

# 9

## ACTIVITIES OF THE BANK OF ISRAEL

### 1. EXPLANATORY NOTES TO THE BANK OF ISRAEL BALANCE SHEET AS AT DECEMBER 31, 1988

The Bank of Israel's balance sheet at the end of 1988 totaled NIS 21,522 million, compared with NIS 18,912 million at the end of the previous year—a nominal increase of 14 percent (a real-term decrease of 2 percent).

The Bank's financial statements reflect private sector capital movements which resulted, at the end of 1988, in a rapid fall of the foreign currency reserves held by the Bank of Israel, and an increase in the foreign currency deposits of the banking corporations with the Bank of Israel. Towards the end of 1988, the Bank's monetary loans to the banking system increased rapidly, while the local-currency deposits of the banking corporations with the Bank declined.

These trends changed in early 1989, following the devaluations at the end of December 1988 and early January 1989. The foreign currency reserves rose rapidly, and the monetary loans decreased.

### 2. ACTIVITIES OF THE MONETARY DEPARTMENT

The department's activities were in two areas: a) the current management of monetary policy; and b) the improvement of the money market's functioning, through the removal of administrative barriers between different segments of the market. The latter activities were in close cooperation with the Bank of Israel's Department of Credit and Foreign Exchange Control.

#### *A. Monetary Policy Measures in 1988*

In 1988, the Bank's monetary policy shifted its focus to the control of monetary absorption and injection, while allowing prices to be determined by the money market.

In late 1987, the Bank introduced several changes in the use of its monetary policy instruments in order to adapt them to this concept. The principal changes

were in the method of auctioning the Bank's monetary loans, the management of reserve requirements, and the use of short-term Treasury bills, as described in the 1987 Annual Report, pp. 145–146.

These revisions require that the Bank of Israel determine currently the volume of financial resources it puts at the disposal of the banking system. As a rule, this quantity is set at the beginning of the accounting month of account of reserve requirements. The volume of the monetary loans is set in accordance with requirements of absorption or injection, considering the expected effects of government operations and the public's purchases or sales of foreign currency, and with a view to maintain the quantitative monetary targets set by the Bank. At times, the Bank changed the original volume of monetary lending during the month, in order to offset unexpected absorptions or injections by the government, or foreign currency purchases or sales in amounts greater than anticipated.

#### **A. 1. Monetary loans**

The Bank of Israel supplied the banking system with reserves mainly through discount-window loans by quotas, and auctioned monetary loans. In the monetary auctions, the Bank offers the banking system a predetermined amount, while the interest rate and the allocation of the loan among the banks is determined by the auction. Generally, these loans are for a fixed term of one week, and are not redeemable before their due date. In the quota discount-window lending the Bank of Israel sets the interest rate, the total amount, and the allocation among the banks; the banks may draw upon or repay these loans daily.

From January until October 1988, the auctioned monetary loans accounted for 85 percent of the total volume of reserves which the Bank supplied to the banking system. The interest rate set in the auctions served as the principal indicator of the money market rate, and of the degree of restrictiveness or relaxation of monetary policy.

In November-December 1988, the Bank intensified its use of quota discount-window lending, at rising interest rates. This was done to bring about a gradual rise of money market interest rates, in response to the purchases of foreign currency. In this period, the proportion of auctioned monetary loans in the Bank of Israel's total lending to the banks declined to 55 percent. Following the devaluation, the reduction in the use of quota lending served as the main instrument of absorption, gradually restoring the interest rate on the reserves supplied by the Bank to the banking system to its level prior to November 1988. (The quota and auctioned monetary loans and their interest rates are shown in Tables 9.1–9.3.)

TABLE 9.1

**Bank of Israel Interest Rates***(Annual rates, payable quarterly)*

Date of change	On deposits with the Bank of Israel		On monetary loans							
	Required reserves	Surplus reserves	Regular A	Regular	Regular B	Regular B-1	Regular C	Regular D	Additional	Special
26.11.1987	14	12		20.00						50
7. 1.1988	14	12		20.00					35	50
17. 3.1988	14	11		18.00					33	48
28. 7.1988	13.75	11		17.25					33	48
27.10.1988	13.75	11		17.25	17.25				33	48
2.11.1988	13.75	11		17.25	17.25		25		33	48
17.11.1988	13.75	11		17.25	17.25		25	29	33	48
5. 1.1989	13.75	11		17.25	17.25	21	25	29	33	48
12. 1.1989	13.75	11	19	17.25	17.25	21	25	29	33	48
19. 1.1989	13.75	11	15	17.25	17.25	21	25	29	33	48
23. 2.1989	12.75	11	15	17.25	abolished	21	25	29	33	48
9. 3.1989	12.75	11	15	17.25		21	25	29	33	48

### **A. 2. Open-market operations in Treasury bills**

The Bank made use of open-market operations in Treasury bills on a substantial scale in order to absorb or inject liquidity, as required by monetary policy considerations. These operations are reflected in the changes in the balance of Treasury bills held by the public (including the commercial banks), as shown in Table 9.6.

The Bank took several steps to expand the market for Treasury bills and to improve its trading procedures, as follows:

- In the auctions of Treasury bills, it was permitted to place orders without limits of price/yield. These orders state only the quantity demanded, while the quantity supplied is allocated at the yield set in the non-competitive bid.
- An additional round of public multilateral trading was introduced, on termination of activity on all other trading floors (bonds, stocks) on the stock exchange. In this trading, the Bank of Israel accepts transactions in amounts exceeding NIS 1 million, as part of its monetary policy.
- The Knesset Finance Committee approved the increase of the maximum outstanding balance of Treasury bills from NIS 3 billion to NIS 6 billion, and the lengthening of their term to (9 and) 12 months. The public's demand for these issues became apparent when the demand for Treasury bills expanded in early 1989: At the end of February, the issues for a term longer than six months amounted to 22 percent of the total outstanding balance of Treasury bills held by the public (including the banks).

### **A. 3. Open-market operations in indexed bonds**

In 1988, the Bank of Israel's transactions in the secondary market for indexed bonds totaled NIS 177 million, compared to NIS 477 million in 1987. During 1988 the Bank mainly purchased bonds; most of the purchases were in January–July, as shown in Table 9.8.

TABLE 9.2

**Discount-Window Lending Quotas and Monetary Loan Auctions***(NIS million)*

	Monthly average	Discount-window quotas						Offered by		Total
		A	Regular	B	B-1	C	D	Special Auction		
1987	December		356					–	563	919
1988	January		416					200	750	1,366
	February		356					267	750	1,373
	March		374					280	300	954
	April		374					280	350	1,004
	May		374					280	250	904
	June		372					279	450	1,101
	July		372					279	350	1,101
	August		372					279	520	1,171
	September		327					245	813	1,385
	October		409					245	1,125	1,779
	November		409	409		561	82	245	763	2,469
	December		423	423		845	211	254	1,200	3,356
1989	January	317	423	423	634	845	211	254	1,400	4,507
	February	845	374	423	845	845	211	254	1,400	5,197
	March	749	374	abolished	749	749	187	225	1,320	4,353

TABLE 9.3

**Utilization and Lending Rates of Bank of Israel Monetary Loans**

		Auction lending rate, percent		Utilization, NIS million		
		Average	Closing rate	Auctioned	Quota	Total
1987	December	24.8	23.6	563	212	775
1988	January	19.2	18.5	750	179	929
	February	16.9	16.0	661	59	720
	March	17.4	16.6	295	110	405
	April	15.2	15.0	274	17	291
	May	15.9	15.6	218	58	276
	June	15.6	15.4	379	11	390
	July	15.7	15.5	337	72	409
	August	15.5	15.2	520	87	607
	September	14.8	14.5	812	72	884
	October	15.3	15.1	1,125	215	1,340
	November	26.3	25.3	763	1,408	2,171
	December	28.9	27.4	1,200	1,731	2,931
1989	January	26.3	25.9	1,400	1,495	2,895
	February	14.9	14.6	1,400	490	1,890
	March	13.6	13.5	1,138	60	1,198

TABLE 9.4

**Reserve Requirements on Sheqel Deposits***(Percent, by interest brackets)*

	1988		1989
	25.2.88 <sup>a</sup>	29.9.88	23.2.89
Up to 6 days	33	26	21
Bracket 1	8	8	8
Bracket 2	25	18	13
Time deposits			
1 week to 3 months	20	16	12
Bracket 1	4	4	4
Bracket 2	16	12	8
3 months to 1 year	10	9	9
Bracket 1	2	2	2
Bracket 2	8	7	7
1 year or longer		7.5	7.5
Bracket 1		1	1
Bracket 2		6.5	6.5
Foreign currency-linked time deposits for 1 year or longer		7.5	7.5
Bracket 1		1	1
Bracket 2		6.5	6.5

<sup>a</sup> For the classification of deposits by term and reserve requirements until February 25, 1988, see Annual Report 1987, p. 147.

*B. Increasing the Money Market's Competitiveness*

The Bank continued, in the year under review, to reduce and eliminate existing administrative restrictions on financial intermediation. These consist of quantitative restrictions on parts of the financial market, and total prohibitions of certain kinds of deposits and credits. The removal of these restrictions is likely to augment financial intermediation in the institutionalized framework of the banking system, narrow the interest-gap between different types of credit, and broaden the base of intermediation which monetary policy can influence.

- Reserve requirements: Twice during 1988, the Bank reduced reserve requirements on unindexed local-currency deposits. At the end of February 1988, the reserve requirements were reduced by an average of about 4 percentage points, and at the end of September, by about 5 percentage points. A further 4 percent reduction became feasible at the end of February 1989. These cuts in liquidity ratios reduced the required reserves on local-currency deposits to nearly half their rate at the end of 1987 (16 percent, as against 30 percent). This had the

purpose of bringing liquidity ratios closer to their commercial level, within the guidelines of current monetary policy. The Bank also introduced NIS deposits for terms over one year with reduced reserve requirement (7.5 percent). The reserve requirement on foreign-currency deposits for more than one year of nonresidents (Patach) was also reduced to 7.5 percent (the changes in reserve requirements are shown in Table 9.4).

- **Guarantee ceilings:** In early 1988, the Bank of Israel raised the ceilings on guarantees against credit substantially; in early 1989, the ceilings were removed altogether (see Table 9.5).

- **Credit in, or linked to, foreign currency:** The Bank took several steps to increase the resources for credit in foreign currency, or linked to foreign currency, to Israeli residents, as follows:

- a) Permission of foreign currency-linked deposits for one year or more, with a reserve requirement of 7.5 percent (deposited with the Bank of Israel without linkage).

- b) Permission to grant Israeli residents credit in foreign currency, in an amount equal to 10 percent of residents' restitution foreign currency deposits in each bank (about \$300 million), in addition to the foreign currency credit subject to ceilings .

- c) Raising the ceilings on foreign currency credits, as a proportion of each bank's foreign currency resources (4.5 percent, equivalent to about \$400 million). The Bank also announced a gradual substitution, over 2<sup>1</sup>/<sub>2</sub> years, of the present allocation of the ceiling by a system based on the volume of foreign currency resources of each bank. This will totally lift the administrative ceilings on foreign currency credits.

- On the Bank's suggestion, the government decided to amend the Interest Law, and permit the granting of indexed loans for one year or more, instead of two years or more at present.

### *C. The Bank of Israel as the Government's Fiscal Agent*

#### **A. 'Arrangement' Bank Shares**

The Bank, in its capacity as the government's fiscal agent, purchased in 1988 'arrangement' bank shares for NIS 80 million, in accordance with a policy adopted by the Ministry of Finance from October 1986 (see Table 9.8).

#### **B. Funding the Government Budget**

The Bank of Israel raised funds on medium and long term for financing the government deficit and for recycling the domestic debt, both through the issue of

TABLE 9.5

**Ceilings on Guarantees against Credit***(Percent change over the ceiling of the previous period)*

Date	Change, percent
23.4.1987	1.3
28.5.1988	2.2
30.7.1988	1.0
29.10.1988	2.3
25.2.1988	10
31.3.1988	10
28.4.1988	10
26.5.1988	10
30.6.1988	10
28.7.1988	10
25.8.1988	10
29.9.1988	10
27.10.1988	0
24.11.1988	0
29.12.1988	0
26.1.1989	0
23.2.89	abolished

bonds and the receipt of deposits from financial institutions for the Ministry of Finance. In 1988, net public borrowing (the excess of bond issues over redemptions, excluding interest payments) amounted to NIS 3,817 million, compared to NIS 1,383 million in 1987 (Table 9.6).

In the year under review, the public sector's market operations were affected by the large redemptions of the 'arrangement' bank shares in October. The Ministry of Finance began recycling operations already in August, through tenders for future delivery at the due date of the bank shares. The actual redemption amount of the tradeable bank shares was NIS 2,472 million (excluding the shares held by the banks for their own account ['nostro'] and financed by foreign currency loans, in an amount of about \$800 million). Bank shares in an amount of NIS 1,800 million, which were not cashed in by their owners, were listed on the stock exchange, and their owners were guaranteed annual interest in dollars at the rate of 6.5 percent or, alternatively, CPI indexation of the shares without interest.

The securitization of the domestic debt continued in 1988. In the process of involving financial institutions in the negotiable bonds market, a first issue was made in February 1988 of 17-year bonds, intended mainly for the social insurance funds. Negotiable bonds issued in 1988 accounted for 63 percent of total bond issues, compared to 53 percent in the preceding year.

Deposits with the Accountant-General against indexed savings schemes remained at their 1987 level—NIS 1,955 million, but their proportion in total gross public borrowing declined to 17 percent, as against 28 percent in 1987. The special bonds issued by the Bank of Israel to pension funds totaled NIS 1,524 million, and the deposits of the insurance companies—NIS 551 million.

The Bank of Israel issues bonds and receives deposits of the National Insurance Institute in favor of the Ministry of Finance. The NII funds deposited with the Bank and transferred to the Ministry of Finance amounted in 1988 to NIS 1,925 million.

TABLE 9.6  
Public Borrowing by Source and Form, 1986–88

	1986	1987	1988	Gross borrowing	
				1987	1988
	<i>NIS million</i>			<i>Percent</i>	
Issues of negotiable bonds <sup>a</sup>	2,502	3,728	7,142	53.6	63.3
Savings schemes	943	1,934	1,956	27.8	17.3
<i>of which:</i> Bonds issued by the Bank	–	–	–	–	–
Social security funds	8	–	108	–	1.0
<i>of which:</i> Bonds issued by the Bank	6	–	–	–	–
Pension funds	863	929	1,524	13.4	13.5
<i>of which:</i> Bonds issued by the Bank	57	574	1,524	8.3	13.5
Insurance companies					
Bonds issued by the Bank	213	357	551	5.1	4.9
Deposits of banking institutions	31.8	7.7	–	0.1	–
<b>Total gross public borrowing</b>	<b>4,560</b>	<b>6,953</b>	<b>11,280</b>	<b>100.0</b>	<b>100.0</b>
<i>of which:</i> Bonds issued by the Bank	2,778	4,657	9,216	67.0	81.7
Total redemptions <sup>b</sup>	5,548 <sup>c</sup>	8,418 <sup>d</sup>	10,702 <sup>e</sup>		
Total net public borrowing	–987	–1,465	578		
Deposits of National Insurance Institute	1,001	1,638	1,925		

<sup>a</sup> From December 1984, bond issues were exclusively by tender.

<sup>b</sup> Includes financial margins on deposits against indexed and dollar-linked savings schemes, and bonuses against old savings schemes.

<sup>c</sup> Includes redemptions from the Bank of Israel's portfolio, in an amount of NIS 515.6 million.

<sup>d</sup> Includes redemptions of NIS 1,305.3 against the blocked bank shares, and redemptions from the Bank of Israel's portfolio, in the amount of NIS 90.1 million.

<sup>e</sup> Includes redemptions of NIS 2,475 against negotiable bank shares, and redemptions from the Bank of Israel's portfolio amounting to NIS 43.7 million.

TABLE 9.7  
**Operations in Treasury Bills, 1986–88**

Date	Sales	Redemptions	Net absorption or injection	Balance held by the public (incl. banks) <sup>a</sup>	Balance held by banks <sup>a</sup>	Average daily turnover	Average <sup>b</sup> annual yield to maturity, by months to maturity								
							0–1	1–2	2–3	3–4	4–5	5–6	7–9		
				<i>NIS million</i>				<i>Percent</i>							
1986	1,006.0	1,006.1	–0.1	158.7		10.3	21.5	21.6	22.0						
1987	3,907.4	3,338.3	569.1	828.5		20.9	15.4	15.9	16.6						
1988	2,270.9	2,654.7	–383.8	636.8	208.8	39.7	16.3	16.7	17.0	17.2	17.4	17.7			
Jan.	147.0	201.2	–54.2	784.0	344.0	21.3	15.9	16.1	16.9	17.3	17.7	18.2			
Feb.	326.9	261.7	65.2	885.3	423.3	38.1	16.5	17.3	17.6	18.1	18.4	18.7			
March	482.1	234.6	247.5	1,149.9	608.9	37.0	16.5	16.9	17.4	17.7	18.0	18.2			
April	372.2	232.0	140.2	1,307.2	637.2	49.7	15.0	15.8	16.5	16.8	17.0	17.0			
May	251.8	309.1	–57.3	1,284.8	592.8	48.3	15.1	16.0	16.7	16.8	16.9	16.9			
June	427.2	180.8	246.4	1,550.4	774.4	37.9	15.2	16.2	16.5	16.6	16.7	16.8			
July	–65.0	206.5	–271.5	1,299.8	518.8	58.4	15.6	15.9	15.9	16.1	16.4	16.5			
Aug.	49.3	298.8	–249.5	1,065.6	400.6	43.1	14.6	14.7	15.0	15.6	15.8	15.9			
Sept.	16.1	189.7	–173.6	893.0	347.0	53.8	14.1	14.5	15.0	15.4	15.6	15.7	15.7		
Oct.	–36.6	132.3	–168.9	732.7	267.7	36.0	15.1	15.4	15.9	15.9	16.0	16.3	16.2		
Nov.	178.3	156.1	22.2	759.4	274.4	34.4	19.2	19.1	19.0	18.6	18.6	19.5	19.1		
Dec.	121.6	251.9	–130.3	636.8	208.8	23.5	22.3	22.2	21.4	21.1	21.5	22.9	21.1		

<sup>a</sup> End of period.

<sup>b</sup> Thursday averages.

TABLE 9.8

**Bank of Israel Open-Market Operations in Bonds, by Type of Bond, 1986–88**

Period	Excess of purchases over sales on the stock exchange									Bank of Israel's share in turnover <sup>a</sup>
	Total	CPI-indexed					Optional linkage	Gilboa variable interest	Rimon fixed interest	
		Short-term 4%, 6%, 7% and others	Arbel 80%	Saguy 4.25% 100%	Galil 3% 100%	Galil 4.25% 100%				
<i>NIS thousand</i>										
1986	-307	71	4	3	-433	-11	75	-10	-5	0.0
1987	-63,650	-8,226	-85,931	38,629	-32,975	44,053	-19,204	-4.	10	6.7
1988	113,567		-2,698	58,567		89,043	-31,348	5.0	-2	2.9
Jan.	26,623		47	10,535		16,038	3			4.8
Feb	-38,134		-3,315	522		-3,964	-31,377			7.8
March	39,548		47	16,658		22,817	26			6.2
April	5,960		23	2,574		3,345	-4	22		1.7
May	41,259		26	13,101		28,129	9	5	-1	6.9
June	8,539		-76	1,616		6,994	10	5		1.5
July	22,278		227	11,210		10,843	-2			4.2
Aug	4,855		291	2,347		2,224	-8	1		1.2
Sept.	269		8	-1		274	-13	1		0.1
Oct.	2,291		4	-1		2,297	-6	-3		0.3
Nov.	20		1	-2		35	-7	-7		0.0
Dec.	59		19	8		11	21	1	-1	0.0

<sup>a</sup> Half the purchases of the Bank of Israel, divided by the turnover on and off the floor on the Stock Exchange.

### 3. THE MANAGEMENT OF STATE LOANS

During 1988, redemptions of voluntary state loans amounted to NIS 4,787 million (including interest and linkage differentials), compared to NIS 2,979 million in 1987. Disbursements of the redemption of the banking groups' deposits against savings schemes (indexed or linked to the dollar or the currency basket), and withdrawals of deposits before their date of maturity amounted to NIS 2,235 million, as compared with NIS 2,372 million in 1987.

The final redemption of the Defense Loans of the 1970s amounted to about NIS 821 million (including interest, linkage differentials and payments for late redemption), as against NIS 70 million in 1987. The amount of this year's redemptions of the Savings Loans of 1970–79 was about NIS 164 million (including interest, linkage differentials and payments for late redemption), as against NIS 157 million in 1987. Disbursements for early redemptions this year were NIS 78 million at the redemption value, as against NIS 98 million in 1987.

### 4. THE DEPARTMENT OF CREDIT AND FOREIGN EXCHANGE CONTROL

In 1988, directed export credit averaged \$2,045 million, compared to \$2,007 million in 1987—a 2 percent rise, as compared to an increase of 15 percent in the exports financed.

The financing of exports, excluding diamonds, was down 1.5 percent over 1987, as against a 12 percent increase in exports, excluding diamonds.

Foreign exchange control is exercised within the framework of the General Permit which defines the transactions in foreign currency and with foreigners in which Israeli residents may engage, and by a range of special permits. The Bank of Israel's Department of Credit and Foreign Exchange Control from time to time introduces changes in the General Permit and other permits, and lays down rules of procedure for the banks authorized to deal in foreign currency. The Department issues special permits in various areas subject to foreign exchange control, among them permits for investments abroad and for the establishment of companies abroad.

The Department, jointly with the Attorney-General and the police, operates an 'indemnity committee' to deal with breaches of foreign currency regulations.

The Department maintains detailed data bases regarding foreign currency, among them—data on the State of Israel's external debt, and the flows of receipts and disbursements in foreign currency.

## 5. SUPERVISION OF THE BANKING CORPORATIONS

The last three years have seen a gradual change in the banking corporations' mode of operation, one result of which was an increase in the risk exposure. The Banking Supervision Department has therefore put increasing emphasis on the management and control of the various risks of the banks. In 1988, the Department dealt in particular with various aspects of credit risk, as conviction grew that the credit management of the banks needs improvement, especially in view of the accelerated expansion of nondirected credit, the stiffer competition for borrowers, the recession, and the crises experienced particularly by large borrowers. In this area, the following steps were taken:

- The general provision for doubtful debts was doubled;
- Preparations were completed for applying a minimal capital ratio, and a proposal is being worked out for the restriction of credit to affiliated borrowers;
- Disclosure to the public of problematic debts was extended;
- In the detailed supervision, emphasis was put on loan management, and the banks were required to re-evaluate part of their loan portfolio;
- An examination was made of how the debts of large borrowers who were in difficulty affected the banks, and of the effect of the recovery programs of these borrowers.

The Banking Supervision Department attaches great importance to the extension and improvement of information given to the public, in order to enhance supervision and control through market forces. Following the report of the committee which dealt with the structure of the banks' annual financial statements, the Department has published a new edition of the instructions concerning the banks' financial statements, and has required the banks to attach the Board of Directors and the management reports to the financial statements. These instructions augment the information to the public.

The adaptation of the Department's supervision of the banks to the increasing risks continued in 1988. Two new control teams were set up, the emphases of the supervisory activities were changed, and the application was begun of the report of the team which formulated instruments and methods for the analysis of the banks' state of business. The re-programming of the banking information data bank was also started.

## 6. ISSUE OF BANKNOTES, COINS AND MEMORIAL COINS

In recent years, the Bank of Israel has taken steps to supply the public with a set of currency denominations to facilitate convenient and efficient transactions, and save on costs of issuing currency. These steps came into full effect in 1988. A high-value denomination banknote was issued, the issue of low-denomination banknotes was stopped, low-value coins were taken out of circulation, the size of coins was proportioned to their denominations, and intermediate denominations were issued. The slowdown of inflation, together with these measures, led to a considerable decrease in the number of banknotes in circulation, and in the expenses of the Bank on banknote and coin issues (from about NIS 26 million in 1982 to NIS 5 million in 1988, at June 1988 prices).

At the end of 1988, currency in circulation amounted to NIS 2,014 million, as against NIS 1,671 million at the beginning of the year—a 20.6 percent increase. In real terms, the increase was only 3.6 percent, following increases of 40, 55 and 20 percent respectively in 1985, 1986 and 1987.

## 7. FOREIGN CURRENCY OPERATIONS

The Foreign Currency Department manages the Bank of Israel's foreign reserves and carries out banking transactions in foreign currency on behalf of the government and the commercial banks. According to Article 7, paragraph 37, of the Bank of Israel Law 5714–1954, the Bank is limited in its foreign currency transactions to the government, the National Institutions, the banking concerns in Israel and abroad, international financial institutions and foreign governments.

In addition to managing the foreign currency reserves, the Department acts as banker to the government ministries engaged in export and import. The Department makes disbursements on behalf of these ministries, opens documentary credits, and gives guarantees for the government's trading operations. The Department also carries out transactions under bilateral trade agreements, and collects foreign currency checks connected with the non-trading operations of the government.

The Foreign Currency Department also manages the foreign currency accounts of the commercial banks which are deposited with the Bank of Israel under the reserve requirements. In this framework, the Department receives and disburses foreign currency on behalf of the banks with financial institutions abroad, with the government, and between the banks. In its capacity of central banker, the Department conducts the daily trading in foreign currency with the banks, once

a day, at noon time. At the end of the daily trade, the Department publishes the representative exchange rates of the principal foreign currencies. The representative rates are calculated on the basis of the selling and buying rates of the U.S. dollar as set by the commercial banks for their customers, and on the basis of the cross rates of the dollar against other currencies in the international money markets.

The Department's principal task is the management of the foreign reserves. These are held to enable the financing of imports and the repayment of the foreign debt when there is an increase in the basic balance of payments deficit. The Bank takes a cautious approach in managing the foreign reserves, and is guided by several objectives: a) to secure a degree of liquidity adequate for the needs of the economy; b) to minimize the diverse risks to which the reserves are exposed; and c) to obtain an appropriate return on the reserves. Thus, for example, for the sake of caution, the reserves are invested mainly in government or government-guaranteed securities, or deposited with solid banks, with emphasis on an appropriate diversification of the investments.

One of the main risks to the reserves are the fluctuations in the foreign cross rates. The table below shows the changes, in recent years, of the exchange rate of the dollar against the Deutschmark—two principal reserve currencies.

1983	1984	1985	1986	1987	1988
<i>Annual percent change</i>					
+14.6	+15.5	-21.8	-21.1	-18.6	+11.5

In order to minimize the risk of fluctuations in foreign cross rates, and preserve the purchasing power of the reserves from the viewpoint of the Israeli economy, the Bank of Israel's practice is to hold the reserves in a basket of currencies similar to the composition of the expected uses of the reserves, i.e., the currency composition of imports and servicing of the external debt. In some cases, the Bank deviates to a limited extent from this relatively safe composition, in the light of expected trends in exchange rates. The forecast of these trends is based on economic policy and developments in the leading economies of the world. Obviously, these are predictions which are not certain to come true. Even when such a deviation is successful and yields profits, these are not a 'free lunch'. They are obtained at the price of incurring the additional risk involved in such operations from the outset.

TABLE 9.9

**Income and Returns to Foreign Currency Reserves, 1985–88**

	1985	1986	1987	1988
	<i>\$ million</i>			
<b>Income</b>				
1. Total income, according to Statement of Income and Expenses	417	520	776	124
2. <i>of which</i> : Dollar exchange rate differentials	273	278	330	327
<b>Rates of Return<sup>a</sup>      Percent</b>				
3. Dollar rate of return	15.3	14.4	15.0	3.2
4. <i>of which</i> : Interest and capital gains	9.8	7.5	6.3	6.2
5.            Exchange rate differentials	5.1	6.4	8.1	-2.8
6. Deutschmark rate of return	-6.3	-7.0	-5.4	15.3
7. Return in terms of expected uses of reserves	9.5	8.3	9.1	6.4
8. <i>of which</i> : Effect of managing the currency composition	-0.2	0.8	2.4	0.1

<sup>a</sup> The rates of return refer to receipts and reserves excluding gold, in annual terms, calculated on a daily basis.

It follows from the above-said, that the proper criterion for evaluating the income from the investment of the reserves is the currency composition of the expected uses of the reserves, and not the dollar or any other currency. Table 9.9 presents the returns on the foreign reserves in 1985–88 (income as a percentage of the reserves in each year), in terms of the expected uses of the reserves, and in terms of dollars and Deutschmarks, and the customary dollar income.

In dollar terms, there were considerable annual fluctuations, in both total dollar income (row 1) and the overall rate of return (row 3). Most of the fluctuations are due to the heavy weight of the dollar exchange rate differentials in each of these years, which reflect the changes in the dollar's exchange rate against the other currencies. In each of the years 1985–87 the dollar weakened considerably. This expressed itself as dollar 'profits' on the part of the reserves held in other currencies. In 1988, the dollar strengthened again to some extent, and this appeared as dollar 'losses'. These 'losses' explain the sharp decline recorded in 1988 in income and returns on the reserves, in dollar terms. When exchange rate differentials are deducted, the income (row 2) and return (row 4) in dollars are much more stable over the years. A comparison of the results in dollar terms with those quoted in Deutschmarks (row 6 compared with row 4) demonstrates the distortion in referring to returns in terms of a specific currency: as expected, in years of a relatively low dollar return, the return in terms of Deutschmarks is high, and *vice versa*.

In contrast to the dollar-term returns, the returns in terms of the currency composition of expected uses of the reserves (row 7) are much less influenced by fluctuations in foreign cross rates and the appearance of 'losses' or 'profits' in dollar terms. This stability is not accidental: it is the result of the cautious policy in investing the reserves, in a composition similar to that of their expected uses, and the measurement of the results by a criterion appropriate to the purpose of holding the reserves.

The returns, in terms of the expected uses of the reserves, among other things, also reflect the slight actual deviations from the currency composition of expected uses. The effect of these deviations on the rate of return (row 8) was very slight in 1987–88. In this period, there was considerable uncertainty regarding the expected changes in foreign cross rates (by comparison with previous years, there were reversals in the value of the dollar in 1985 and 1988). In these two years, the Bank of Israel therefore restricted the deviations from the currency composition of the reserves by expected uses. This was done to minimize the loss that would have been caused in case the deviation was in the wrong direction, and additional but uncertain returns were purposely forgone. In 1986 and 1987 the deviations from the currency composition were slightly greater; as the dollar weakened in these two years, the deviations yielded an additional return of 0.8 and 2.4 percent, respectively.

The returns to the investment of the reserves also reflects the interest on the investment in each currency (row 4). The annual changes are influenced considerably by the levels of interest rates in the various currencies in international markets, and the changes in these interest rates and their timing.

## 8. ECONOMIC RESEARCH AND PUBLICATIONS

As every year, the Bank's *Annual Report* contains a substantial part of the current research on the economy carried out by the Bank's Research Department. Other current studies carried out in 1988 by the Department's economists are the following:

1. *Report on the Increase in the Money Supply*, by the Governor of the Bank of Israel.
2. *Three Surveys of Recent Economic Developments*.
3. The National Budget for 1989, in cooperation with the Ministry of Finance and the Ministry of Economic Planning.
4. A program for the Renewal of Economic Growth and the Reduction of Inflation.

5. Internal surveys on monetary and macro-economic developments.
6. Position papers on policy in the money and capital markets, the foreign currency market, and the labor market.
7. Survey of Developments in Judea-Samaria and Gaza, 1985–86.
8. Main Israeli Economic Data (published weekly).

In addition to its current research, the Department carried out special studies, of which the following were published:

1. Labor Supply and Demand in the Business Sector, 1962–84.
2. An Estimate of Inflationary Expectations in Israel under the Disinflation Program of 1984–85.
3. Wage Policy during Disinflation: The Israeli Stabilization Program of 1985.
4. Monetary Policy and Institutions in Israel—Past, Present and Future.
5. Short-term Monetary Control in Israel.

The Research Department also publishes a series of discussion papers, presenting the economic profession with pre-publication drafts of economic studies. The following discussion papers were published in 1988:

1. The Logic of Ricardian Equivalence and the Deficit-Inflation Debate.
2. The Determinants of the Government Budget.
3. Indexes of Export Profitability.
4. The Publication of the CPI and an Examination of the Securities Market's Efficiency in Israel.
5. The Seniority Structure of the Labor Force and its Effect on Wages, 1972–83: The Approach of Permanent and Temporary Workers.
6. The Fiscal and Monetary Dynamics of Israeli Inflation: A Cointegrated Analysis, 1970–85.
7. The Demand for Liquid Assets in Israel, 1970–85.
8. The Trade Balance Ratio and the Real Exchange Rate in Israel, 1955–86.
9. A Democratic Model of the "Rent-Sought" Benefit Cycle.

Many studies on diverse subjects are in preparation. The main studies that have already been discussed internally in draft form are the following:

1. The Interest Rate, Saving and Investment in Israel.
2. The Capital Market Reform: Objectives and First Results.

3. An Evaluation of Inflation Forecasts in Israel, 1984–87.
4. The Interrelationship between Natural Population Growth and Product in Israel, 1964–86.
4. The Distribution of Real Interest by Economic Sectors.
5. Price Indexes of Tradeable and Nontradeable Goods.
6. Skill-Intensity in Israeli Industry.
7. The Distribution of Product among Labor and Capital.
8. An Econometric Model of the Israeli Economy.
9. Monetary Policy and Capital Movements since the Stabilization of the Exchange Rate.
10. The Inflationary Process and its Effect on Tax Revenue in Israel.
11. Gaps between Borrowing and Lending rates.
12. Wage Rigidity and its Effects on the Labor Market.

#### 9. BANK OF ISRAEL PUBLICATIONS

The following publications appeared in 1988:

##### **Research Department**

1. Annual Report, 1987 (Hebrew, English abridgement).
2. Main Points of the Annual Report 1987 (Hebrew and English).
3. Calendar of Economic Events, 1987 (Hebrew).
4. Recent Economic Developments, Nos. 43, 44, 45 (Hebrew and English).
5. Economic Developments in Judea-Samaria and Gaza, 1985–86.
6. National Budget for 1988.
7. *Main Israeli Economic Data* (binder, weekly updates, Hebrew and English).
8. The Israeli Economy—Facts in Figures, 1988
9. Economic Review, 60, 61, 62, 63

##### **Banking Supervision Department**

10. Annual Survey of Israel's Banking System, 1988 (Hebrew and English).
11. Annual Statistics of Israel's Banking System, 1983–87 (Hebrew and English)
12. Current Statistics of Banking Institutions (binder, weekly updates, Hebrew and English).
13. Directory of Israeli Bank Branches on 1.1.88 (Hebrew).
14. Banking Review No. 7 (Hebrew).
15. Banks in Israel—Selected Figures, 1987

16. Uncovered Checks, Legislation and Instructions (Hebrew).

#### **Bank of Israel Comptroller**

17. Financial Statements for the Year 1987.

#### **State Loans Administration**

18. Instructions for the Redemption of Registered Compulsory Loans (binder, periodic updates, Hebrew).

19. Instructions for the Redemption of Foreign Debts (binder, periodic updates).

#### **Currency Department**

20. Annual Survey, 1987 (Hebrew).

#### **General Counsel**

21. Banking Legislation (binder, periodic updates, Hebrew).

#### **Controller of Foreign Exchange**

22. Foreign Currency Control Directives (updates and circulars, Hebrew).

23. Foreign Currency Liabilities (semi-annual, Hebrew).

24. The Private Sector's Balance of Payments, Cash Basis (semi-annual, Hebrew).

#### **Monetary Department**

25. Capital Market Developments, Annual Survey, 1987 (Hebrew).

#### **Foreign Currency Department**

26. Foreign Currency Exchange Rates, 1987 (Hebrew and English).

27. Representative Sheqel Exchange Rates (weekly, Hebrew and English).

### 10. THE GOVERNOR'S OFFICE

Sylvia Piterman was appointed deputy director of the Monetary Department on 4.5.88, and Director of the Department on 1.5.89.

Shmuel Bilitzki was appointed Director of the Foreign Currency Department, in addition to his duties as Director of the State Loans Administration and the Comptroller's Office. He replaced Shmuel Peled, who retired.

On 16.2.89, Amnon Goldschmidt, the Supervisor of Banks, joined the Bank's senior executive board, replacing his predecessor, Galia Maor, who retired.

## 11. ADVISORY COMMITTEE AND ADVISORY COUNCIL

The Advisory Committee discussed the following issues: The changes in the instruments of monetary policy, including the reductions of reserve requirements; changes in the Bank of Israel's lending rates; the adaptation of the monetary loans to policy objectives; expansion of the facilities for the financing of capital goods imports; changes in the management of export funds; raising the ceilings on nondirected foreign currency credit; the lifting of the ceilings on sheqel-denominated guarantees; and measures related to the money and capital markets, within the framework of the economic program. The Committee endorsed the changes proposed by the Bank of Israel.

The Advisory Committee and Advisory Council heard reviews by the Governor and the members of the Bank's management on issues of monetary policy, the level of interest rates, and economic developments, and held discussions on these issues. The Council also discussed the Bank's Annual Report for 1987 and the 1987 Annual Report of the Supervisor of Banks. The Council also discussed the bank share arrangement and the economic program adopted by the government in January 1989.

**BANK OF ISRAEL**  
**BALANCE SHEET AS OF 31ST DECEMBER 1988**  
(millions of NIS)<sup>a</sup>

	Notes	31.12.88	31.12.87		Notes	31.12.88	31.12.87
<b>Foreign assets</b>				<b>Banknotes and coins in circulation</b>		<b>2,015</b>	<b>1,671</b>
Gold, foreign exchange, and foreign securities	7,390		9,114	<b>Foreign liabilities</b>			
Other foreign assets	1	7,391	9,377	Allocation of SDR	6	259	230
				Accounts with the IMF and other foreign liabilities	7	61	45
						<b>320</b>	<b>275</b>
<b>Government debt</b>				<b>Deposits of government and National Institutions</b>			
Long-term debt	2	9,047	7,380	Foreign currency		2,944	2,751
				Local currency	8	2,081	719
						<b>5,025</b>	<b>3,470</b>
<b>Loans</b>				<b>Deposits of banking corporations</b>			
At the discount-window <sup>b</sup>	3,547		907	<b>Foreign currency</b>			
Other <sup>b</sup>	306	3,853	1,206	Against resident deposits—restitutions	6,046		5,689
				Against resident deposits—other	4,561		3,315
				Against nonresident deposits	1,189		915
						<b>11,796</b>	<b>9,919</b>
<b>Securities</b>	4			<b>Local currency</b>		<b>1,180</b>	<b>2,479</b>
Tradeable		746	461				
Nontradeable		112	188				
		<b>858</b>	<b>649</b>	<b>Other deposits</b>	9	<b>68</b>	<b>59</b>
<b>Other accounts</b>	5	<b>373</b>	<b>300</b>	<b>Other accounts</b>	10	<b>798</b>	<b>719</b>
				<b>Capital and general reserve</b>	11	<b>320</b>	<b>320</b>
		<u><b>21,522</b></u>	<u><b>18,912</b></u>			<u><b>21,522</b></u>	<u><b>18,912</b></u>

<sup>a</sup> See Note 1a.

<sup>b</sup> New classification starting in 1987.

For contingent accounts, see Note 12.

The accompanying notes are an integral part of the financial statements

(—)  
Michael Bruno

(—)  
Zvi Auerbach

**STATEMENT OF INCOME AND EXPENSES FOR  
THE YEAR ENDING DECEMBER 31, 1988**  
(NIS million<sup>a</sup>)

	Notes	1988	1987
<b>Income<sup>b</sup></b>			
From investments abroad	13	1,522	1,449
From credit to the the government		1,693	32,145
From loans		260	147
From securities	14	59	108
Other income		29	62
Total income		<b>3,563</b>	<b>3,911</b>
<b>Expenses<sup>b</sup></b>			
On foreign currency deposits of the government and the National Institutions		586	30
On local currency deposits of the government and the National Institutions		392	3,387
On foreign currency deposits of banking corporations in Israel		1,795	1,631
On local currency deposits of banking corporations in Israel			223
387			
On other deposits and liabilities		81	72
Administrative and general expenses	15	69	115
Printing banknotes and minting coins		6	5
Total expenses		<b>3,152</b>	<b>2,627</b>
Excess of income over expenses		<b>411</b>	<b>1,284</b>
Plus income from the Government subject to matched timing	16	43	207
<b>Net income</b>		<b>454</b>	<b>1,491</b>
<b>Appropriation statement</b>			
Transfer to the Government		<b>454</b>	<b>1,491</b>
Total		<b>454</b>	<b>1,491</b>

<sup>a</sup> See note 1a.

<sup>b</sup> Includes differentials arising from the adjustment of assets and liabilities denominated in or linked to foreign currency for changes in the exchange rate for foreign currencies against the new sheqel.

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

**STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR  
ENDING DECEMBER 31, 1988  
A. TOTAL**

(NIS million)

	Balance on				Percent change	
	Unadjusted		Adjusted <sup>a</sup>		over preceding year	
	31.12.88	31.12.87	31.12.88	31.12.87	Nominal	Real
<b>Assets</b>						
Foreign assets	7,391	9,377	7,391	10,915	-21.2	-32.3
Government debt	9,047	7,380	9,047	8,590	22.6	5.3
Loans						
Discount window	3,547	907	3,547	1,056	291.1	235.9
Other <sup>b</sup>	306	299	306	348	2.3	-12.1
Securities	858	649	858	755	32.2	13.6
Other accounts <sup>b</sup>	373	300	525	503	24.3	4.4
Total assets	<b>21,522</b>	<b>18,912</b>	<b>21,674</b>	<b>22,167</b>	13.8	-2.2
<b>Liabilities</b>						
Banknotes and coins in circulation	2,015	1,671	2,015	1,945	20.6	3.6
Foreign liabilities	320	275	320	320	16.4	-
Deposits of government and National Institutions						
In foreign currency	2,944	2,751	2,944	3,202	7.0	-8.1
In local currency	2,081	719	2,081	837	189.4	148.6
Foreign-currency deposits of banking corporations						
Against resident deposits						
Restitutions	6,046	5,689	6,046	6,622	6.3	-8.7
Other	4,561	3,315	4,561	3,859	37.6	18.2
Against nonresident deposits	1,189	915	1,189	1,065	29.9	11.6
Local-currency deposits of banking corporations	1,180	2,479	1,180	2,886	-52.4	-59.1
Other liabilities <sup>b</sup>	866	778	866	905	11.3	-4.3
Capital and general reserve <sup>c</sup>	320	320	472	526	-	-10.3
Total liabilities	<b>21,522</b>	<b>18,912</b>	<b>21,674</b>	<b>22,167</b>	13.8	-2.2

<sup>a</sup> See Note 1a. The CPI rose by 16.4 percent from December 1987 to December 1988.

<sup>b</sup> 'Other loans', 'other accounts', and 'other liabilities' include items in foreign currency or linked to the exchange rate, and unindexed items.

<sup>c</sup> The difference between the adjusted and unadjusted figures includes a NIS 54 million adjustment to the real end-1988 value.

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

**STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR  
ENDING DECEMBER 31, 1988  
B. IN FOREIGN CURRENCY<sup>a</sup>**

(US \$million)

	Balance on		Percent change over preceding year
	31.12.88	31.12.87	
<b>Assets</b>			
Foreign assets	4,091	6,095	-32.9
Government debt	4,089	4,797	-14.8
Loans	141	170	-17.1
Other accounts	93	118	-21.2
Total assets	<b>8,414</b>	<b>11,180</b>	-24.7
<b>Liabilities</b>			
Foreign liabilities	177	178	-0.6
Deposits of government and National Institutions	1,630	1,788	-8.8
Deposits of banking corporations			
Against resident deposits			
Restitutions	3,347	3,698	-9.5
Other	2,525	2,154	17.2
Against nonresident deposits	658	595	10.6
Other liabilities	152	158	3.9
Total liabilities	<b>8,495</b>	<b>8,565</b>	-0.8
Foreign reserves held by the Bank of Israel <sup>b</sup>	<b>3,433</b>	<b>5,329</b>	-35.6

<sup>a</sup> Foreign currency or foreign-currency linked. See also notes in part A of this table.

<sup>b</sup> Defined as gold, foreign exchange, and foreign securities, less deposits of banks abroad and foreign-currency deposits of banking corporations in Israel against nonresident deposits.

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

## NOTES TO THE FINANCIAL STATEMENTS, DECEMBER 31, 1988

### 1. ACCOUNTING POLICIES

#### *a. Unit of measurement*

The financial statements are presented in nominal new sheqalim. The Statement of Changes in Assets and Liabilities is given in inflation-adjusted terms as well; the figures are adjusted by the Consumer Price Index (CPI) published on 15.1.89 (124.2; the index published on 15.1.88 stood at 106.7).

#### *b. Foreign currency assets*

Assets and liabilities in foreign currency are translated into NIS at the representative exchange in effect on the balance-sheet date. (No rates were announced on the last day of 1988; accordingly, those for the first trading day of 1989 are used for the 1988 financial statements.) The rates are as follows (NIS per unit):

	31.12.1988	31.12.1987
US \$	1.8065	1.5386
SDR	2.4130	2.1640
First currency basket <sup>1</sup>	1.9920	1.7083

SDR were translated using the SDR/US\$ ratio. Gold is stated at SDR35 per fine ounce.

Foreign-currency linked assets and liabilities are valued at the representative rates in effect on the balance-sheet date and include linkage differentials.

Income and expenses in foreign currency are recorded in the Statement of Income and Expenses at the representative exchange rates in effect on the date of transaction.

#### *c. Securities*

Foreign securities are stated at their foreign-currency cost (weighted average purchase price) or market value, whichever is the lower; the calculation is for each type of security separately.

Local-currency tradeable securities are recorded at their adjusted par value *plus* accrued interest and indexation differentials or at market value, whichever is the lower; the calculation is for each type of security separately.

Nontradeable securities are recorded at adjusted value, taking account of Opinion No. 46 of the Institute of Certified Public Accountants in Israel. Adjustment is by the last CPI published before the balance-sheet date.

#### *d. Premises and equipment*

Bank premises and equipment are stated at cost net of depreciation.

<sup>1</sup> This is the basket in effect until 31.7.1986. It consists of: US\$ 0.35; £ 0.1295; DM 0.515; Ffr. 0.6832; Fl. 0.2187.

*e. Participation in international financial institutions*

The participation is included in the item 'other accounts' and stated at cost. The cost includes amounts required to maintain the value of the participation in foreign currency terms, in accordance with the terms of the participation in the various institutions (for the participation in the IMF see Note 7).

*f. Employee pensions and severance pay*

Provision for employee pensions and severance pay is actuarially computed at the balance-sheet date. Part of the domestic securities is held against the employee pension and severance pay liability. Income from these securities in excess of the current provision is set off against the increase in this liability in the Statement of Income and Expenses.

*g. Transfer to the government: matched timing*

Income from the government on account of government securities is, like all the Bank's income and expenses, recorded in the Statement of Income and Expenses on accrual basis. The government's expenses on government securities, on the other hand, are recorded on cash basis. In order to prevent transfer to the government of accrued profits (interest and indexation differentials) not yet matched by a cash flow, they are recorded here and are not included in the Bank's net profit transferred to the government.<sup>2</sup>

Income from securities held against employee pension and severance pay liability is not subject to the matched timing principle (see Note 1c).

CREDIT TO THE GOVERNMENT—LONG-TERM DEBT

The principal items under this head are:

a. NIS 7,323 million indexed to the first currency basket (see footnote to Notes 1b) and carrying 8 percent interest also linked to the basket (The amount outstanding on 31.12.1987 was NIS 7,325 million.)

b. NIS 1,660 million (granted on 31.3.1988) at prime rate plus 2 percent. The average rate of interest during 31.3.88–31.12.88 was 17.4 percent (annual rate, on basis of quarterly imputation).

Each year's interest and indexation differentials fall due on 31st December. Principal is repayable in annual instalments until 2013.

3. OTHER LOANS

Consist mainly of medium- and long-term foreign-currency loans, connected with exports; these loans are made out of a number of specific funds for such purposes as promotion and marketing.

In October 1988, the financing of the diamond export funds was transferred to banking corporations in Israel (on 31.12.1987, the balance, net of banking corporations' participation, stood at NIS 53 million).

<sup>2</sup> Fiscal-calendar year discrepancies are the exception: if the income is due by the end of the fiscal year (31.3), it will be transferred by the Bank on the preceding 31.12.

#### 4. SECURITIES

*Tradeable securities* consist of government bonds, wholly or partly linked to the consumer price index or the US \$; their market value is NIS765 million (NIS 461 million on December 31, 1987).

*Nontradeable securities* consist mainly of compulsory government bonds purchased from firms in accordance with the Government Loans (Sundry Provisions) Law, 5738-1977.

#### 5. OTHER ACCOUNTS (ASSETS)

This item consists mainly of (a) accrued interest and other accrued income; (b) participation in the following international financial institutions: International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, and Inter-American Development Fund; (c) premises and equipment net of accumulated depreciation.

#### 6. SPECIAL DRAWING RIGHTS

Allocation of special drawing rights amounted to SDR106 million (same amount on December 31, 1987). The item 'gold, foreign exchange, and foreign securities' includes SDR46,000 (SDR91,000 on December 31, 1986).

#### 7. ACCOUNTS WITH THE IMF AND OTHER FOREIGN LIABILITIES

Accounts with the IMF General Account: The quota stood at SDR 447 million on 31.12.88 (same amount as on 31.12.87), or NIS 1,086 million (NIS 966 million on 31.12.87). Liabilities equalled the quota on both dates.

Other liabilities consist of NIS 52 million owing to international financial institutions and NIS 9 million on account of trade agreements (the corresponding figures for 31.12.1987 are NIS 41 million and NIS 4 million).

#### 8. LOCAL-CURRENCY DEPOSITS OF GOVERNMENT AND NATIONAL INSTITUTIONS

This item includes only government deposits, among them a special deposit of NIS 89 million, proceeds of government bonds issues purchased by the Bank of Israel for the purpose of bond-price stabilization on the Tel Aviv Stock Exchange.

#### 9. OTHER DEPOSITS

These consist mainly of deposits of the U.S.-Israel Binational Industrial Research and Development Fund and a deposit of the U.S.-Israel Binational Science Fund.

#### 10. OTHER ACCOUNTS (LIABILITIES)

This item consists mainly of (a) income from the government subject to matched timing (see Notes 1g and 16); (b) accrued interest and amounts payable; and (c) provision for employee pensions and severance pay.

#### 11. CAPITAL AND GENERAL RESERVE

The Bank's capital at the Balance Sheet date is NIS60 million and the General Reserve NIS260 million (same amounts on December 31, 1987).

#### 12. CONTINGENT LIABILITIES

The contingent liabilities are as follows: (a) uncalled amounts on account of shares and participations subscribed to international financial institutions—NIS 580 million (NIS 441 million on December 31, 1987); (b) documentary credits—NIS 44 million (NIS 62 million on December 31, 1987); and (c) guarantees—NIS 10 million (NIS 18 million on December 31, 1987).

#### 13. INCOME FROM INVESTMENTS ABROAD

In terms of U.S. dollars this amounted to \$124 million (\$776 million in 1987).

#### 14. INCOME FROM SECURITIES

This item does not include income from securities held against the employee pensions and severance pay liability, which covered part of the increase in the liability (see Note 1f).

#### 15. ADMINISTRATIVE AND GENERAL EXPENSES

Administrative expenses, excluding previous years' expenses and deflated by the average rise in the CPI, calculated on a monthly basis, increased by 3 percent (in 1987 they increased by 5 percent). In 1987 general expenses include a NIS 57 million provision for possible losses in connection with the North American Bank.

#### 16. TRANSFER TO THE GOVERNMENT—NET INCOME

Net income (the amount to be transferred to the government) includes income from government securities accruing in previous years but received in the current year (or due by the end of the current fiscal year). Accumulated income subject to matched timing declined from NIS 368 million on 31.12.87 to NIS 325 million on 31.12.88, i.e., NIS 43 million was transferred to the government in 1988 (NIS 207 million in 1987).

BANK OF ISRAEL

THE GOVERNOR AND MANAGEMENT

May 31, 1988

*Governor*

MICHAEL BRUNO

SENIOR EXECUTIVE BOARD

MORDECHAI FRAENKEL, Senior Director, Economic Research and management of  
Foreign Exchange

AMNON GOLDSCHMIDT, Senior Director, Supervisor of Banks

DAVID KLEIN, Senior Director, Monetary Operations and Foreign Exchange Control

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\* As of May 31, 1989