <b>38,243</b> | <b>8.6</b>     | <b>4.0</b>  | <b>3,699</b>                            | <b>2,661</b> | <b>-28.1</b>   | <b>100.0</b> | <b>104.0</b>            | <b>10.9</b> | <b>7.2</b>          | <b>9.9</b>  | <b>5.5</b>                       | <b>1.8</b> | <b>0.998</b>        |
| <b>The bank itself<sup>f</sup></b>                             | <b>16,707</b>                           | <b>20,331</b> | <b>19.5</b>    | <b>21.7</b> | <b>6,670</b>                            | <b>6,548</b> | <b>-1.8</b>    |              |                         | <b>47.7</b> | <b>39.2</b>         | <b>17.7</b> | <b>14.7</b>                      | <b>1.2</b> | <b>0.898</b>        |

<sup>a</sup> Profits in the companies in which the banks have a holding include "profits from ordinary activities and profits from extraordinary activities" and do not include dividends or receipts from the sale of surplus holdings.

<sup>b</sup> The average yield divided by the standard deviation measures the yield on an investment adjusted by the inherent risk.

<sup>c</sup> The Sharpe index was calculated for the period 1997-2007. The risk-free interest rate is 4.46 percent, obtained from the average yield to maturity for CPI-indexed five-year government bonds.

<sup>d</sup> This item has been reclassified and does not include profits from the activities of Bank Mishkan following its merger within Bank Hapoalim on 31/12/03. In 2004 profits in respect of mortgage activities of Mishkan were included in Bank Hapoalim. These profits totaled NIS 110 million.

<sup>e</sup> This includes merchant and investment finance banks as well holding and investment companies and other financial companies, mainly those of Bank Hapoalim.

<sup>f</sup> The contribution to net profits and the yield of the investment in banking and financial companies abroad in 2006 was biased downward considerably, due to the significant negative profit statement of Discount Bank.

<sup>g</sup> Discount Bank's holdings in First International Bank were not discounted from the total investments nor from the contribution to profits.

<sup>h</sup> The yield on investment in these companies was downwardly biased, as the investment in non-banking companies does not have to maintain a minimum capital requirement, and therefore the capital invested in them can serve fully for profit-earning banking activity, which was not taken into account in the yield above.

<sup>i</sup> Companies in which the banks have a holding which are not detailed as major companies in Note 6 of the Financial Statements.

<sup>j</sup> The investment in the bank itself is derived from deducting the investment in companies in which the bank has a holding, according to balance sheet value, from total shareholders equity, and this differs from the definition of shareholders equity for purposes of calculating item 23a according to the Banking Law (Licensing). The contribution to net profits of the bank itself was calculated as the net ordinary profits after tax plus extraordinary profits, by bank. This is in effect the profits from ordinary activities (and from extraordinary activities) of the bank, discounted by the (net) profits from ordinary activities and from extraordinary profits of all companies in which the bank has a holding (both major and non-major).

SOURCE: Published financial reports.

**b. The banking groups' credit card activity**

Credit card activity increased considerably during recent years. Apart from the upsurge in activity deriving from the continual increase in the public's use of credit cards, the credit card companies expanded their activities in this important consumer segment, where there is still hardly any competition to the banks and the credit card companies. The banks' joint activity with their subsidiaries in this area created two separate markets for credit consumers: in one market, the banks controlling the credit card companies offer consumer credit at their own risk. In the other market, the credit card companies have created a consumer credit market for households that prefer to take such credit directly without the banks' intermediation and at their own risk. An examination of the return on investment from the aspect of these companies' contribution over time to the profit of the banks heading the groups shows that the risk-adjusted profitability on this activity is relatively high, reflecting the banks' desire to expand these companies' areas of activity and their investment in them. The Sharp Index of credit card activity is 0.94 compared with 0.90 on the entire range of activities on the banks themselves (Table 1.9). The continued growth in credit card activity derives from the ready availability of the cards and the ease of using them at businesses, which has transformed them into a preferred means of payment. The persistent increase in credit card purchases by telephone and the Internet has also led to the growth in the number of credit cards. The companies issuing the cards have succeeded in creating for themselves a clientele with a sound payments record, obviating the need for collateral. The contractual association is formed directly with the consumers, thereby keeping operating expenses lower than those involved in activity with the banks' branches. The credit card companies have managed to differentiate the market according to levels of income and expenditure. This has enabled them to segment the market and to discriminate in prices (in the interest rate on credit and in the fixed usage fees) between different consumers. Until recently, most of the credit cards issued in Israel were of the deferred debit type. Today however, another two types of credit cards exist: One of them is a revolving credit card, in which the customer chooses the monthly amount which he wishes to repay, with the balance of his debt deferred to the next month while accruing interest. This is effectively a loan in which the customer himself determines the rate of repayment of the principal and interest debited to him and can change this rate every month, for as long as he does not exceed the credit line allocated to him. Unlike transactions conducted by cards that are issued via the banks, the issuing body (which belongs to the banking group) is exposed to the credit risk inherent in using the cards because it is a guarantor for the credit that was granted. The size of the approved credit line is determined by means of credit-scoring systems. The increased usage of credit cards of this type mainly derives from the credit card companies' strategy of expanding their market segment by issuing in excess of the customer potential deriving from the parent bank: The credit is also granted to customers who do not necessarily belong to the bank at the head of the group. The increased usage of these cards also results from the Supervisor of Banks' directives

**Table 1.10**  
**Credit Card Activity, 2004-07**

|  | 2004  | 2005                   | 2006  | 2007  | Rate of change<br>from 2005 to 2006<br>(percent) | Rate of change<br>from 2006 to 2007<br>(percent) |
|--|-------|------------------------|-------|-------|--|--|
| Number of cards active at the end of the year                                | 3.8   | 4.2                    | 4.4   | 4.7   | 3.9  | 7.6  |
| <i>of which:</i> Cards at the sole responsibility of the credit card company | 0.39  | 0.52                   | 0.57  | 0.71  | 8.8  | 24.8   |
| Number of transactions   | 449.9 | 490.4                  | 541.2 | 595.9 | 10.4   | 10.1   |
| <i>of which:</i> in Israel   | 442.5 | 482.5                  | 532.0 | 585.5 | 10.3   | 10.1   |
| Amount of transactions   | 107.5 | 118.1                  | 131.5 | 146.3 | 11.3   | 11.3   |
| <i>of which:</i> in Israel   | 102.4 | 113.1                  | 125.8 | 139.4 | 11.2   | 10.9   |
|  |       | Indicators of activity |       |       |  |  |
| Average credit card transaction (NIS)  | 238.8 | 240.8                  | 242.9 | 245.5 | 0.88   | 1.07   |
| Average monthly expenditure per credit card (NIS)                            | 2,350 | 2,342                  | 2,511 | 2,597 | 7.20   | 3.46   |
| Average number of transactions per card per year                             | 118.1 | 116.7                  | 124.0 | 127.0 | 6.27   | 2.37   |

SOURCE: Reports to the Supervisor of the Banks.

that provide regulatory coverage for credit lines in demand deposits and current loan accounts.<sup>33</sup> Customers who were restricted in the amount of credit which they could use in their accounts used this product as an alternative to an overdraft as a source of credit. Outstanding consumer credit of this type, which is at the credit card companies' risk as stated, expanded by the high rate of 46 percent during 2007, and totaled NIS 2.2 billion at the end of the year. As a result of these developments, issues of revolving credit cards with a credit line parallel to and alternative to bank credit increased. The number of active credit cards<sup>34</sup> and the number of transactions in Israel and abroad rose in comparison with 2006. Credit card transactions totaled NIS 146 billion, NIS 139 billion of them in Israel, 11 percent more than in 2006 (Table 1.12). This could be indicative of a major change in customers' pattern of behavior.

Three credit card companies that are controlled by the large banking corporations currently operate in Israel:<sup>35</sup> (1) the Isracard conglomerate, which is wholly owned by Bank Hapoalim and is the managerial and operational umbrella for three credit card companies that are controlled by the bank—Isracard Ltd., Europay Israel Ltd. (Eurocard) and Poalim Express Limited; (2) Leumicard, which is wholly owned by Bank Leumi; (3) Israel Credit Cards (ICC), which is owned by Bank Discount and the First International Bank and currently holds 51 percent of Diner's Club. The credit card companies operate as both issuers and clearers for a number of brands, principally Visa and Mastercard.

### c. Activity abroad

For many years now, the Israeli banks have managed extensive international activity via their overseas offices—principally subsidiaries and branches. The Israeli banks' international activity consists of the provision of financial services in the overseas offices' host countries, in other countries and in Israel as well.

The overseas offices enable the Israeli banks to diversify their sources of profit and to expand their business base. However, their activity involves risks, part of which have actually materialized. The realization of credit risk was reflected by relatively large volumes of problem loans, particularly in the USA, and operational risk materialized at the beginning of the decade as the result of embezzlement in Switzerland.

Overseas offices' assets totaled NIS 166.4 billion at the end of 2007. These assets accounted for 17.3 percent of total assets, similar to the rate recorded at the end of

<sup>33</sup> Regulation 325. See Box 1.1 in the Supervisor of Banks' Annual Survey 2006, pp 21-23.

<sup>34</sup> Including cards for conducting transactions only, which are mostly connected with a customers club, and cards intended for conducting transactions and cash withdrawal.

<sup>35</sup> The Isracard conglomerate, which is wholly owned by Bank Hapoalim; Leumicard, which is wholly owned by Bank Leumi; Israel Credit Card, which is jointly owned by Bank Discount (63 percent of voting rights and 51 percent of equity) and the First International Bank. (In December 2006 the latter completed an additional acquisition of voting rights and equity in Israel Credit Cards. Following the acquisition, it now holds 20 percent of the voting rights and 27 percent of the equity in that company.) It should be noted that each of the companies issues and clears a number of brands.

**Table 1.11****Banking Representation Abroad: Branches, Offices and Positions, 1991-2007**

| Year              | Total offices | Number of branches<br>and representative<br>offices <sup>a</sup> | Number of offices<br>of subsidiaries <sup>b</sup> | Number of<br>positions <sup>c</sup> |
|-------------------|---------------|--|---|-------------------------------------|
| 1991-1995 average | 120           | 72   | 48  | 2,827                               |
| 1996-2000 average | 97            | 63   | 34  | 2,084                               |
| 2001-2005 average | 114           | 63   | 51  | 2,413                               |
| 2004              | 120           | 64   | 56  | 2,502                               |
| 2005              | 110           | 63   | 47  | 2,296                               |
| 2006              | 147           | 61   | 86  | 3,050                               |
| 2007              | 163           | 61   | 102   | 3,300                               |

<sup>a</sup> Branches and representative offices of Israeli banking groups abroad.

<sup>b</sup> Branches of subsidiaries abroad.

<sup>c</sup> Not including overtime.

SOURCE: Reports to the Supervisor of Banks.

2006. Of this amount, 23 percent were assets of branches abroad, which expanded by 15 percent compared with 2006. Overseas offices' share in total bank credit amounted to 11.6 percent at the end of 2007 compared with 10.8 percent at the end of 2006 (Table 1.12).

Approximately 60 percent of overseas offices' activity is centered in the USA, 37 percent in Western Europe, principally in the UK and Switzerland, and the remainder consists of activity by foreign banks in the emerging market. These banks were purchased by Israeli groups in recent years, as will be described later. In 2007, 163 overseas offices operated compared with 147 at the end of 2006. The entire increase was recorded in the number of subsidiaries' offices (Table 1.11).

Overseas offices' activity resulted in a loss of \$ 135 million in 2007 compared with a profit of \$ 122 million in 2006. The loss resulted from the price slide in the Bank Hapoalim group's mortgage-backed bonds. These losses were recorded at Bank Hapoalim's New York branch. In Western Europe however, overseas offices recorded a profit of \$ 78.4 million, similar to that in 2006. Overseas offices' shekel contribution to the banking group's net profit was affected during the past two years by the strengthening of the shekel against the currencies of their host countries. As a result, the Israeli's banking groups recorded a loss of NIS 70 million on their investments abroad in 2007.

The Israeli banks' international activity is managed in three ways: (1) via their subsidiaries, which are foreign banks operating abroad; (2) via their branches in Israel that conduct international activity; (3) via their branches abroad.

The first and principal channel is the activity of subsidiaries, which are foreign banks to all extents and purposes and that are owned by Israeli banks. These banks mainly

**Table 1.12**  
**Overseas Offices' Role in Total Credit and Assets in the Five Major Banking Groups in Israel, 1999-2007**

(NIS billion)

|      | Assets                                  |  |   | Credit   |  |   |
|------|---|--|---|--|--|---|
|      | Total assets in the five banking groups | <i>Of which:</i> Overseas offices <sup>a</sup> | Assets of overseas offices as share of total assets (%) | Total credit <sup>b</sup> in the five banking groups | <i>Of which:</i> Overseas offices <sup>a</sup> | Credit from overseas offices as share of total credit (%) |
| 1999 | 637.6                                   | 88.9   | 13.9  | 407.3  | 38.6   | 9.5   |
| 2000 | 699.6                                   | 100.0  | 14.3  | 464.9  | 42.0   | 9.0   |
| 2001 | 795.6                                   | 117.1  | 14.7  | 543.4  | 45.5   | 8.4   |
| 2002 | 778.6                                   | 139.4  | 17.9  | 541.8  | 51.1   | 9.4   |
| 2003 | 789.1                                   | 135.6  | 17.2  | 535.2  | 52.0   | 9.7   |
| 2004 | 812.1                                   | 148.1  | 18.2  | 536.2  | 57.1   | 10.7  |
| 2005 | 877.5                                   | 157.7  | 18.0  | 573.3  | 58.7   | 10.2  |
| 2006 | 912.0                                   | 159.0  | 17.4  | 582.7  | 63.0   | 10.8  |
| 2007 | 961.8                                   | 166.4  | 17.3  | 635.4  | 73.5   | 11.6  |

<sup>a</sup> Overseas offices in the US, Western Europe, South America and the Cayman Islands.

<sup>b</sup> Balance sheet credit.

SOURCE: Reports to the Supervisor of Banks.

engage in global private banking and provide advanced banking services, including global investment management for private customers. They also grant credit to local residents, principally customers defined as middle market. Apart from operating as an international banking network, the subsidiaries cooperate—directly and indirectly—with financial institutions engaged in brokerage, leasing and underwriting, via their holdings in these financial institutions. This enables the subsidiaries to expand their securities trading activity and to diversify the sources of credit for their customers. The subsidiaries are located in financial centers in Europe (Switzerland, Germany, the UK and France), the USA, South America (Argentina, Brazil and Chile), South Africa, Australia and in off-shore banking centers. The five large banking groups' investments abroad, which is measured at their book equity, totaled NIS 10.5 billion at the end of 2007, which was equivalent to 18 percent of the five large banking groups' shareholders' equity.

The second and smaller channel for the Israeli banks' international activity, from the aspect of activity volume, is activity via branches in Israel which supply banking services to Israelis operating abroad. They also serve nonresidents who operate via them. This usually involves classical banking activity, principally credit and the provision of banking services to companies operating abroad, in the area of real estate for example.

**Table 1.12.A**  
**Main Data on Subsidiaries Abroad**

(percent unless otherwise stated)

|   | Banks in<br>emerging markets<br>purchased<br>recently <sup>a</sup> | Subsidiaries<br>in Western<br>Europe <sup>b</sup> | Peer<br>group <sup>c</sup> | Total<br>subsidiaries<br>abroad |
|---|--|---|----------------------------|---------------------------------|
| <b>Profitability indices</b>                |  |   |                            |                                 |
| Return on equity (ROE)                      | 7.7  | 6.9   | 11.1                       | 8.0                             |
| Return on assets (ROA)                      | 2.8  | 0.9   | 1.2                        | 0.7                             |
| Total margin                                | 6.2  | 2.0   | 4.1                        | 2.0                             |
| Operating coverage ratio                    | 0.3  | 0.7   | 0.6                        | 0.4                             |
| Efficiency ratio                            | 1.5  | 1.5   | 1.5                        | 1.5                             |
| Annual salary per employee post<br>(\$'000) | 42   | 47  | 17.1                       | 104                             |
| Net income (\$ million)                     | 26.7   | 84.1  | 301.0                      | 185.1                           |
| <b>Risk indices</b>                         |  |   |                            |                                 |
| Share of credit in balance sheet            | 0.6  | 0.5   | 0.6                        | 0.5                             |
| Ratio of loan-loss provision to credit      | 0.7  | 0.1   | 0.7                        | 0.2                             |
| Ratio of problem loans to credit            | 0.4  | 0.2   | 1.9                        | 2.1                             |
| Credit coverage ratio                       | 170.4  | 177.0   | 71.5                       | 54.2                            |
| Industry concentration <sup>d</sup>         | 0.15   | 0.20  |                            | 0.16                            |
| Capital adequacy                            | 33.4   | 21.4  | 13.2                       | 11.5                            |
| Total balance sheet assets (\$ million)     | 1,513.2  | 8,971.3   | 25,228.6                   | 26,666.0                        |
| Off-balance-sheet risk (\$ million)         | 378.9  | 1,473.4   | 4,749.2                    | 8,127.0                         |

<sup>a</sup> Including Bank Pozitif (Turkey); Demir Bank Kazakhstan; and Bank Leumi Romania.<sup>b</sup> The peer group for Bank Pozitif, Demir Bank, and Bank Leumi Romania includes all the banking subsidiaries abroad similar to them in size, i.e., with assets of up to \$1 billion. This group includes mainly Bank Leumi Switzerland, Bank Leumi Luxembourg, Israel Discount Bank Switzerland, United Mizrahi Bank (Switzerland), FIBI Bank (UK) London, and FIBI Bank (Switzerland) Zurich.<sup>c</sup> The peer group includes banks each of whose total assets are between \$ 500 million and \$1,000 million. The data are based on the financial statements for 2006.<sup>d</sup> The Herfindahl-Hirschman (H) Index of concentration in the credit portfolio by principal industry.

SOURCE: Reports to the Supervisor of Banks.

The third channel is activity by the overseas branches of parent companies in Israel, which are located in the world's major cities where international financial centers operate. These branches' activity largely consists of private banking for households that have an affinity to the State of Israel. The branches supply consultancy and asset management services, as well as general banking services to Israeli companies operating abroad. Part of the branches also supply credit and credit lines for foreign or Israeli companies on the basis of assets and collateral that are held in Israel. A number of representative

offices of Israeli banks also operate in this channel of activity, most of them in South America. These offices are responsible for bringing in customers, whom they direct to the branches. At the end of 2007 as at the end of 2006, the Israeli banks had 61 branches and representative offices abroad (Table 1.10). The assets of branches abroad at the end of 2007 totaled \$10 billion, an amount equivalent to 23 percent of overseas offices' total assets.

Despite extensive international deployment and the large investments involved, banking activity abroad failed to create a significant and stable source of profit for the Israeli banks. The competition abroad from local banks with a long tradition of activity with local residents and the large number of foreign banks operating in the international financial centers make it very difficult for the overseas offices to penetrate these markets.

Subsidiaries abroad again showed a poor performance in 2007 and the net shekel return for their parent banks was notable for high variability and a relatively low average level (Table 1.9). Indices of the subsidiaries' performance, such as the Sharp Index and the RAROC Index, show that the subsidiaries abroad are unstable profit centers characterized by poor performance (Table 1.9 and Table 3.9) compared with the banks' other profit centers, such as the credit card companies or the mortgage banks. The RAROC Index, which measures the risk-adjusted return on the overseas offices' activity was negative in both 2007 and 2006. In 2007 the parent banks incurred losses of NIS 70 million from the activity of their subsidiaries abroad. These losses mainly derived from negative exchange rate differentials resulting from the appreciation of the shekel against all the currencies in which the overseas offices of the Israeli banks operate.

As a result of the poor performance of the banks' international activity and the stringent supervisory restrictions that have been imposed on the banks' activity in recent years as a result of the implementation of the Bachar Committee's recommendations,<sup>36</sup> the banks changed the strategy adopted in their international activity. This led to the expansion of activity in the emerging markets which has been apparent in recent years, via the acquisition of local banks that have operated in their natural environment for many years. This strategy was reflected by the purchase and holding of means of control in those foreign banks, with the intention of merging them within the banking group. During 2006 and 2007, the Israeli banking system purchased four foreign banks abroad. In 2006, Bank Leumi completed the acquisition of a local Rumanian bank (Eurom Bank S.A.), and its name was changed to Bank Leumi Rumania.<sup>37</sup> Bank Hapoalim completed the acquisition of Bank Pozitif Kredi Ve Kalkinma Bankasi Anonim Sirketi (hereinafter: "Bank Pozitif") which operates in Turkey and specializes in corporate banking and investment banking.<sup>38</sup> In 2007 Bank Pozitif, which is now controlled by Bank Hapoalim as stated, purchased CKB Bank, which operates in Kazakhstan. In December 2007, via a

<sup>36</sup> See the Supervisor of Banks' Annual Survey for 2005 for further details on this subject.

<sup>37</sup> Bank Leumi Rumania is a banking corporation that operates 33 branches and offices, and engages in diverse financial activity: the receipt of deposits, the extension of credit, foreign trade and foreign-currency activity.

<sup>38</sup> Bank Hapoalim's investment in Bank Pozitif amounted to NIS 535 million December 2007.

wholly owned subsidiary, Bank Hapoalim completed the purchase of control in another bank which operates in Ukraine—OJSC Ukrainian Innovation Bank.<sup>39</sup> At the beginning of 2008 Bank Hapoalim completed the acquisition of a small local Swiss bank in order to merge it with its Swiss subsidiary. Towards the end of 2007, Bank Hapoalim reported that it was negotiating for the purchase of 75 percent of OJSC Commercial Bank, which operates in Russia. This bank's balance sheet amounted to \$ 645 million at the end of 2007.

The investment in banks in the emerging markets has proved to be more profitable than the investments in banks in developed economies or via branches operating there. Accordingly, the ROE of Bank Pozitif, the largest of the holdings in the emerging markets, amounted to nearly 10 percent in 2007 compared with only 7 percent in the peer group.<sup>40</sup> The aggregate margin of all three of the banks in the emerging markets was also considerably higher than in the peer group (Table 1.12a). However, the risk at the new banks is relatively high on the basis of several indices: As an example, the ratio of problem loans to total credit at Bank Pozitif and Damir Bank amounted to 0.5 percent, significantly more than in the peer group (0.2 percent only). The very fact that the Israeli banks decided to expand their activity to the emerging markets involves additional risks, such as operational risks, technical risks and strategy risks, whose extent we are unable to measure at present.

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<sup>39</sup> This acquisition was made via Tarshish Holdings. The amount of the investment, NIS 136 million, provided Bank Hapoalim with 75.8 percent of the means of control in the bank. The bank operates in Ukraine via 30 branches.

<sup>40</sup> Also included in the peer group of Bank Pozitif, Damir Bank and Bank Leumi Rumania are banking subsidiaries abroad that are similar to them in size, with assets of up to a billion dollars: Bank Leumi Switzerland, Bank Leumi Luxembourg, Bank Discount Switzerland, United Mizrahi Bank Switzerland, FIBI Bank UK and FIBI Bank Switzerland.

**Table 1.13**  
**Assets and Liabilities of the Overseas Offices,<sup>a</sup> 2005–07**

|  | US            |            |            |               |             |             | Western Europe |               |             |              |               |               | Total overseas offices <sup>b</sup> |               |            |              |           |        |
|--|---------------|------------|------------|---------------|-------------|-------------|----------------|---------------|-------------|--------------|---------------|---------------|-------------------------------------|---------------|------------|--------------|-----------|--------|
|  | 2005          |            | 2006       |               | 2007        |             | 2005           |               | 2006        |              | 2007          |               | 2005                                |               | 2006       |              | 2007      |        |
|  | (\$ million)  | (percent)  | Change     | (\$ million)  | (percent)   | Change      | (\$ million)   | (percent)     | Change      | (\$ million) | (percent)     | Change        | (\$ million)                        | (percent)     | Change     | (\$ million) | (percent) | Change |
| Credit to the public                       | 7,995         | 17.8       | 14.4       | 4,622         | 16.6        | 52.2        | 4,622          | 5.387         | 16.6        | 52.2         | 4,622         | 12,743        | 14,914                              | 19,102        | 17         | 28.1         |           |        |
| Cash and bank deposits                     | 4,511         | -24.1      | -11.8      | 3,558         | 13.4        | 15.3        | 3,558          | 4,036         | 13.4        | 15.3         | 3,558         | 8,092         | 7,491                               | 7,699         | -7.4       | 2.8          |           |        |
| <i>of which: in related banks</i>          | 1,053         | -26.3      | -19.9      | 1,407         | -24.3       | 3.7         | 1,407          | 1,065         | -24.3       | 3.7          | 1,407         | 2,473         | 1,855                               | 1,747         | -25        | -5.8         |           |        |
| Securities                                 | 10,326        | 7.5        | 5.8        | 2,089         | 44.6        | 14.4        | 2,089          | 3,021         | 44.6        | 14.4         | 2,089         | 12,421        | 14,131                              | 15,197        | 13.8       | 7.5          |           |        |
| <b>Total assets</b>                        | <b>23,502</b> | <b>5.3</b> | <b>6.5</b> | <b>10,592</b> | <b>20.1</b> | <b>31.3</b> | <b>10,592</b>  | <b>12,725</b> | <b>20.1</b> | <b>31.3</b>  | <b>10,592</b> | <b>34,255</b> | <b>37,629</b>                       | <b>43,232</b> | <b>9.9</b> | <b>14.9</b>  |           |        |
| Deposits of the public                     | 18,347        | 7.1        | -6.6       | 5,858         | 33.4        | 34.3        | 5,858          | 7,815         | 33.4        | 34.3         | 5,858         | 24,333        | 27,599                              | 28,988        | 13.4       | 5            |           |        |
| Deposits of banks                          | 1,656         | 28.8       | 121.4      | 3,512         | -1.3        | 28.7        | 3,512          | 3,467         | -1.3        | 28.7         | 3,512         | 5,187         | 5,617                               | 9,208         | 8.3        | 63.9         |           |        |
| <i>of which: in related banks</i>          | 1,393         | 39.1       | 99.1       | 2,731         | -6.1        | 28.4        | 2,731          | 2,566         | -6.1        | 28.4         | 2,731         | 4,142         | 4,519                               | 7,172         | 9.1        | 58.7         |           |        |
| <b>Total liabilities</b>                   | <b>22,509</b> | <b>5.2</b> | <b>6.3</b> | <b>9,744</b>  | <b>19.4</b> | <b>32.5</b> | <b>9,744</b>   | <b>11,638</b> | <b>19.4</b> | <b>32.5</b>  | <b>9,744</b>  | <b>32,404</b> | <b>35,471</b>                       | <b>40,774</b> | <b>9.5</b> | <b>14.9</b>  |           |        |
| Equity                                     | 993           | 6.9        | 8.8        | 848           | 28.1        | 18.6        | 848            | 1,087         | 28.1        | 18.6         | 848           | 1,851         | 2,159                               | 2,458         | 16.6       | 13.9         |           |        |
| Off-balance-sheet credit risk <sup>c</sup> | 7,897         | 32         | -1.4       | 1,943         | 22.5        | 35.4        | 1,943          | 2,381         | 22.5        | 35.4         | 1,943         | 9,855         | 12,819                              | 13,519        | 30.1       | 5.5          |           |        |
| Activity in derivatives <sup>d</sup>       | 12,961        | 35.5       | -7.1       | 9,197         | 7.1         | 13.2        | 9,197          | 9,847         | 7.1         | 13.2         | 9,197         | 22,167        | 27,410                              | 27,467        | 23.7       | 0.2          |           |        |

<sup>a</sup> Selected items.

<sup>b</sup> Including overseas offices, primarily in South America, not included in the US (including the Cayman Islands) or Europe.

<sup>c</sup> Volume of off-balance-sheet credit risk before conversion and weighting coefficients.

<sup>d</sup> Face value.

SOURCE: Reports to the Supervisor of Banks.

**Table 1.14**  
**Main Items in Profit and Loss Statements of the Overseas Offices,<sup>a</sup> 2005–07**

|  | US           |              |               |            |               |              | Western Europe |              |             |             |              |              | Total overseas offices <sup>b</sup> |             |               |  |           |  |
|--|--------------|--------------|---------------|------------|---------------|--------------|----------------|--------------|-------------|-------------|--------------|--------------|-------------------------------------|-------------|---------------|--|-----------|--|
|  | 2005         |              | 2006          |            | 2007          |              | 2005           |              | 2006        |             | 2007         |              | 2005                                |             | 2006          |  | 2007      |  |
|  | (\$ million) |              | (percent)     |            | (percent)     |              | (\$ million)   |              | (percent)   |             | (percent)    |              | (\$ million)                        |             | (percent)     |  | (percent) |  |
| Net interest income before loan-loss provision | 421.8        | 425.1        | 171           | 0.8        | -59.8         | 143.1        | 197.1          | 241.5        | 37.7        | 22.5        | 569.8        | 627.9        | 419                                 | 10.2        | -33.3         |  |           |  |
| Loan-loss provision                            | 10.4         | 8.9          | 13.3          | -14.4      | 49.4          | -7.2         | 3.1            | 15.5         | -143.1      | 400         | 3.5          | 12           | 28.8                                | 242.9       | 140           |  |           |  |
| Operating fees                                 | 53.6         | 55.9         | 70.2          | 4.3        | 25.6          | 94.4         | 130            | 154.2        | 37.7        | 18.6        | 149          | 186.8        | 225.5                               | 25.4        | 20.7          |  |           |  |
| Other income                                   | 13.9         | 13.4         | 16.6          | -3.6       | 23.9          | 8.3          | 8.7            | 11.5         | 4.8         | 32.2        | 23.1         | 22.9         | 29.2                                | -0.9        | 27.5          |  |           |  |
| <b>Total non-interest and other income</b>     | <b>68.6</b>  | <b>74.1</b>  | <b>89.8</b>   | <b>8</b>   | <b>21.2</b>   | <b>108.9</b> | <b>141.2</b>   | <b>169.6</b> | <b>29.7</b> | <b>20.1</b> | <b>179.5</b> | <b>217.1</b> | <b>261.6</b>                        | <b>20.9</b> | <b>20.5</b>   |  |           |  |
| Salaries and related expenses                  | 164.6        | 199.6        | 195.4         | 21.3       | -2.1          | 88           | 119.4          | 156.3        | 35.7        | 30.9        | 255.2        | 322.1        | 355.2                               | 26.2        | 10.3          |  |           |  |
| Other expenses                                 | 103.8        | 91           | 92.7          | -12.3      | 1.9           | 74.5         | 74.5           | 90.8         | -           | 21.9        | 181          | 168.5        | 186.5                               | -6.9        | 10.7          |  |           |  |
| <b>Total operating and other expenses</b>      | <b>322.1</b> | <b>341.2</b> | <b>346.3</b>  | <b>5.9</b> | <b>1.5</b>    | <b>189</b>   | <b>230</b>     | <b>291.7</b> | <b>21.7</b> | <b>26.8</b> | <b>517.2</b> | <b>578</b>   | <b>645.3</b>                        | <b>11.8</b> | <b>11.6</b>   |  |           |  |
| Ordinary before-tax income                     | 157.9        | 149          | -98.8         | -5.6       | -166.3        | 70.3         | 105.2          | 103.9        | 49.6        | -1.2        | 228.6        | 255          | 6.5                                 | 11.5        | -97.5         |  |           |  |
| Provision for taxes on ordinary income         | 36.2         | 25.7         | 36.5          | -29        | 42            | 19.8         | 25.7           | 26.1         | 29.8        | 1.6         | 56.5         | 51.8         | 63.4                                | -8.3        | 22.4          |  |           |  |
| <b>Net income</b>                              | <b>121.1</b> | <b>122.8</b> | <b>-135.9</b> | <b>1.4</b> | <b>-210.7</b> | <b>50.5</b>  | <b>79.6</b>    | <b>78.4</b>  | <b>57.6</b> | <b>-1.5</b> | <b>171.6</b> | <b>202.6</b> | <b>-57.1</b>                        | <b>18.1</b> | <b>-128.2</b> |  |           |  |

<sup>a</sup> Selected items.

<sup>b</sup> Including overseas offices, primarily in South America, not included in the US (including the Cayman Islands) or Europe.

SOURCE: Reports to the Supervisor of Banks.

Table A.1.1

Unindexed Local-Currency Assets and Liabilities of Commercial Banks, <sup>a</sup> 2005–07

|                                       | End-of-year balance |                |                | Change on previous year |           | Annual average balance (Dec 2003 prices) |                | Change on previous year |            | Balance-sheet composition |            |
|---------------------------------------|---------------------|----------------|----------------|-------------------------|-----------|--|----------------|-------------------------|------------|---------------------------|------------|
|                                       | 2005                | 2006           | 2007           | 2006                    | 2007      | 2006                                     | 2007           | 2006                    | 2007       | 2006                      | 2007       |
|                                       | (NIS million)       |                |                | (percent)               |           | (NIS million)                            |                | (percent)               |            | (percent)                 |            |
| <b>Assets</b>                         |                     |                |                |                         |           |  |                |                         |            |                           |            |
| Banknotes and coins                   | 3,453               | 3,884          | 4,700          | 12                      | 21        | 3,917                                    | 4,536          | 16                      | 1          | 1                         | 1          |
| Deposit in Bank of Israel             | 17,818              | 12,818         | 12,779         | -28                     | 0         | 11,015                                   | 11,985         | 9                       | 4          | 4                         | 3          |
| Deposit in banks                      | 7,626               | 7,787          | 15,494         | 2                       | 99        | 8,934                                    | 12,158         | 36                      | 3          | 3                         | 3          |
| Credit to the public                  | 208,049             | 245,504        | 276,273        | 18                      | 13        | 218,913                                  | 256,207        | 17                      | 72         | 72                        | 73         |
| <i>Makam</i> and unindexed bonds      | 57,235              | 52,200         | 53,241         | -9                      | 2         | 53,787                                   | 53,417         | -1                      | 18         | 15                        | 15         |
| <i>Of which: makam</i>                | 15,012              | 10,106         | 8,274          | -33                     | -18       | 11,450                                   | 11,270         | -2                      | 4          | 3                         | 3          |
| Other assets                          | 5,587               | 8,541          | 13,350         | 53                      | 56        | 6,817                                    | 11,144         | 63                      | 2          | 3                         | 3          |
| <b>Total assets</b>                   | <b>299,768</b>      | <b>330,734</b> | <b>375,837</b> | <b>10</b>               | <b>14</b> | <b>303,384</b>                           | <b>349,445</b> | <b>15</b>               | <b>100</b> | <b>100</b>                | <b>100</b> |
| <b>Liabilities</b>                    |                     |                |                |                         |           |  |                |                         |            |                           |            |
| Monetary loan from Bank of Israel     | 1,028               | 8,280          | 411            | .                       | -95       | 3,661                                    | 10,160         | 178                     | 1          | 3                         | 3          |
| Deposit from banks                    | 6,232               | 5,927          | 9,994          | -5                      | 69        | 7,288                                    | 8,920          | 22                      | 2          | 2                         | 2          |
| Deposit of the government             | 1,207               | 1,089          | 867            | -10                     | -20       | 865                                      | 864            | 0                       | 0          | 0                         | 0          |
| Total deposits of the public          | 305,312             | 333,258        | 364,978        | 9                       | 10        | 308,974                                  | 348,853        | 13                      | 93         | 89                        | 89         |
| Demand deposits                       | 38,300              | 41,588         | 50,350         | 9                       | 21        | 36,491                                   | 45,202         | 24                      | 11         | 11                        | 11         |
| SRO deposit                           | 35,005              | 37,985         | 41,405         | 9                       | 9         | 32,523                                   | 38,957         | 20                      | 10         | 10                        | 10         |
| Resident time and short-term deposits | 230,754             | 253,057        | 273,131        | 10                      | 8         | 238,948                                  | 264,494        | 11                      | 72         | 67                        | 67         |
| Other deposits                        | 1,253               | 628            | 91             | -50                     | -85       | 1,011                                    | 199            | -80                     | 0          | 0                         | 0          |
| Other liabilities                     | 11,986              | 24,778         | 29,141         | 107                     | 18        | 12,580                                   | 25,308         | 101                     | 4          | 6                         | 6          |
| <b>Total Liabilities</b>              | <b>325,765</b>      | <b>373,332</b> | <b>405,390</b> | <b>15</b>               | <b>9</b>  | <b>333,368</b>                           | <b>394,105</b> | <b>18</b>               | <b>100</b> | <b>100</b>                | <b>100</b> |
| Activity in derivatives               | 32,252              | 48,078         | 45,064         | 49                      | -6        | 39,755                                   | 50,352         | 27                      | 12         | 13                        | 13         |
| Surplus of assets over liabilities    | 6,255               | 5,480          | 15,511         | .                       | .         | 9,771                                    | 5,692          | .                       | .          | .                         | .          |

<sup>a</sup> Including data on all the commercial banks on a bank basis, not including subsidiaries.

SOURCE: Reports to the Supervisor of Banks.

**Table A.1.2**  
**Local-Currency CPI-Indexed Assets and Liabilities in Commercial Banks,<sup>a</sup> 2005-07**

|   | End-of-year balance<br>(December 2003 prices) |                | Change on<br>previous year |           | Annual average<br>balance (December<br>2005 prices) |                | Change on<br>previous<br>year |           | Balance-sheet<br>composition |            |
|---|---|----------------|----------------------------|-----------|---|----------------|-------------------------------|-----------|------------------------------|------------|
|   | 2005  | 2006           | 2006                       | 2007      | 2006  | 2007           | 2006                          | 2007      | 2006                         | 2007       |
|   | (NIS million)                                 |                | (percent)                  |           | (NIS million)                                       |                | (percent)                     |           | (percent)                    |            |
| <b>Assets</b>                                   |   |                |                            |           |   |                |                               |           |                              |            |
| Credit to the public                            | 137,174                                       | 136,484        | 146,440                    | -1        | 7   | 137,882        | 140,635                       | 2         | 78                           | 77         |
| Deposit in banks                                | 31,935  | 26,742         | 28,435                     | -16       | 6   | 28,910         | 26,777                        | -7        | 16                           | 15         |
| Credit to the government                        | 1,366   | 1,267          | 1,519                      | -7        | 20  | 1,175          | 1,224                         | 4         | 1                            | 1          |
| Bonds   | 5,600   | 12,420         | 15,576                     | 122       | 25  | 9,461          | 14,770                        | 56        | 5                            | 8          |
| Other assets                                    | 413   | 260            | -2,740                     | -37       | .   | 319            | 227                           | -29       | 0                            | 0          |
| <b>Total assets</b>                             | <b>176,487</b>                                | <b>177,173</b> | <b>189,229</b>             | <b>0</b>  | <b>7</b>  | <b>177,746</b> | <b>183,632</b>                | <b>3</b>  | <b>100</b>                   | <b>100</b> |
| <i>of which: Credit from earmarked deposits</i> | 1,492   | 918            | 698                        | -38       | -24   | 1,054          | 776                           | -26       | 1                            | 0          |
| <b>Liabilities</b>                              |   |                |                            |           |   |                |                               |           |                              |            |
| Deposits of the public:                         |   |                |                            |           |   |                |                               |           |                              |            |
| Savings   | 37,121  | 30,170         | 24,122                     | -19       | -20   | 34,139         | 26,288                        | -23       | 23                           | 18         |
| Indexed deposits                                | 73,445  | 75,161         | 78,971                     | 2         | 5   | 74,834         | 74,653                        | 0         | 50                           | 52         |
| Other deposits                                  | 2,967   | 2,553          | 5,740                      | -14       | 125   | 2,747          | 3,707                         | 35        | 2                            | 3          |
| Total deposits of the public                    | 113,533                                       | 107,884        | 108,833                    | -5        | 1   | 111,720        | 104,648                       | -6        | 75                           | 73         |
| Deposit from banks                              | 6,858   | 4,664          | 4,719                      | -32       | 1   | 5,715          | 4,721                         | -17       | 4                            | 3          |
| Deposit of the government                       | 4,658   | 4,121          | 3,596                      | -12       | -13   | 4,342          | 3,918                         | -10       | 3                            | 3          |
| Other liabilities                               | 27,955  | 28,565         | 28,697                     | 2         | 0   | 27,860         | 29,319                        | 5         | 19                           | 21         |
| <b>Total liabilities</b>                        | <b>153,005</b>                                | <b>145,234</b> | <b>145,845</b>             | <b>-5</b> | <b>0</b>  | <b>149,638</b> | <b>142,607</b>                | <b>-5</b> | <b>100</b>                   | <b>100</b> |
| <i>of which: Earmarked deposits</i>             | 2,243   | 1,354          | 1,088                      | -40       | -20   | 1,597          | 1,251                         | -22       | 1                            | 1          |
| Derivatives                                     | -13,510                                       | -21,189        | -35,376                    | 57        | 67  | -19,544        | -26,606                       | 36        | -13                          | -19        |
| Surplus of assets over liabilities              | 9,972   | 10,750         | 8,009                      | .         | .   | 8,564          | 14,419                        | .         | .                            | .          |

<sup>a</sup> Including data on all the commercial banks on a bank basis, not including subsidiaries.

SOURCE: Reports to the Supervisor of Banks.

Table A.1.3  
Assets and Liabilities of Commercial Banks Denominated in and Indexed to Foreign Currency,<sup>a</sup> 2005-07

|  | End-of-year balance |               | Change on previous year |           | Annual average balance |               | Change on previous year |           | Balance-sheet composition |            |
|--|---------------------|---------------|-------------------------|-----------|------------------------|---------------|-------------------------|-----------|---------------------------|------------|
|  | 2005                | 2006          | 2006                    | 2007      | 2006                   | 2007          | 2006                    | 2007      | 2006                      | 2007       |
|  | (\$ million)        |               | (percent)               |           | (\$ million)           |               | (percent)               |           | (percent)                 |            |
| <b>Assets</b>                                    |                     |               |                         |           |                        |               |                         |           |                           |            |
| Banknotes and coins                              | 332                 | 422           | 400                     | 27        | 371                    | 425           | 15                      | 15        | 1                         | 1          |
| Deposits in banks abroad                         | 16,518              | 23,376        | 22,045                  | 42        | 19,243                 | 23,160        | 20                      | 20        | 33                        | 37         |
| Deposits in banks in Israel                      | 1,468               | 1,188         | 1,167                   | -19       | 1,260                  | 1,121         | -11                     | -11       | 2                         | 2          |
| Deposits in Bank of Israel                       | 240                 | 533           | 596                     | 122       | 243                    | 1,091         | .                       | .         | 0                         | 2          |
| Nondirected credit to residents                  | 24,016              | 22,771        | 23,970                  | -5        | 23,863                 | 23,544        | -1                      | -1        | 41                        | 37         |
| Nondirected credit to nonresidents               | 3,381               | 3,664         | 4,327                   | 8         | 3,531                  | 3,903         | 11                      | 11        | 6                         | 6          |
| Credit to the government                         | 402                 | 264           | 199                     | -34       | 334                    | 234           | -30                     | -30       | 1                         | 0          |
| Securities <sup>b</sup>                          | 5,385               | 7,085         | 8,522                   | 32        | 6,286                  | 7,579         | 21                      | 21        | 11                        | 12         |
| Other assets                                     | 2,312               | 1,946         | 2,513                   | -16       | 2,415                  | 2,189         | -9                      | -9        | 4                         | 3          |
| <b>Total assets</b>                              | <b>54,053</b>       | <b>61,249</b> | <b>63,740</b>           | <b>13</b> | <b>57,545</b>          | <b>63,245</b> | <b>10</b>               | <b>10</b> | <b>100</b>                | <b>100</b> |
| <i>of which: Denominated in foreign currency</i> | 51,431              | 59,033        | 61,962                  | 15        | 55,161                 | 61,277        | 11                      | 11        | 96                        | 97         |
| <b>Liabilities</b>                               |                     |               |                         |           |                        |               |                         |           |                           |            |
| Deposits from banks abroad                       | 1,546               | 1,246         | 1,504                   | -19       | 1,525                  | 1,393         | -9                      | -9        | 3                         | 2          |
| Deposits from banks in Israel                    | 302                 | 378           | 415                     | 25        | 319                    | 399           | 25                      | 25        | 1                         | 1          |
| Loan from Bank of Israel                         | ..                  | ..            | ..                      | ..        | 0                      | 3             | .                       | .         | 0                         | 0          |
| Deposits of the government                       | 1,533               | 1,482         | 1,428                   | -3        | 1,511                  | 1,456         | -4                      | -4        | 3                         | 2          |
| Residents' deposits                              | 46,387              | 52,470        | 59,741                  | 13        | 49,516                 | 55,348        | 12                      | 12        | 89                        | 91         |
| Nonresidents' deposits                           | 19,986              | 21,933        | 23,150                  | 10        | 20,805                 | 22,402        | 8                       | 8         | 37                        | 37         |
| Residents' and restitutions deposits             | 4,762               | 5,169         | 5,576                   | 9         | 5,001                  | 5,322         | 6                       | 6         | 9                         | 9          |
| Other residents' deposits                        | 21,639              | 25,368        | 31,016                  | 17        | 23,710                 | 27,624        | 17                      | 17        | 43                        | 45         |
| Other liabilities <sup>c</sup>                   | 2,620               | 2,213         | 2,832                   | -16       | 2,733                  | 2,458         | -10                     | -10       | 5                         | 4          |
| <b>Total Liabilities</b>                         | <b>52,389</b>       | <b>57,789</b> | <b>65,920</b>           | <b>10</b> | <b>55,605</b>          | <b>61,057</b> | <b>10</b>               | <b>10</b> | <b>100</b>                | <b>100</b> |
| <i>of which: Denominated in foreign currency</i> | 49,751              | 55,452        | 63,865                  | 11        | 53,104                 | 58,896        | 11                      | 11        | 96                        | 96         |
| Derivatives                                      | -4,072              | -6,365        | -2,519                  | 56        | -4,570                 | -5,770        | 26                      | 26        | -8                        | -9         |
| Surplus of assets over liabilities               | -2,408              | -2,905        | -4,700                  | .         | -2,630                 | -3,582        | .                       | .         | .                         | .          |

<sup>a</sup> Including data on all the commercial banks on a bank basis, not including subsidiaries.

<sup>b</sup> Excluding investment in shares in subsidiaries and in affiliated companies.

<sup>c</sup> Including intermediate amounts, bonds, and promissory notes recognized as earmarked deposits.

SOURCE: Reports to the Supervisor of Banks.

**Table A.1.4**  
**Distribution of Credit to the Public, Total Commercial Banking System,<sup>a</sup> 2005-07**

|  | End-of-year balance |         |         | Change in end-of-year balance |           |           | Average balance |         |      | Change in average balance |           |           |  |
|--|---------------------|---------|---------|-------------------------------|-----------|-----------|-----------------|---------|------|---------------------------|-----------|-----------|--|
|  | At current prices   |         |         | 2006                          |           |           | 2007            |         |      | 2006                      |           | 2007      |  |
|  | 2005                | 2006    | 2007    | (NIS million)                 | (percent) | (percent) | 2005            | 2006    | 2007 | (NIS million)             | (percent) | (percent) |  |
| Total credit to the public                     | 471,275             | 493,634 | 531,835 | 5                             | 8         | 8         | 478,483         | 508,835 | 6    | 100                       | 100       |           |  |
| Total local-currency credit <sup>b</sup>       | 345,224             | 381,988 | 423,030 | 11                            | 11        | 11        | 356,795         | 396,868 | 11   | 75                        | 78        |           |  |
| Unindexed                                      | 208,049             | 245,504 | 276,590 | 18                            | 13        | 13        | 218,913         | 256,233 | 17   | 46                        | 50        |           |  |
| Overdraft accounts and facilities <sup>c</sup> | 39,493              | 42,919  | 42,754  | 9                             | -0        | -0        | 40,072          | 40,998  | 2    | 8                         | 8         |           |  |
| Other short-term credit <sup>f</sup>           | 123,303             | 152,819 | 182,433 | 24                            | 19        | 19        | 130,619         | 166,608 | 28   | 27                        | 33        |           |  |
| On-call credit                                 | 45,253              | 49,766  | 51,403  | 10                            | 3         | 3         | 48,223          | 48,627  | 1    | 10                        | 10        |           |  |
| CPI-indexed                                    | 137,174             | 136,484 | 146,440 | -1                            | 7         | 7         | 137,882         | 140,635 | 2    | 29                        | 28        |           |  |
| Total foreign-currency credit                  | 126,051             | 111,646 | 108,805 | -11                           | -3        | -3        | 121,688         | 111,967 | -8   | 25                        | 22        |           |  |
| To residents (total)                           | 110,490             | 96,167  | 92,162  | -13                           | -4        | -4        | 106,007         | 96,049  | -9   | 22                        | 19        |           |  |
| of which: Foreign-currency-indexed             | 7,426               | 6,734   | 4,660   | -9                            | -31       | -31       | 7,137           | 5,621   | -21  | 1                         | 1         |           |  |
| To nonresidents (total)                        | 15,561              | 15,479  | 16,643  | -1                            | 8         | 8         | 15,681          | 15,917  | 2    | 3                         | 3         |           |  |

<sup>a</sup> Including data on all the commercial banks on a bank basis, not including subsidiaries.

<sup>b</sup> From 2004 and 2005, credit data include credit balances of mortgage bank activities of Mishkan and Tefahot that were merged into Hapoalim and Mizrahi, respectively. The data were reclassified and comparative figures for 2002, 2003 and 2004 were adjusted accordingly.

<sup>c</sup> Including credit at the bank's responsibility only. Does not include credit to specialized banking corporations.

SOURCE: Reports to the Supervisor of Banks.

**Table A.1.5**  
**Average Annual Effective Yields on Selected Assets and Liabilities in the Various Segments, 2006 and 2007**

|  | Annual average            |            | 2007       |            |            |            | 2007                            |            |            |            |            |            |
|--|---------------------------|------------|------------|------------|------------|------------|---------------------------------|------------|------------|------------|------------|------------|
|  | 2006                      | 2007       | I          | II         | III        | IV         | 2006                            | 2007       | I          | II         | III        | IV         |
|  | (Nominal rates of return) |            |            |            |            |            | (Expected real rates of return) |            |            |            |            |            |
| <b>Unindexed local-currency segment</b>                |                           |            |            |            |            |            |                                 |            |            |            |            |            |
| Demand deposits <sup>a</sup>                           | 1.2                       | 0.9        | 0.9        | 0.9        | 0.9        | 1.0        | -1.0                            | -0.6       | -0.4       | -0.2       | -1.2       | -0.5       |
| SRO deposits <sup>a</sup>                              | 4.1                       | 3.0        | 3.3        | 2.8        | 2.8        | 3.0        | 0.7                             | 2.3        | 1.9        | 1.7        | 0.6        | 1.5        |
| Resident time deposits <sup>a</sup>                    | 4.3                       | 3.5        | 3.8        | 3.4        | 3.3        | 3.5        | 1.1                             | 2.5        | 2.4        | 2.3        | 1.2        | 2.0        |
| <b>Total unindexed deposits</b>                        | <b>4.0</b>                | <b>3.2</b> | <b>3.5</b> | <b>3.1</b> | <b>3.0</b> | <b>3.1</b> | <b>0.9</b>                      | <b>2.1</b> | <b>2.1</b> | <b>2.0</b> | <b>0.8</b> | <b>1.6</b> |
| Term credit <sup>a</sup>                               | 7.4                       | 6.3        | 6.6        | 6.2        | 6.0        | 6.2        | 7.4                             | 5.6        | 5.2        | 5.1        | 3.8        | 4.7        |
| Overdraft accounts and facilities <sup>c</sup>         | 11.0                      | 9.9        | 9.8        | 9.6        | 10.1       | 10.3       | 4.6                             | 9.0        | 8.4        | 8.4        | 7.8        | 8.7        |
| Total unindexed credit                                 | 8.1                       | 6.9        | 7.2        | 6.7        | 6.7        | 6.9        | 1.6                             | 6.2        | 5.7        | 5.6        | 4.4        | 5.3        |
| <i>Makam</i> <sup>b</sup>                              | 5.8                       | 4.5        | 5.2        | 4.7        | 3.9        | 4.2        | 1.6                             | 3.9        | 3.8        | 3.6        | 1.8        | 2.7        |
| <b>Banks' deposits with Bank of Israel<sup>c</sup></b> | <b>5.2</b>                | <b>2.8</b> | <b>6.9</b> | <b>7.3</b> | <b>7.5</b> | <b>7.3</b> | <b>3.9</b>                      | <b>5.4</b> | <b>4.8</b> | <b>5.2</b> | <b>5.6</b> | <b>5.9</b> |
| <b>Total unindexed assets</b>                          | <b>7.2</b>                | <b>6.2</b> | <b>6.5</b> | <b>6.1</b> | <b>5.9</b> | <b>6.2</b> |                                 | <b>5.4</b> | <b>5.1</b> | <b>5.0</b> | <b>3.7</b> | <b>4.6</b> |
| CPI-indexed local-currency segment                     |                           |            |            |            |            |            | 1.9                             | 2.9        | 2.7        | 2.8        | 3.1        | 2.8        |
| Savings plans <sup>d</sup>                             | .                         | .          | .          | .          | .          | .          | 3.0                             | 2.9        | 2.5        | 1.9        | 1.8        | 2.3        |
| Indexed bonds <sup>e</sup>                             | .                         | .          | .          | .          | .          | .          | 4.7                             | 3.7        | 3.2        | 2.9        | 3.4        | 3.3        |
| CPI-indexed credit <sup>f</sup>                        | .                         | .          | .          | .          | .          | .          | .                               | 5.3        | 4.9        | 4.4        | 4.7        | 4.9        |

**Table A.1.5 (Cont' d)**  
**Average Annual Effective Yields on Selected Assets and Liabilities in the Various Segments, 2006 and 2007**

|  | Annual average |      | 2007 |     |       |       | Annual average |      |       |      |      |      |
|--|----------------|------|------|-----|-------|-------|----------------|------|-------|------|------|------|
|  | 2006           | 2007 | I    | II  | III   | IV    | 2006           | 2007 | I     | II   | III  | IV   |
|  |                |      |      |     |       |       |                |      |       |      |      |      |
| <b>Foreign-currency-denominated and indexed credit</b> |                |      |      |     |       |       |                |      |       |      |      |      |
| (In dollar terms <sup>e</sup> )                        |                |      |      |     |       |       |                |      |       |      |      |      |
| (Nominal rates of return)                              |                |      |      |     |       |       |                |      |       |      |      |      |
| Time deposits  | 1.0            | 1.4  | 1.2  | 1.4 | 1.9   | 1.3   | -2.0           | -8.1 | -10.2 | -8.3 | -4.9 | -9.0 |
| Foreign-currency-denominated deposits <sup>i</sup>     | 4.4            | 4.5  | 4.7  | 4.6 | 4.7   | 4.1   | 1.4            | -5.3 | -7.0  | -5.3 | -2.4 | -6.4 |
| Foreign-currency-indexed credit                        | 7.1            | 7.1  | 7.2  | 7.2 | 7.3   | 6.9   | 4.0            | -2.9 | -4.8  | -3.0 | 0.1  | -3.9 |
| Foreign-currency credit to residents                   | 6.5            | 6.6  | 6.7  | 6.6 | 6.7   | 6.2   | 3.4            | -3.4 | -5.2  | -3.5 | -0.5 | -4.5 |
| Deposits abroad <sup>l</sup>                           | 5.1            | 5.2  | 5.2  | 5.2 | 5.3   | 4.9   | 2.0            | -4.7 | -6.6  | -4.8 | -1.8 | -5.7 |
| <b>Annual rates of change</b>                          |                |      |      |     |       |       |                |      |       |      |      |      |
| CPI  | -0.1           | 3.4  | -0.9 | 4.9 | 5.3   | 4.4   |                |      |       |      |      |      |
| NIS/\$ exchange rate                                   | -8.2           | -9.0 | -6.5 | 9.4 | -20.4 | -15.6 |                |      |       |      |      |      |
| Tel Aviv 100 index                                     | 12.0           | 25.3 |      |     |       |       |                |      |       |      |      |      |
| General bonds index                                    | 4.6            | 4.0  |      |     |       |       |                |      |       |      |      |      |
| General corporate bonds index                          | 3.2            | 3.5  |      |     |       |       |                |      |       |      |      |      |

<sup>a</sup> Effective annual yields/costs, as reported by the seven major banking groups.

<sup>b</sup> The market yield for two months on unindexed bonds.

<sup>c</sup> Calculated as the effective annual rate of return received on depositing with the Bank of Israel. Balances used in the calculation are average balances in the period.

<sup>d</sup> Average rate of interest on savings deposits.

<sup>e</sup> Average gross yield to maturity of all CPI-indexed bonds (market rate).

<sup>f</sup> Based on reports of cost of credit extended during the month.

<sup>g</sup> The data refer to dollar denominated credit and deposit items.

<sup>h</sup> Real interest calculated on the basis of the public's inflation expectations, derived from the capital market, and the expected exchange rate, calculated from the rate of actual depreciation over the previous twelve months.

<sup>i</sup> Including nonresidents' and residents' restitutions deposits.

<sup>j</sup> 3-month Libor interest rate.

SOURCE: Based on the seven major banks' reports on costs and tariffs, reports to the Supervisor of the Banks and estimates from the Bank of Israel.

