

CHAPTER XX

ACTIVITIES OF THE BANK OF ISRAEL

1. SUMMARY OF THE BALANCE SHEET AT THE END OF 1978¹

Main Developments

The balance sheet of the Bank of Israel totalled IL 126,935 million at the end of 1978, as opposed to IL 72,486 million in 1977 – an increase of 75 percent, compared with 99 percent in 1976. The lower rate this year was due to the smaller revaluation differentials on foreign currency assets and those linked to the exchange rate resulting from the devaluation of the Israeli pound. Excluding revaluation, the balance sheet rose 46 percent, as against 42 percent in 1977. This year's relatively rapid growth reflects changes in the main items: the swelling of foreign exchange reserves in dollar terms, which far eclipsed the 1977 rate; a continued relatively steep rise in Bank of Israel credit for financing exports; and a relatively slow growth of the Bank's credit to the government.

As against the appreciable increase in foreign currency assets there was a sharp rise in foreign currency liabilities. This is attributable to the monetary expansion, which in large measure was reflected in the public's foreign currency deposits (since the decontrol of foreign exchange these are almost as liquid as IL deposits) and the sizable volume of foreign transfer receipts deposited with the Bank of Israel by the banks. In contrast, there was a relatively sluggish rise in the IL liability items: currency in circulation and banking institutions deposits in Israeli currency, most of which constitute required liquid asset cover.

Claims on the Rest of the World

The Bank of Israel's foreign currency assets² expanded strongly in 1978, from \$ 1,359 million at the end of 1977 to \$ 2,242 million – an increase of \$ 883 million, compared with \$ 203 million the year before.

This year's incremental foreign exchange reserves (in dollar terms) include \$ 300 million in interest and exchange rate differentials received by the Bank on the investment of

¹ Most of this section was published in Bank of Israel, *Financial Statements for the Year 1978*, February 1979.

² Defined as gold, Special Drawing Rights, and foreign currency assets, less deposits of foreign banks and foreign residents.

TABLE XX-1

**CLAIMS ON AND LIABILITIES TO FOREIGNERS IN GOLD AND
FOREIGN EXCHANGE, 1977-78**
(\$ million)

End of year	1977	1978	Increase
Assets			
Gold, foreign currency, and securities in foreign currency	1,570.9	2,678.6	1,107.7
Other foreign currency assets	212.0	277.7	65.7
Total claims on the rest of the world	1,782.0	2,956.3	1,173.4
Liabilities			
Allocation of Special Drawing Rights	52.0	55.9	3.9
Foreign currency deposits of foreign banks	9.8	7.7	-2.1
Liabilities to IMF	93.6	97.4	3.8
Other liabilities	12.5	12.6	0.1
Nonresidents' deposits (Patach)	202.0	428.7	226.7
Total liabilities to the rest of the world	369.9	602.3	232.4
Net claims on the rest of the world (foreign currency assets)	1,413.0	2,354.0	941.0
Net foreign exchange reserves held with the Bank of Israel ^a	1,359.1	2,242.2	883.1

^a Gold, Special Drawing Rights, and foreign currency assets, less foreign nonresidents' deposits and foreign currency deposits of banks abroad.

its holdings.³ Excluding this sum, the net level was up \$ 583 million (as opposed to a \$ 3 million drop in 1977). This increase reflects the contrasting influence of the government and the private sector. The government contributed even more to the increment this year than it had in 1977 - \$ 713 million vs. \$ 497 million. The private sector continued

³ This income consists of \$ 136 million in interest and \$ 164 million in exchange rate differentials on those reserve assets invested in currencies which appreciated in relation to the dollar. It should be noted that those currencies on which the Bank earned exchange rate differentials in 1978 bore a low rate of interest relative to that on other currencies; thus the distinction between income from interest and that from exchange rate differentials has only limited significance.

to pull down the level because of a net purchase of foreign currency, which, however, was smaller than last year — \$ 130 million as against \$ 500 million. In contrast to the past two years, the decline in purchases did not reflect any improvement in the sector's balance of payments deficit on current account; rather it stemmed from a net capital import, most of it in the last two months of the year. In the first two weeks of December alone some \$ 250 million of foreign credit receipts were transferred to this country.

An analysis of the data shows that the \$ 680 million total addition to the reserves during the year (an increase of \$ 883 million compared with \$ 203 million in 1977) occurred in the main components: \$ 94 million in Bank of Israel income, \$ 216 million in government transfers, while most of the remaining \$ 370 million consisted of net capital transfers of the private sector.

It should be noted that in contrast to the \$ 250 million speculative foreign currency transfers of the private sector at the end of the year, which as stated, augmented the reserves, they were run down by a similar amount at the beginning of the year because of an exceptionally steep growth in foreign currency credit through the export funds (in the Diamond Fund to finance speculative stockpiling, and in the Export Shipments Fund due to structural changes in the fund itself). These developments at the beginning and the end of the year offset each other, so that their net effect on the country's international reserves was virtually nil.

The Bank's gross foreign currency asset holdings came to \$ 2,956 million at the end of 1978, compared with \$ 1,783 million the year before — an increase of \$ 1,173 million, which exceeded the growth of net reserves. The difference between the net and gross reserves stemmed from the inclusion of that part of foreign resident deposits which were held at the Bank of Israel as required liquid asset cover, which increased greatly in 1978.

Government Accounts

Bank of Israel credit to the government expanded by IL 7,482 million, compared with IL 11,728 million in 1977, and reached IL 30,290 million. While the increase was smaller in 1978, it does not directly reflect the government's liquidity injection. On the one hand, an item which does not represent the injection of liquidity exerted an expansionary effect on such credit; interest and linkage differentials paid by the government on its debt to the Bank of Israel (totalling IL 8,181 million). On the other hand, two items which do not represent the absorption of liquidity had a contractionary effect on such credit: government transfers of foreign currency mobilized abroad for financing its Israeli currency outlays (about IL 10,500 million) and Bank of Israel profits for 1978 (IL 1,008 million) transferred to the Treasury. After adjusting for these sums, the estimated amount of money put into the economy through the government's activities came

to about IL 10.8 billion in 1978, compared with IL 8.8 billion the year before. (In fiscal 1978/79 the injection amounted to IL 4.3 billion.) To measure the government's influence on aggregate domestic demand, its demand surplus has to be estimated in Israeli currency terms, i.e. including its credit transactions with the public (see Chapter XI).

The additional credit to the government consisted of long-term advances, which was partly offset by a decline in provisional advances. The bulk of the long-term advances were made in March 1978, when IL 12 billion was provided for covering the budget deficit at the end of the previous fiscal year (1977/78). Provisional advances were slashed by IL 5,396 million, pulling down the balance to IL 4,156 million at the end of 1978.

The growth of credit did not trace an even path during the year, since it was influenced not only by the differential pace of issuing the redeeming indexed bonds, but also by the timing of foreign currency transfers from abroad. The fluctuations in the government's injection were more moderate in the first three quarters of 1978, when the figure averaged about IL 1 billion a month; October witnessed a reversal of trend following a sizable issue of bonds to the public, which resulted in a steep decline in credit to the government and the absorption of about IL 2.6 billion. The reason for this large issue was the heavy advanced purchases made on the last day of the month of bonds linked to the current index, in anticipation of the sizable redemption of bonds maturing in November. The same phenomenon occurred on the last day of November in respect of bonds falling due in December, but this time it merely prevented a net injection that month. In December there was again a government injection, amounting to IL 2.8 billion.

The balance of the government's foreign currency assets totalled IL 6,439 million, after rising by IL 4,225 million. This formidable increase stemmed mainly from the foreign currency deposits of government business-type enterprises.

Rediscounts and Loans

This item includes credit granted to banking institutions as loans and against notes, intended primarily to finance the Bank of Israel's share in the export funds. Such credit soared IL 14,996 million, or 83 percent (including revaluation differentials on the foreign currency components due to the devaluation of the IL), to reach IL 33,085 million at the end of 1978. It should be noted that the changes in this balance sheet item reflect only the Bank's participation in the funds. (For details on the growth of total directed and nondirected credit to the public see Chapter XVII.)

The foreign currency component of Bank of Israel credit reached IL 27,354 million (\$ 1,439 million) at the end of 1978, after swelling by IL 13,834 million (\$ 560 million), or 64 percent, during the year. More than half of the increment — \$ 300 million, or 61 percent — was recorded in the fund for financing diamond exports, which stood at \$ 790

TABLE XX-2
BALANCE SHEET OF THE BANK OF ISRAEL, 1978
(IL million)

	Total assets and liabilities				Assets and liabilities in foreign currency or linked to foreign currency (expressed in U.S. dollars)			
	Balance at 31.12.77	Balance at 31.12.78	Increase IL million	%	Balance at 31.12.77	Balance to 31.12.78	Increase IL million	%
Assets								
Claims on the rest of the world	27,435	56,214	28,779	104.9	1,783	2,956	1,173	65.8
Credit to government	22,808 ^a	30,290 ^a	7,482	32.8	455	1,348	893	196.3
Loans and rediscounts								
In foreign currency	13,520	27,354	13,834	102.3	879	1,439	560	63.7
In IL	4,569	5,731	1,162	25.4				
Securities	2,770	5,114	2,344	84.6				
Other accounts	1,384 ^a	2,232 ^a	848	61.3	40	71	31	77.5
Total assets	72,486	126,935	54,449	75.1	3,157	5,814	2,657	84.2
Liabilities								
Banknotes and coin in circulation	6,860	9,747	2,887	42.1				
Liabilities to IMF and international financial institutions	1,632 ^a	2,092 ^a	460	28.2	106	110	4	3.8
Foreign currency deposits of the government and of the National Institutions	2,214	6,439	4,225	190.8	144	339	195	135.4
Foreign currency deposits of banking institutions in Israel	48,908	91,424	42,516	86.9	3,178	4,808	1,630	51.3
Against residents' deposits – restitution	(32,763)	(50,150)	(17,387)	(53.1)	(2,129)	(2,637)	(508)	(23.9)
Against residents' deposits – other	(13,036)	(33,122)	(20,086)	(154.1)	(847)	(1,742)	(895)	(105.7)
Against nonresidents' deposits	(3,109)	(8,152)	(5,043)	(162.2)	(202)	(429)	(227)	(112.4)
Deposits of banking and financial institutions in Israel	9,150	10,716	1,566	17.1				
Other accounts	3,722 ^a	6,517 ^a	2,795	75.1	133	177	44	33.1
Total liabilities	72,486	126,935	54,449	75.1	3,561	5,434	1,873	52.6
Foreign exchange reserves held at the Bank of Israel ^b					1,359	2,242	883	65.0

^a Includes both sums in or linked to foreign currency and unlinked sums.

^b Defined as gold, foreign currency and securities in foreign currency, less foreign currency deposits of banks abroad and foreign currency deposits of banking institutions in Israel against nonresidents' deposits.

million at the end of the year. The growth of such credit outstripped the expansion of sales of polished stones; the lion's share of the increment was used to finance the stockpiling of rough diamonds, whose prices rose precipitately during the year. There was also an exceptionally sharp rise in dollar terms in the Export Shipments Fund, which also expanded faster than overseas sales. In IL terms the increase was IL 160 million, or 70 percent, and it can be ascribed to the following factors: a change in the structure of the fund, with the Bank of Israel's share rising at the expense of that of commercial banks;⁴ the hiking of the financing rate from 75 to 85 percent; and the heavier utilization of the fund following the reduction of the interest rate from 6 to 4 percent (this greatly increased the differential between this rate and that charged on dollar credits from abroad, which rose to over 10 percent during the year. There was also a greatly accelerated rise in dollar terms in the fund for financing imports for export production: \$ 103 million, or 84 percent. This too contributed to the stronger tendency to turn to the foreign currency credit funds following the lowering of the interest charge and the rise in the subsidy element of such finance. It is important to note that part of this extra credit did not play a role in the monetary expansion, since it was not converted to Israeli currency but was placed in foreign currency deposits carrying a high rate of interest in order to realize the hidden subsidy, or was used to pay foreign debts.

The Israeli currency component of Bank of Israel credit grew by IL 1,162 million, or 25 percent, during the year to reach IL 5,731 million. This sluggish rise was the net result of a strong 60 percent increase in export credit, at the expense of a decline in credit for domestic activity. The much larger volume of export credit in 1978 mainly reflects the stepped up participation of the Bank of Israel in the Export Production Fund, the largest fund providing Israeli currency finance for overseas sales. The balance of the Bank's participation in this fund reached IL 3,888 million, a rise of about IL 1,600 million, or 70 percent, compared with 62 percent in the previous year. This notable increase resulted from the adjustment of the rates of financing to the mounting domestic production costs and from a real expansion of exports. There was a more moderate rise in the other Israeli currency export funds – the Citrus and Indirect Exports Funds. As stated, directed credit for financing domestic activity was cut back this year, and firms entitled to receive such finance were compensated by being allowed to cash in their Employers Loans certificates ahead of maturity (see the next section).

Securities

The securities portfolio of the Bank of Israel consists mostly of index-linked government bonds, purchased by the Bank in its capacity as the government's agent for the is-

⁴ This share was reflected not by an increase in credit to the public, but by a structural change in the financing of the fund.

TABLE XX-3

BANKNOTES AND COIN IN CIRCULATION, BY DENOMINATION, 1976-77

End of period	1977		1978	
	IL '000	%	IL '000	%
Banknotes				
IL 5	63,744	1.0	55,362	0.6
IL 10	237,195	3.6	271,952	2.9
IL 50	394,647	5.9	405,151	4.3
IL 100	4,094,418	61.4	3,566,674	37.7
IL 500	1,871,347	28.1	5,163,461	54.5
Total	6,661,351	100.0	9,462,600	100.0
Coin				
1-500 prutot ^a	1,953	1.3	1,953	0.9
1 agora ^b	2,998	2.0	3,069	1.4
5 agorot ^b	8,096	5.3	9,628	4.4
10 agorot ^b	24,254	16.0	33,380	15.2
25 agorot ^b	7,924	5.2	10,147	4.6
IL 1/2 ^c	24,850	16.4	30,707	13.9
IL 1 ^c	81,602	53.8	111,775	50.7
IL 5	—	—	19,656	8.9
Total coin	151,677	100.0	220,315	100.0
Total banknotes and coin	6,813,028		9,682,915	
Commemorative coins	90,775		108,096	
Total coin	6,903,803		9,791,011	
Less: Gold commemorative coins with a gold content equal to or exceeding their face value	43,586		43,586	
Total currency in circulation	6,860,217		9,747,425	

^a Including paper tokens with a denomination of 250 prutot.

^b The agorot series includes mintmarked coins.

^c The IL 1/2 and IL 1 series also include banknotes and mintmarked coins.

suance of these bonds, and to regulate secondary market trade in such paper. In 1978 there were added to the portfolio nontradable bonds (the Employers Loan and various Defense Loans), acquired under the aforementioned arrangement for compensating firms for the reduction of directed credit for domestic market activities. The portfolio also contains treasury bills and Short-Term Loan holdings.

Including revaluation, the Bank's securities portfolio expanded IL 2,344 million in 1978 to stand at IL 5,114 million. This 85 percent advance includes IL 920 million in

linkage differentials and accrued interest on government bonds. Excluding these sums, the portfolio grew by IL 1,424 million, due to the acquisition of IL 975 million of nontradable bonds from firms before maturity date. This represents only about one-sixth of the potential amount employers could have redeemed under this arrangement. The low rate is explained by the worthwhileness of continuing to hold such paper and by the tax concessions applicable to them. As usual, the Bank also acquired government bonds in the secondary market, but the volume was not very large this year, and most of the purchases were made in the first four months; during the rest of the year the trend was mixed.

Banknotes and Coin in Circulation

The balance of banknotes and coin in circulation reached IL 9,747 million at the end of 1978, up IL 2,887 million or 42 percent, compared with 35 percent last year. The more rapid rise in currency this year was consistent with the rate of increase of prices, but stands out relative to the moderate growth of the total money supply (about 36 percent), which lagged behind the rate of inflation. As a result, the proportion of currency in the money supply moved up a notch to 35 percent.

That currency in circulation increased faster than the total money supply is explained by the fact that the acceleration of domestic inflation, which raised the opportunity cost of holding money, influenced IL demand deposits more than it did currency; the latter, which is needed for day-to-day transactions, has no substitutes, whereas the foreign currency reform created substitutes for IL demand deposits in the form of foreign currency demand deposits, which are about as liquid as those in Israeli currency.

In 1978 the number of banknotes in circulation declined from about 86 million at the end of 1977 to 83 million at the end of the year reviewed. This occurred despite the surge of total currency in circulation, and in the main it reflected the growing use of IL 500 notes because of the continuing erosion of the value of money; these notes accounted for 53 percent of total currency at the end of 1978, as against 27 percent at the end of the previous year. Also contributing to the drop in the number of banknotes was the introduction in September 1978 of a IL 5 coin in place of the note of that denomination.

IL Deposits of Banking Institutions

The Israeli currency deposits of banking and financial institutions in the Bank of Israel, which consist mostly of obligatory liquid asset cover, totalled IL 10,716 million at the end of 1978, a rise of IL 1,566 million or 17 percent, compared with 58 percent in 1977. This much slower increase is not indicative of any monetary contraction, for since the foreign currency reform the public has tended to hold part of its liquid balances

TABLE XX-4

**INTEREST RATES PAID BY THE BANK OF ISRAEL ON IL DEPOSITS
OF BANKING AND FINANCIAL INSTITUTIONS**
(percent)

Type of asset	Percent of total deposits of the public				
	Total liquidity requirement	Interest rate steps			
		0%	9%	17%	28%
Ordinary demand deposits	70	15	47.5	7.5	Balance
Time deposits:					
2-3 months	25	9	10	6	Balance
3-4 months	23	8	10	5	Balance
4-5 months	21	7	9	5	Balance
5-6 months	19	6	8	5	Balance
6+ months	17	5	8.5	3.5	Balance
Negotiable certificates of deposit:					
3-6 months	26	8	13	5	Balance
6+ months	20	7	8	5	Balance

in foreign currency accounts, which have shot up rapidly. The slowdown is also explained by the banks' liquidity deficits, which reached sizable dimensions by the end of the year.

The Bank of Israel pays interest on the obligatory deposits at rates varying according to the deposit balance and the liquidity position of the banking institutions. The deposit balance is divided into four interest rate groups, according to the type of deposits in the institution.⁵ Besides the liquidity requirement for the public's deposits, 5 percent cover must be held on total nondirected IL credit, on which the Bank of Israel pays 28 percent interest. In 1978 banks were penalized 10-22 percent for liquidity deficits, with the rate varying with the size of the deficit and its duration. These fines are not recognized as a deductible expense for tax purposes. As a result, their maximum effective rate exceeded 65 percent (including interest forgone because of the nondeposit of the funds with the

⁵ From these obligatory deposits must be deducted the bank's vault cash, various sums connected with the directed credit extended by the bank, and the amount of liquidity exemptions to which it is entitled.

Bank of Israel). At the end of 1978 it was decided to raise the penalty rate in view of the rapid expansion of credit, which had plunged the banks into large liquidity deficits. This change, along with other monetary steps, was implemented at the beginning of 1979, and brought the penalty up to 15–30 percent, or a maximum effective rate of about 100 percent.

Foreign Currency Deposits of Banking Institutions

Banking institution deposits in foreign currency are held at the Bank of Israel as required liquid asset cover against three types of deposits: restitution receipts of Israeli residents (Pazak and Tamam), other (ordinary) resident deposits (Patam), and accounts owned by foreign residents, exporters, and new immigrants (Patach). The balance of these foreign currency accounts reached IL 91,424 million (\$ 4,808 million) by the end of the year, a rise of IL 42,516 million (\$ 1,630 million), or 87 percent (51 percent in dollar terms, compared with 26 percent in 1976 and 1977). The accelerated rise in dollar terms this year was a result of the virtual doubling of Patam and Patach deposits, whereas restitution deposits expanded much more moderately. The expansion of Patam reflected the continued adjustment of the public's assets portfolios in January (a growth of \$ 200 million), as well as the steep jump in the first two weeks of December (about \$ 250 million), when a substantial portion of the foreign currency credit transferred to the country during this period for speculative motives was deposited. These changes reflect the differential liquidity requirements on these deposits: 100 percent for restitution funds, 90 percent for Patam demand deposits, 80 percent for Patam time deposits, and 10–15 percent for Patach deposit (for the development of these components see Chapter XVII).

2. PROFIT AND LOSS ACCOUNT⁶

The Bank's Profit and Its Distribution

The Bank of Israel's profit on ordinary operations amounted to IL 3,477 million this year, compared with IL 2,937 million in 1977. Total profit, i.e. after adjusting for revaluation differentials on foreign currency items due to the devaluation of the IL, came to IL 2,214 million, as against IL 683 million in 1977. The foreign currency valuation adjustments resulted in a net expense of IL 1,263 million this year, compared with IL 2,254 million in 1977. The Bank of Israel has a net liability in German marks (due to the large restitution deposits); this liability appreciated in IL terms proportionally more

⁶ See note 1 on the first page of this chapter.

than the Bank's net assets in U.S. dollars (most of the export credit and part of the foreign currency reserves), since the mark strengthened against the dollar.⁷ Consequently the foreign currency valuation adjustment again resulted in a net expense in IL terms.

It should be emphasized that the revaluation differentials which appear in the Bank of Israel's profit and loss statement did not have a contractionary effect on foreign currency reserves; on the contrary, in foreign currency terms there was a net profit, for the German mark rose faster than the dollar, and a substantial portion of the reserves were invested in marks and other currencies which appreciated against the dollar.

The net profit of the Bank of Israel for 1978, which as usual was transferred to the Treasury, amounted to IL 1,008 million, as opposed to IL 221 million last year. This figure is net of adjustments on account of previous years,⁸ as well as unrealized government income subject to matched timing.⁹

Income

The Bank's total income for the year was IL 28,931, compared with IL 26,631 in 1977. These figures include revaluation differentials on foreign currency assets, stemming from the devaluations of the Israeli pound against various currencies. The Bank's operating income, i.e. excluding revaluation differentials, amounted to IL 8,016 million in 1978, up IL 4,618 million, or 74 percent, from 1977.

The largest income item this year is interest on foreign currency investments abroad, which totalled IL 2,376 million (\$ 136 million), compared with IL 1,243 million (\$ 94 million) in 1977. The rise in dollar terms stemmed from the growth in the average balance of these assets and the rise in interest rates on the international money markets (in particular on dollars).¹⁰

The second largest item is interest on loans and rediscounts in foreign and local currency, which amounted to IL 2,111 million, compared with IL 1,360 million in 1977.

⁷ In 1978 the Israeli pound was devalued by 42.1 percent against the German mark, and by only 23.5 percent against the dollar.

⁸ A deduction of IL 298 million in 1978. No adjustments were made in 1977.

⁹ This income, which amounted to IL 908 million in 1978 and IL 462 million in 1977, originated in the linkage differentials and accrued interest on government bonds which had not yet been redeemed or paid in each of the years. Under the matched timing method of recording, they are not included in the net profit of the Bank of Israel transferred to the government that year.

¹⁰ These sums do not include \$ 164 million of income from exchange rate differentials on foreign currency balances, but it is reflected in the exchange rate differentials credited to this item.

This year's growth was due to increase in the annual average balance of such credit, and not to the raising of the interest charge; the interest rate was in fact lowered on some types of foreign currency export credit.

Income from interest on the government's debt rose from IL 1,089 million in 1977 to IL 1,723 million, chiefly as a result of the increase in the government's long-term liabilities in March, 1978. (This figure does not include revaluation differentials on the government's long-term debt linked to a basket of currencies).

This year also witnessed a rapid growth in income from the Bank of Israel's securities portfolio, from IL 795 million in 1977 to IL 1,477 million. These figures include linkage differentials and accrued interest on unredeemed government bonds. There was also a striking increase in fines received for shortfalls in required liquid asset cover. This income, which jumped from IL 53 million to IL 325 million, reflects the rise in the average level of the liquidity deficits during 1978.

Expenditures

The Bank's expenses in 1978 totalled IL 26,717 million, as against IL 25,948 million last year. There was a decline in revaluation differentials on foreign currency liabilities (from IL 24,267 million in 1977 to IL 22,178 million) and a steep rise in operating expenses. The decrease in revaluation differentials on foreign currency liabilities (the major part of which constitutes the banks' required liquidity against foreign currency deposits of the public) took place despite the substantial rise in this item in dollar terms, and is explained by the fact that the devaluation of the Israeli pound against the various currencies was lower this year than in 1977. These differentials are actually indexation increments which the Bank pays on part of the public's foreign currency deposits re-deposited with it as liquid asset cover.

The Bank's operating expenses, i.e. excluding revaluation differentials, consist for the most part of interest payments on the banks' obligatory deposits with the Bank of Israel in foreign and local currency. The steep rise in these outlays, from IL 1,681 million in 1977 to IL 4,539 million this year, mainly reflects the substantial growth of the Bank's interest payments on obligatory liquidity deposits in foreign currency, from IL 567 million last year to IL 2,527 million in 1978. This development is attributable to the rise in dollar interest rates and, even more so, to the bulging of local resident deposits (Patam) and foreign resident deposits (Patah). Interest on these accounts is paid solely by the Bank of Israel, whereas the government participates in interest payments on restitution deposits.

Interest payments on IL banking institution deposits with the Bank of Israel reached IL 915 million, compared with IL 636 million in 1977; this was consistent with the

moderate growth of these deposits in 1978. There was a sharp rise in interest expenditure on the government's foreign currency deposits, which expanded greatly during the year.

3. DIRECTED BANK OF ISRAEL CREDIT¹¹

The granting of directed credit is the responsibility of the Credit Control Department of the Bank of Israel, which is assisted by committees comprising representatives of the various government ministries. The credit is granted primarily to meet the working capital requirements of export enterprises, and is financed by joint funds of the Bank of Israel and the commercial banks. Directed export credit is extended partly in Israeli currency, at 12 percent interest, and partly in foreign currency (in the Diamond Fund the interest is 6 percent and in most of the other funds 4 percent). Credit from the working capital funds is given in Israeli currency at 25 percent interest, and is intended chiefly for the industrial and agricultural sectors (except for the Employers Loan Fund, credit from which is linked to the c-o-l index). For the sake of comparison it should be noted that in 1978 the market interest rate was about 11 percent on dollars and 40 percent or more on Israeli currency.

In 1978 further steps were taken to increase directed credit for the export sector and to reduce that for financing domestic activity (see below). The low interest rate charged on directed credit is made possible by the low interest collected by the Bank of Israel on its participation in the various funds. For the Bank's share in financing directed credit (a breakdown of the funds' sources of financing and their interest rates), see Table XX-4.

The total amount of directed credit in Israeli and foreign currency provided by the export and working capital funds came to IL 36,393 million at the end of 1978, compared with IL 21,612 million at the end of 1977 – a growth of IL 14,781 million, or 68 percent. The amount supplied for export (in foreign and Israeli currency) was IL 34,186 million at the end of this year – up 83 percent. By contrast, credit for domestic activity fell by 24 percent to IL 2,207 million, due to the policy of restricting it in favor of an increase in export credit.

The Export Funds

The export funds finance all stages of export: production through the Export Production Fund (in Israeli currency); the import of inputs through the Import-for-Export Fund

¹¹ The data on directed credit in this section differ somewhat from those in Chapter XVII of this report, because these figures are based on the weekly liquidity statement for the last Wednesday of each month, whereas in Chapter XVII they are based on the reports for the last day of each month.

TABLE XX-5
STRUCTURE AND TERMS OF DIRECTED CREDIT FUNDS, 1977-78
 (percent)

	Sources of funds in 1976				Sources of funds in 1977			
	Commercial banks	Bank of Israel		Interest rate in 1978	Commercial banks	Bank of Israel		Interest rate in 1977
		Liquidity exemptions	Rediscounts or loans			Liquidity exemptions	Rediscounts or loans	
Export funds in foreign currency								
Imports for export production	15.0	-	85.0	4.0	10.0	-	90.0	4.0
Regular export shipments	15.0	-	85.0	4.0	10.0	-	90.0	4.0
Special export shipment	15.0	-	85.0	9.0	10.0	-	90.0	9.0
Diamonds	-	-	100.0	6.0	-	-	100.0	8.0
Export funds in IL								
Export production	15.0	20.0	65.0	12.0	10.0	25.0	65.0	12.0
Citrus	15.0	20.0	65.0	12.0	10.0	25.0	65.0	12.0
Indirect exports	15.0	20.0	65.0	20.0	10.0	25.0	65.0	20.0
Working capital funds in IL								
Industry and crafts	40.0	10.0	50.0	24.0	40.0	10.0	50.0	24.0
Agriculture	40.0	10.0	50.0	24.0	40.0	60.0	-	25.0
Supervised farm credit	40.0	60.0	-	25.0	40.0	-	60.0	28.0
Assistance to agricultural settlements	-	-	-	-	40.0	10.0	50.0	24.0
Assistance to industrial enterprises ^a	40.0	-	-	28.0	40.0	-	-	28.0
General fund	40.0	10.0	50.0	24.0	40.0	10.0	50.0	24.0

^a Government deposit - 60 percent.

(in foreign currency); and shipments through the Export Shipments Fund (in foreign currency). In addition to these, there are two branch cofunds: the Diamond Fund (in foreign currency), and the Citrus Fund (in Israeli currency). There is also an Indirect Export Fund, which assists enterprises supplying intermediates for export production. Occasionally credit is granted outside the funds for special transactions requiring long-term financing.

The balance of directed export credit, which amounted to about IL 34,186 million at the end of 1978, consists of IL 7,282 million in Israeli currency and IL 26,904 million (\$ 1,415 million) in foreign currency, of which IL 14,805 million (\$ 780 million) is in the Diamond Fund.

Directed IL export credit increased 59 percent during the year (65 percent on an annual average). There was a steep rise in the Export Production Fund (73 percent during the year and 82 percent as a yearly average), in contrast to a slow rise in the Citrus Fund and zero growth in the Indirect Exports Fund. This brought up the weight of the Export Production Fund in such financing to more than 80 percent by the end of the year. The reasons for its rapid expansion were the 45 percent adjustment of the rate of financing provided by this fund, to bring it in line with the annual average increase in export costs (from IL 9.18 to IL 13.28 to the dollar), and the growth of exports in dollar terms.

The growth of directed export foreign currency credit, in dollar terms, amounted to 54 percent during the year (58 percent on an annual average). This reflects the steep rise in the Diamond Fund and Export Production Fund, while the Export Shipments Fund experienced a relatively moderate growth.

The rapid growth of the Diamond Fund (57 percent in December levels and 75 percent on an annual average) stands out in comparison with the restrained growth, in dollar terms, of diamond imports and exports. This is explained by the larger volume of credit this year for financing diamond inventories, which rose substantially, chiefly as a result of the rapid price rise in this branch during the year, and, to a smaller extent, a real increase in diamond stocks in terms of carats.

The growth of foreign currency export credit, excluding diamonds, amounted to 50 percent during the year (39 percent on an annual average). As stated, this reflects the steep jump in the Imports-for-Export Fund (84 percent during the year, 94 percent on an annual average), while the Export Shipments Fund rose only moderately in dollar terms. The formidable expansion of the former fund was largely influenced by the increase this year in the subsidy element of such credit due to the cut in the interest rate from 6 to 4 percent and the rise in the dollar interest rate on the world money markets. This brought up the utilization rate of this fund from 80 percent in 1977 to 96 percent. In the Export Shipments Fund the rate of increase only slightly exceeded the export growth

TABLE XX-6

DIRECTED EXPORT CREDIT, 1977-78
(IL million)

	1977		1978		Percent increase	
	End-of-year balance	Average balance	End-of-year balance	Average balance	End-of-year balance	Average balance
In Israeli currency						
Export production	3,471	2,706	6,007	4,924	73.1	82.0
Citrus	715	495	930	570	30.1	15.2
Indirect exports	396	309	345	313	-12.9	1.3
Total	4,582	3,510	7,282	5,807	58.9	65.4
In foreign currency						
Imports for export production	2,011	1,078	4,588	3,468	128.1	221.7
Export shipments (incl. banks' participation)	4,179	2,546	7,088	5,194	69.6	104.0
Diamonds	7,634	4,301	14,805	12,527	93.9	191.3
Special arrangements outside the funds	307	274	423	325	37.8	18.6
Total	14,131	8,199	26,904	21,514	90.4	162.4
In dollar terms	(919)	(779)	(1,415)	(1,231)	(54.0)	(58.0)
Total credit from export funds	18,718	11,709	34,186	27,321	82.7	133.3

rate in dollar terms. In other words, despite the rise in the subsidy element, there was no exceptional increase in the utilization rate.

Working Capital Funds for Domestic Production

In 1978 the credit balance in the working capital funds for domestic production declined, in accordance with the policy of the government and the Bank of Israel to restrict subsidized credit for domestic activity and divert it to the export sector. Most of the decline took place in the working capital funds for industry, agriculture, and transportation, while supervised agricultural credit and the General Fund showed a slight nominal rise (but declined in real terms). There was a precipitous drop in the long-term funds set up after the Yom Kippur War for financing the import of trucks and equipment, which are presently being liquidated. The Employers Loan Fund also shrank this year. To compensate for the reduction of directed credit for domestic uses, the Bank of Israel began to implement the arrangement for the purchase ahead of maturity of Employers Loan certificates from industrial and agricultural enterprises which had been eligible for directed credit. This arrangement is intended to bolster the liquidity situation of these enterprises by enabling them to cash in their linked nonnegotiable loan holdings so as to increase their working capital, while abolishing subsidized credit for domestic production. In 1978 the Bank of Israel broadened the scope of this arrangement to also include hotels, public transportation companies, and building contractors. The total amount of loan certificates purchased by the Bank of Israel under this arrangement in 1978 came to IL 975 million (see section e above).

In September, 1978 a new fund was established in cooperation with the Ministry of Agriculture to assist agricultural settlements encountering liquidity problems. The balance of loans provided reached IL 170 million by the end of the year.

4. ADMINISTRATION OF STATE LOANS

Issue and Redemption of Noncompulsory Government Securities¹²

In 1978 the Bank of Israel issued IL 12.2 billion of linked government bonds to the public and institutional investors, compared with some IL 2 billion in each of the two preceding years. Most of the growth in gross issues stemmed from the heavier demand of the public due to the large volume of bonds redemptions (see the discussion below).

¹²The data in this section reflect the operations of the State Loans Administration but do not include issues by other financial institutions. These amounted to IL 20.8 billion in 1978, compared with IL 15.2 billion in 1977. The overall issue amounts appear in the analysis of the bond market in Chapter XIX.

TABLE XX-7
 DIRECTED CREDIT FOR DOMESTIC PRODUCTION, 1977-78
 (IL million)

	1977		1978		Percent increase	
	End-of-year balance	Average balance	End-of-year balance	Average balance	End-of-year balance	Average balance
1. Credit from working capital funds	2,502	2,148	1,899	2,282	-24.1	6.2
Industry and crafts	727	595	432	617	-40.6	3.7
Agriculture	435	501	284	392	-34.7	-21.8
Assistance to agricultural settlements	—	—	170	40
Supervised farm credit	246	220	289	280	17.5	27.3
General fund	77	65	82	86	6.5	32.3
Assistance to industrial enterprises	248	113	217	247	-12.5	118.6
Assistance to transport enterprises	41	36	10	24	-75.6	-33.3
Employers Loan Fund ^a	728	618	415	596	-43.0	-3.6
2. Emergency credit	262	305	162	212	-38.2	-30.7
Trucks	158	194	85	122	-46.2	-37.1
Vehicle and equipment imports	104	112	77	90	-26.0	-19.6
3. Credit from outside the funds	135	162	146	161	8.1	-0.6
Liquidity exemptions	13	37	12	11	-7.7	-70.3
Rediscounts in IL	122	125	134	150	9.8	20.0
4. Total directed credit for domestic production (1+2+3)	2,899	2,616	2,207	2,655	-23.9	1.5

^a Excludes linkage differentials.

The improvement and diversification of bond and savings scheme terms, the publicity aimed at making the public aware that bonds with an 80 percent linkage to the index also bear a real positive return, and the Bank of Israel's efforts to ensure a steady sale of original issues by stabilizing bond prices and returns in the secondary market all helped to stimulate demand for linked bonds. This must be viewed in conjunction with the expectations of a worsening of inflation, which became stronger especially in the second half of the year.

The increased sale of linked government bonds directly to the public brought up its weight in Bank of Israel issues, from 38 percent in 1977 to 77 percent this year (IL 9.4 billion), with the weight of institutional investors (bank savings schemes, social insurance funds, and insurance companies) declining to 23 percent (IL 2.8 billion). It also increased the proportion of government bonds in total gross issues of linked bonds, from 12 percent in 1977 to 37 percent, since the public tends to purchase linked government bonds issued by the Bank of Israel. By contrast, there was a decline in the share of bonds issued by other financial institutions, which are purchased by affiliated institutional investors. Contributing to this development was the policy of not permitting other financial institutions to issue bonds directly to the public in 1978, as well as the obligation imposed on banks to purchase government bonds of the type offered to the public at a specified rate as part of the cover for their new savings schemes. This brought the institutional investors back into the linked bond market, from which they had withdrawn in 1975, and should help to regulate and stabilize trade in bonds on the secondary market (see below).

In February, 1978 the terms of bonds offered to the public were improved and diversified: the interest on bonds linked 80 percent to the index was raised to 7 percent gross (with the option of redemption after either five or ten years), while the issue was begun of bonds offering either full linkage to the dollar or 80 percent linkage to the index and carrying 5 percent interest (redeemable after six or ten years). At first the public preferred the option bonds, but during the year, and particularly in the latter part, this tendency weakened for index-linked bonds were yielding a higher return: the consumer price index rose much faster than the rate of the devaluation of the Israeli pound against the dollar, and the net interest on bonds linked solely to the index is 1.3 percent higher. The relative advantage of option bonds was therefore almost wiped out, so that the public's purchases of linked bonds issued by the Bank of Israel (especially toward the end of the year) consisted mostly of those with 80 percent linkage. These accounted for 88 percent (IL 8.3 billion) of all purchases, compared with 12 percent (IL 1.1 billion) for the double-option bonds.

Purchases by banks to cover savings schemes increased dramatically this year, due to the requirements to place a certain percentage of the cover in the same type of bonds

TABLE XX-8

STATE LOAN ISSUES AND REDEMPTIONS, 1977-78^a
(IL million)

	Interest rate			1977				1978			
				Gross issues	Redemption of principal	Interest and linkage increments	Net issue (1-2-3)	Gross issues	Redemption of principal	Interest and linkage increments	Net issue (1-2-3)
				(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
A. Medium- and long-term											
1. To the public and to savings schemes											
For 10 years, 80% index linkage	7.0	6.0, 4.0	701	-	1	700	8,302	-	23	8,279	
For 10 years, 90% index linkage	4.0		12	-	63	-51	-	-	91	-91	
For 10 years, full linkage to index	4.0		-	-	196	-196	-	-	294	-294	
For 10 years, double linkage option	5.0		-	-	-	-	2,349	-	-	2,349	
For 6 years, full linkage to dollar	5.5		-	-	-	-	49	-	-	49	
For 8 years, 70% linkage to dollar	6.0		50	-	-	50	-	-	5	-5	
For 5 years, option	4.84		-	504	2,143	-2,647	-	1,441	7,942	-9,383	
For 7 years, full linkage to index	6.5	3.25	-	-	186	-186	-	-	276	-276	
Absorption loan	4.0		-	38	195	-233	-	30	252	-282	
Other ^b	-		-	5	5	-10	6	2	34	-30	
Total state loans	-		2,034	624	3,371	-1,961	12,223	1,555	9,874	794	

2. For savings schemes										
For 6 years, linked option for savings schemes	4.25	299	—	—	299	186	—	—	186	
For 6 years, dollar option for savings schemes	5.0	—	—	—	—	32	—	—	32	
3. For financial institutions										
For 17, 20 years, for social insurance funds	6.5, 5.0	235	10	129	96	390	9	212	169	
Insurance companies loans	6.2, 5.8, 9.2	737	19	264	454	909	23	448	438	
7½% bank Defense Loan	7.5	—	48	189	-237	—	50	297	-347	
B. Short-Term Loan ^c		710	696	35	-21	500	572	54	-126	
C. Compulsory loans (redemption only)										
Defense Loan 1970-73		—	36	169	-205	—	30	199	-229	
Savings Loan 1970-72		—	522	1,477	-1,999	—	457	1,754	-2,211	
War Loan 1973-74 ^d		—	35	58	-93	—	54	111	-165	
Cost-of-Living Allowance Loan		—	—	—	—	—	1	1	-2	
Total compulsory loans		—	593	1,704	-2,297	—	542	2,065	-2,607	

a The data in this table were provided by the State Loans Administration; they do not coincide with the data appearing in the economic analysis of the bond market in Chapter XIX.

b Includes unlinked and other loans.

c Includes sales and redemptions by the Bank of Israel.

d Includes payments on account of voluntary war loans.

as are offered to the public. They acquired IL 1.3 billion worth of double-option bonds (20 percent of the accumulation in the dollar-option schemes), and IL 200 million worth of index-linked bonds (13 percent of the accumulation in the new scheme launched in December, 1978).

Besides bank purchases to cover savings schemes, financial institutions purchased IL 1.3 billion of government bonds from the Bank of Israel this year, of which some IL 900 million were against insurance company deposits and IL 400 million for social insurance and advanced study funds.

Total redemptions of noncompulsory state loans grew substantially in 1978 to reach IL 1.6 billion face value, which is equivalent to IL 11.5 billion in redemption value;¹³ this compares with IL 700 million and IL 4 billion, respectively in 1977.

Net capital mobilization from noncompulsory bonds issued by the Bank of Israel (gross sales less redemptions at market value and interest payments) totalled IL 800 million in 1978, compared with a negative figure of IL 2 billion in 1977. For the first time since 1975 gross issues exceeded redemptions and interest payments.

The balance of the Short-Term Loan held by the public tumbled from IL 82 million at the end of 1977 to IL 11 million at the end of the year reviewed. The fading attraction of this paper is explained by the fact that the gross interest rate (only 22 percent) fell far short of the rate of inflation, and especially the fact that the foreign currency liberalization opened up to the public a wide array of investment options (in foreign currency and featuring c-o-l indexation). In view of this situation the Bank of Israel suspended the sale of the loan to the public in March, 1979.

Distribution and Redemption of Compulsory Loans

The value of compulsory loan certificates – the Savings, Defense, War, and Cost-of-Living Loans – distributed in 1978 came to IL 837 million, as against IL 2,426 million in 1977. The steep drop was due to the fact that this year the distribution was begun of the 1974 Compulsory Savings Loan, which only employers were obligated to acquire, whereas in preceding years compulsory loan certificates were distributed to the general public. This year the distribution was continued of Defense and Savings Loan certificates for 1970–73, War Loan certificates (compulsory and voluntary) for 1970–73, and Cost-of-Living Loan certificates. In 1978, 738,000 compulsory certificates were mailed to recipients, compared with 1,607,000 in 1977.

The Bank of Israel stepped up its efforts to locate those whose certificates were returned because of an unreported change of address. About 162,000 certificates were

¹³ The difference reflects linkage differentials, interest, and linkage on accrued interest.

remained, compared with some 52,000 in 1977. In 1978, 330,000 certificates were returned, as against 407,000 in 1977.

Redemption of the last third of the 1972 Employers' Savings Loan and the second third of the 1973 Employers' Savings Loan began in August, 1978. Total redemptions of savings loans for 1970–73 amounted to IL 451 million face value in 1978, equivalent to IL 2,195 million redemption value (including accrued interest and linkage differentials), compared with IL 522 million and IL 2 billion, respectively, in 1977. In other words, there was a decline in redemptions in terms of face value but a large growth in redemption value. The first interest coupon of the 1971 Defense Loan came due for repayment in October, 1978; by the end of the year 465,000 coupons had been cashed in, for a total of IL 69 million.

Defense and War Loan certificates may be redeemed ahead of maturity in the case of the elderly or the death of the registered owners. Such redemptions amounted in 1978 to IL 65 million face value, or IL 323 million redemption value, compared with IL 68 million and IL 292 million respectively in 1977. The Bank of Israel began to pay 22 percent interest on compulsory loans, including the Absorption Loan redeemed after maturity date; this expenditure amounted to IL 16 million in 1978.

Under the arrangements for the early redemption of nonnegotiable Employers Loan certificates to compensate for the reduction of subsidized credit for domestic purposes, Bank of Israel in 1978 redeemed certificates with a total face value of IL 412 million (about IL 1 billion redemption value), of which some IL 396 million was in place of working capital credits and IL 16 million in place of conversions of development loans (IL 894 million and IL 81 million redemption value, respectively).

Bank of Israel Open-Market Operations

The Bank of Israel functions in the bond market as the agent of the government to regulate trade in government bonds and to promote sales of original issues, taking into account the prevailing monetary situation. The principal object of the Bank's activity is to prevent sharp fluctuations in bond prices during secondary market slumps and, insofar as possible, to reduce the differential between the secondary market return and the yield on newly issued bonds, without changing the market trend.

The Bank of Israel's operations in the bond market took on added significance in 1978. In view of the substantial redemptions, the Bank intensified its efforts to motivate the public to reinvest these funds in government bonds. It improved the terms of bonds offered to the public, since the worsening of the terms over the past three years apparently made the public shy away from this financial asset, as reflected in its failure to reinvest the proceeds in such paper.

TABLE XX-9

BANK OF ISRAEL OPEN-MARKET OPERATIONS, 1978
(IL million)

	Net purchase (-sale) on the Stock Exchange							Total transactions	Percent of total Stock Exchange trade
	Index-linked				Double option	Dollar-linked	Total		
	80%	90%	100%	Others					
1978	118	113	-219	-23	104	4	97	1,793	13
January	5	28	56	9	0	0	98	156	13
February	8	25	26	16	0	1	76	115	12
March	17	51	43	9	2	-3	119	173	17
April	5	19	69	2	7	2	104	131	13
May	2	8	3	-2	5	0	16	87	10
June	13	19	27	-2	10	1	68	143	16
July	8	-2	-47	-8	9	3	-37	137	13
August	5	-6	-84	-10	18	-1	-78	156	14
September	3	-2	-50	-5	19	0	-35	119	10
October	-8	-18	-65	-9	2	0	-98	112	11
November	-11	-6	-112	-14	4	1	-138	178	13
December	71	-3	-85	-9	28	0	2	286	13

During the first half of 1978, the Bank of Israel purchased IL 415 million worth of bonds (net) on the Stock Exchange in order to moderate the decline in the price of index-linked bonds, and to narrow the gap between the Stock Exchange returns and those on new bond issues. In the second half of the year, after the resurgence of demand for index-linked bonds, the Bank of Israel sold IL 318 million worth of bonds (net) on the Exchange. The total volume of the Bank's transactions (purchases and sales) in government bonds amounted to IL 1,780 million in 1978, up 70 percent from the previous year. The bulk of this sum (IL 1,080 million or 61 percent) was in fully index-linked bonds, IL 540 million (30 percent) was in partially index-linked bonds, while only 9 percent (IL 170 million) was in double-option and dollar-linked bonds. The Bank accounted for 13 percent of total bond market trade, compared with 7 percent in 1977 — a reflection of its much heavier intervention this year.

The Bank's Short-Term Loan transactions on the Stock Exchange dropped from IL 110 million in 1977 to IL 74 million; this accompanied the decline in the public's holdings of such paper.

Safekeeping of Domestic Loans and Servicing the Public

The Bank of Israel accepts for safekeeping the securities of insurance companies, banking institutions, the Accountant General, the Stock Exchange Clearinghouse, various companies, and individuals requesting the registered bonds they have purchased. The management of the accounts includes the deposit and withdrawal of bonds and calculation of interest payments, principal redemption, and linkage increments.

The Stock Exchange Clearinghouse account is the largest and most active of these accounts: the daily turnover runs into hundreds and sometimes thousands of bonds. In 1978 about 250,000 bonds were withdrawn from this account, compared with 180,000 in 1977. Insurance companies are legally required to deposit bonds or cash with the Accountant General; the Bank of Israel administers about 100 such accounts. It also administers 44 series of bonds issued by Tefahot Israel Mortgage Bank.

The Bank of Israel enables the general public to redeem bonds and to cash in interest coupons of the various State loans at its branches in the three largest cities, in addition to redemption at commercial banks. In 1978 about 68,000 persons presented around 225,000 bonds and coupons at the Bank of Israel's windows. Approximately 80,000 persons applied for clarification of details concerning compulsory loans; some 31,000 of the applications were in writing. For the convenience of the public the Bank began to operate a computerized system this year which enables any individual or company to immediately receive a list of its compulsory loan holdings and all relevant details.

Foreign Loans

The Bank of Israel handles the conversion and redemption of the Independence and Development Loans (Israel Bonds). The Bonds, which are sold abroad, can be converted (ahead of maturity) and redeemed in Israel by institutions, investors, tourists, new immigrants, and returning Israeli residents, under the conditions determined by the Controller of Foreign Exchange. In 1978 conversions and redemptions in Israel reached \$ 132 million (\$ 120 million principal and \$ 12 million interest); this compares with \$ 108 million (\$ 100 million principal and \$ 8 million interest) in 1977. In current IL prices, conversions amounted to IL 2,313 million in 1978, 94 percent more than in the previous year. The weight of conversions in Israel in total foreign loan redemptions rose to over 50 percent this year.

A breakdown of conversions by holder shows an increase for tourists, immigrants, and returning residents, who converted \$ 45 million worth of Bonds in 1978 (34 percent of total conversions), compared with \$ 29 million (27 percent) in 1977. The share of institutions and investors dropped from 73 percent in 1977 to 66 percent. The quarterly percentage breakdown for 1978 was similar to that the year before.

5. SUPERVISION OF BANKING AND FINANCIAL INSTITUTIONS

Institutions Subject to Supervision

The trends which characterized the development of institutions subject to supervision in 1977 carried over through the year reviewed: the amalgamation of smaller banking institutions with large banking concerns, and the development and stabilization of small institutions specializing in a specific field in which they enjoy a relative advantage.

Bank Branches

At the end of 1978 there were 995 branches of commercial banks and cooperative credit societies operating in Israel (including head offices) and 22 agencies. During the year 20 new branches were opened in Israel and four in the Arab sector. The number of agencies declined by two. The number of branches in Judea, Samaria, and the Gaza Strip rose to 28 this year, following the opening of two branches in Jewish settlements in these areas.

Israeli Banking Activity Abroad

The expansion of Israeli banking business abroad, which characterized 1977, became more pronounced in 1978; in addition to the growth in the number of branches, their contribution to the consolidated balance sheets of the banking concerns increased greatly.

TABLE XX-10

**BANKING AND FINANCIAL INSTITUTIONS UNDER BANK OF ISRAEL
SUPERVISION, 1976-78**

End of year	1976	1977	1978
Commercial banks ^a	20	21	25
Cooperative credit societies	6	5	3
Mortgage banks	16	16	16
Investment banks ^b	7	10	9
Financial institutions	13	12	10
Total	62	64	63

^a Excludes four inactive banks, and the Israel Bank of Agriculture, which is defined as a commercial bank but deals mostly in investments; includes the Maritime Bank, which is defined as an investment bank but operates mainly as an ordinary banking institution.

^b Includes the Israel Bank of Agriculture but not the Maritime Bank.

Two of the reasons for this expansion are the desire of Israeli banks to penetrate additional markets and to serve Jewish communities overseas, and the buoyant demand of Israeli residents for foreign currency since the liberalization. The opening of bank branches abroad was made possible to a certain extent by legislative changes in the host countries.

In 1978 six new branches of Israeli banks were opened, and one subsidiary was established. The balance sheets of the overseas branches amounted to about \$ 7 billion at the end of 1978, up more than 40 percent from the end of 1977.

Audits

The teams of examiners specializing in various aspects of banking — foreign currency, credit, liabilities, administration and reporting, securities and savings schemes — extended their audits to additional subjects which had not been treated in previous years.

Audits of Specialized Banking Institutions

A new system of reporting for investment banks, better suited to the nature of their activity, was completed in 1978. The regulations concerning the preparation of annual

financial statements of such institutions also went into effect, and they thereupon began to report according to the accrual method.

In the financial institutions the emphasis was placed on protecting the public with respect to withdrawals from secondary education savings schemes consequent upon the introduction of free secondary schooling.

Institutional Integration

This unit prepared a number of evaluation reports on commercial banks and their branches overseas.

Research

In addition to the preparation of the Annual Survey of the Banking System, memoranda on various banking matters, and current surveys, the research unit dealt with the following:

1. the cost to Israeli firms of overdraft facilities;
2. commissions and interest on demand deposits;
3. the concentration of Israel's commercial banking system and an international comparison;
4. a description of administrative expenditure for the Israeli banking system;
5. multinational banking: the Israeli experience.

Information and Statistics

This year the unit undertook a new project, the publishing of a statistical annual, which will appear for the first time in 1979 and contain statistical data on the banking system for the years 1974-78. The unit assumed responsibility for the reports of the Foreign Exchange Control Department, which was transferred from the Ministry of Finance to the Bank of Israel. Alongside the reports received from banks on their balances, the Department of the Examiner of Banks is planning to introduce the reporting of movements and balances analyzed by maturity dates. New reports were introduced for interest rates on deposits of the public (weekly) and interbank foreign currency deposits opened (monthly), analyzed by the deposit period and the interest rate. In addition, the unit compiled samples of effective interest rates on overdraft accounts (non-directed credit).

Complaints of the Public

During 1978, 1,151 complaints against banking institutions were received from the public, compared with 887 in the previous year, a growth of some 30 percent. The in-

crease is partly explained by the expansion of banking activity, and partly by the growing consciousness of the public concerning such matters. One of the subjects dealt with by the Examiner of Banks was the bouncing of checks because of insufficient funds.

Interbank Clearinghouse

Despite the increased use of checks encoded with magnetic ink at the end of 1978, some checks were still not encoded, and this caused problems because of the need to sort them by hand. The Clearinghouse Committee therefore decided to take steps to halt the presentation of nonencoded checks for normal clearing.

In 1978 the total value of documents (checks, notes, and debit advices, excluding credit advices) which passed through the clearinghouses reached IL 626,975 million, compared with IL 402,876 million in 1977 – a growth of 55.6 percent, as against 71.3 percent in 1977. During the year 88 million checks were presented, compared with 71 million in 1977 (a 24 percent rise), while 4.8 million checks were returned (about 5 percent of the number presented), as against 4.7 million checks in 1977 (around 7 percent).

Advisory Committee on Matters Relating to Banking Business

The committee discussed the following subjects: checks without coverage, exemption from liquidity for doubtful debts, orders for new securities issued to the public, clearing of checks deposited in banks on Fridays, minimum commercial liquidity on a daily basis, the proposed banking law (licensing), semi-annual financial report of commercial banks, the principal developments in the banking system during 1977, arrangements for providing services to customers' employees; distribution of certain preferred dividends by investment banks; instructions for the preparation of yearly financial statement by investment banks; and changes in the instructions for the preparation of yearly financial statements by commercial banks and mortgage banks. (The members of the committee are listed at the end of this chapter.)

6. ISSUE OF CURRENCY AND COMMEMORATIVE COINS AND MEDALS

Trade Coins

On September 21, 1978 the Bank of Israel issued a new IL 5 trade coin, composed 75 percent of copper and 25 percent nickel. It will gradually replace the IL 5 banknote, which bears the portrait of Henrietta Szold. The obverse features a lion, taken from the seal of "Shema, servant of Jeroboam" found in the excavations at Megiddo in 1904. The coin weighs 11.2 grams and its diameter is 30 millimeters.

TABLE XX-11

COINS MINTED IN 1977-78

Coin	In Israel	In Canada	Total
1 agorot	8,864,000	—	8,864,000
5 agorot	21,480,000	38,716,000	60,196,000
10 agorot	24,050,000	104,335,750	128,385,750
25 agorot	12,200,000	—	12,200,000
IL 1/2	14,325,000	—	14,325,000
IL 1	25,361,000	36,391,000	61,752,000
IL 5	8,350,000	—	8,350,000
Total	114,630,000	179,442,750	294,072,750

Commemorative and Special Coins

In 1978 the commemorative Independence Day coin marking the thirtieth anniversary of the State featured the theme "The Unity of the People and Its Land". The coin was minted in silver (B.U. and proof) and gold. The coin has a face value of IL 1,000; is made of gold and copper (900/100), weighs 12 grams, and has a 25 mm. diameter. The silver coin has a face value of IL 50, is made of silver and copper (500/500), weighs 12 grams, and has a diameter of 25 mm. The rim of the B.U. silver coin bears the inscription "30 Years of the State of Israel" in Hebrew. The edges of the silver proof coin and the gold coin are milled.

In 1978 the Bank issued another in the series of Hanukka coins. It has a face value of IL 25 and its composition is 75 percent copper and 25 percent nickel; it weighs 15 grams and has a 34 mm. diameter. Its theme is a fourteenth century French Hanukka lamp. The coin was issued in two forms: B.U. with a smooth edge, and proof with a milled edge.

As in the past, the Bank issued a special mint set (bearing the Hebrew date 5738) identical to the trade coins in circulation but with a mintmark in the form of a tiny Star of David. All six denominations at the time — 1, 5, 10, and 25 agorot, and IL ½ and IL 1 — were issued in this series of 57,200 unit per denomination.

Committee for the Planning of Banknotes and Coins

This committee assists the Bank in planning the banknotes, trade and commemorative coins, and medals to be issued, and recommends to the Governor of the Bank the designs

TABLE XX-12

COMMEMORATIVE COINS ISSUED BY THE BANK OF ISRAEL,
1977/78-1978/79

Coin	Brilliant uncirculated	Proof	Gold	Total
1978 Independence Day, IL 50				
Total	40,500	22,000	12,100	74,600
Minted in Jerusalem	40,500	—	—	40,500
Minted in Switzerland		22,000	12,100	34,100
Hanukka coin (14 th century French Hanukka lamp) IL 25				
Total	36,200	—	—	58,500
Minted in Jerusalem	36,200	—	—	36,200
Minted in Canada	—	22,300	—	22,300

it has approved from among those submitted by competing artists. (The members of this committee are listed at the end of the chapter.)

7. THE BANK OF ISRAEL AS REPRESENTATIVE OF THE STATE
IN INTERNATIONAL FINANCIAL INSTITUTIONS

The Bank of Israel, in coordination with the Ministry of Finance, handles the current contacts with international economic institutions: the International Monetary Fund, which deals with the global problems of the international monetary system, and the World Bank group,¹⁴ which helps developing countries to strengthen their economies. The Bank of Israel also represents the State in the Inter-American Development Bank, which promotes investments in Latin America.

International Monetary Fund

Israel's contacts with the International Monetary Fund (IMF) were concentrated in three areas this year. The first was the international monetary system and the steps taken

¹⁴The International Bank for Reconstruction and Development (the World Bank), the International Development Association, and the International Finance Corporation.

by the IMF in this arena. In April, 1978 the second amendment to the IMF Articles of Agreement, which Israel had signed in 1977, was approved. Under the amendment all member states are committed to closely cooperate with the IMF in everything associated with exchange rate policies, with the aim of reestablishing a system of stable exchange rates in place of the fixed exchange rate system, which collapsed in 1971. The amendment abolished the official price of gold, with the intention of progressively abolishing its role in the monetary system, and confirmed the right of each state to choose for itself whatever exchange rate it wanted, until the establishment of a new unified system. In accordance with this, the IMF is selling off during the period 1976–80 one third of its gold holdings (50 million ounces), half by means of public tenders at market prices,¹⁵ and half by means of sales to all member-states, at the official price. Israel has twice purchased gold from the IMF: in January, 1978 and 1979, each time about 28,000 ounces, for a total of about one million Special Drawing Rights,¹⁶ (at the official price of 35 SDRs per ounce). As a complementary step to the demonetization of gold in the international monetary system, the amended Articles obligate the IMF and all member-states to work to strengthen the position of the SDR among the principal reserve assets while improving the terms for holding them. The interest rate on this asset was thus raised from 60 to 80 percent of the average market rate, and its permissible uses were broadened to include the settlement of accounts, of granting loans, and as collateral. The IMF also announced a new allocation of SDRs, in the amount of 12 billion, to be divided in three annual instalments beginning in January, 1979.

The second area of contact was the consultations between all member countries and the IMF on matters of economic policy, and the Fund's closer monitoring of developments in their exchange rate policy. Israel's annual consultations with the Fund were held in March, 1979, when a Fund mission visited the country. They met with leading economic figures and held technical discussions with Bank of Israel and Ministry of Finance officials in order to prepare a comprehensive survey on the aforementioned subjects for discussion by the Fund's board of directors.

The third area of contact is IMF aid to member-states. In February, 1978 the Fund considered Israel's request for utilizing IMF resources should her balance of payments situation deteriorate in the wake of the foreign currency reform of October, 1977. Israel had to submit specific economic plans, as is customarily required when applying

¹⁵ The difference arising from sales at the actual price and the market price is transferred to the Trust Fund, which grants special assistance to the poorest developing nations.

¹⁶ The value of a Special Drawing Right, which is based on a basket of 16 major currencies, was equal to \$ 1.25 in 1978.

for such assistance. Since the fear of a worsening of the balance of payments faded, the matter was dropped. In August, 1978 an IMF delegation visited Israel for clarifications and discussions concerning a request for a compensatory financing facility (CFF). This fund provides assistance to countries whose export proceeds have dropped below the long-run trend. Upon the recommendation of the delegation, the IMF board of directors approved a loan to Israel in the amount of about 72 million SDRs, which was received in September 1978. In this context it should be noted that the member-states became eligible for greater IMF assistance in April, 1978 as a result of the ratification of the sixth quota increase: the quotas of all the countries were raised from 29 to 39 billion SDRs and that for Israel from 130 to 205 million SDRs.

During 1978 Israel's debt repayments to the Fund amounted to about 44 million SDRs, bringing its total liabilities at the end of the year to 480 million SDRs; of this amount, approximately 132 million were on account of the Oil facility, 137 million were owing to the CFF, and 35 million represented the balance of the reserve and credit tranches. The remaining liabilities (about 172 million SDRs) constituted Israel's quota in Israeli pounds; this is not an actual debt, but under certain circumstances the IMF may request Israel to convert part of the sum into other currencies for the purpose of providing assistance to other countries.

The World Bank and Affiliated Institutions

1. World Bank (IBRD)

This institution plans and finances development projects (from its own and from external resources) in developing countries, and concentrates in those areas in which these countries are lacking in technical skills and available resources. The subscriptions actually paid by the member countries are relatively small, amounting to \$ 3.2 billion by the end of 1978 and representing only 10 percent of the \$ 32 billion total share capital. (The \$ 29 billion difference constitutes capital "on call", to be called only in cases of liquidity difficulties, including bankruptcy.) But thanks to its sizable financial leverage, the World Bank is capable of supervising a large number of projects (about 1,400 in 1978). The scope of its activities, which far exceeds its equity capital, reached some \$ 50 billion in 1978.

In February, 1976 the board of directors of the World Bank decided to increase its capital; scheduled to be completed in 1979, this will expand its capital stock to about \$ 40 billion. The quota allocated to Israel should raise her share capital to about \$ 210 million (the actual payment involved amounts to only 10 percent of this sum, of which \$ 6 million is in Israeli currency and about \$ 680,000 in foreign currency).

For a number of years the World Bank has been deleting those developing nations with a high per capita income from the list of countries eligible for its aid, on the grounds

of limited resources; Israel is one of the countries stricken off the list. In 1978 Israel continued to utilize the loans approved in earlier years; in 1978 this came to about \$ 17 million, bringing up the total to \$ 234 million, out of the \$ 284 million (approved). The \$ 50 million balance not yet utilized includes projects for the development of highways (about \$ 13 million) and sewerage (around \$ 16 million), and the provision of investment credit through the Industrial Development Bank (approximately \$ 21 million).

2. International Development Association (IDA)

This affiliated institution performs the same functions as the World Bank but grants loans on easier terms and only to the poorest nations. At this stage the fourth and the fifth replenishments are being made by member-states, which will increase the IDA's capital from about \$ 7 billion to \$ 17 billion.

Until the last two replenishments (in 1975), Israel's contribution to the Association's resources was approximately \$ 2.1 million; this can now be increased to \$ 2.5 million. It will be recalled that in 1973 the government of Israel decided to contribute five equal annual instalments of IL 840,000 each to the fourth replenishment; the last instalment was paid in November, 1978.

3. International Finance Corporation (IFC)

This World Bank affiliate assists private enterprises by providing loans and participating in their share capital in cases where the availability of private capital on reasonable terms is limited.

The IFC, whose operations amounted to about a billion dollars in 1978, has also decided upon a substantial increase in capital, which in 1979 is scheduled to bring the total up from the present figure of \$ 110 million to \$ 650 million. The additional quota for Israel has been set at about \$ 3.2 million, to be paid over four years (in addition to her present participation of \$ 50,000).

Inter-American Development Bank (IDB)

This institution finances the development of the socio-economic infrastructure of the Latin American countries. In 1978 it granted some \$ 2 billion in loans and grants to help finance projects costing more than \$ 3.4 billion.

In July 1976 Israel was accepted as a nonregional member of the IDB; today there are 15 such members. Israel undertook to purchase \$ 5 million of shares in the bank, of this, \$ 820,000 was to be actually paid in and some \$ 5 million was to be contributed to the fund for special activities. Under the agreement with the bank, in 1976 Israel began to pay her share in the bank's capital in five equal yearly payments. Israel's membership in

the IDB confers on Israeli firms the right to participate in tenders for the execution of projects on the American continent, which are financed by IDB loans.

8. FOREIGN CURRENCY CONTROL

In September, 1978 the control of foreign currency was transferred from the Ministry of Finance to the Bank of Israel, after it was recognized that this function ought to be performed within the framework of monetary policy. The Minister of Finance appointed a senior Bank of Israel official as Controller of Foreign Exchange.

It was agreed that the Bank of Israel would exercise such control as part of the government's economic policy, and that the Bank would coordinate its efforts with the Ministry of Finance; for this purpose a joint committee was set up. It was also agreed that matters of principle, or those with broad public importance would remain within the purview of the Minister of Finance, while other permits and instructions to authorized dealers would be issued by the Controller of Foreign Exchange. The police will be charged with uncovering violators of the currency control regulations.

In the initial stage after the transfer the Controller of Foreign Exchange concentrated on improving the information system – which is based on the reports of the banks, authorized traders, the government, and other agencies – as well as on requests for specific permits not covered under the blanket permit, and on implementation of the restrictions in foreign currency credit.

9. ECONOMIC RESEARCH

As usual, the Bank's Annual Report includes much of the current research on the Israeli economy conducted by the Research Department. Among the additional studies published during 1978 were the following:

1. *Recent Economic Developments*, No. 26 and No. 27.
2. The Governor's report on the increase in the money supply for the period 31.10.77 to 31.3.78.
3. The Governor's report on the increase in the money supply for the period 31.3.78 to 29.9.78.
4. Periodic internal surveys on monetary developments.
5. *Economic Indicators* – a weekly publication with a restricted circulation.
6. *National Budget for 1979*, prepared in cooperation with the Ministry of Finance and presented to the Knesset together with the State budget.

In addition to current research, the Department carried out a number of basic studies of specific subjects, of which the following were published:

1. *An Econometric Model of the Israeli Economy.*
2. *Israel's Capital Stock, 1960-77.*
3. *Economic Review*, No. 48-49, which includes the following studies:
 - a. Israel's External Debt Burden.
 - b. A Lost Decade of Growth? Economic Policy Since 1973.
 - c. The New Economic Policy and Protection Levels in Industrial Import Substitutes and Exports.
 - d. The Effect of Inflation on Stock Yields, 1965-74.
4. *Economic Review*, No. 50, which includes the following:
 - a. Motorized Transportation Infrastructure Costs.
 - b. Private Consumption Prices by Main Components, 1964-77.
 - c. A Real Examination of Security Prices in Calculating the Return and Risk Under Uncertainty Regarding the Inflation Rate (a note).
5. Research Department economists published the following studies in *Israel Economic Papers 1977*:
 - a. The Effectiveness of Price Control and Wage Restraint in Israel.
 - b. Policy Measures and Their Influence on Exports and the Real Exchange Rate.
 - c. Aggregate Private Consumption Function.

Studies by Bank of Israel economists which will be published in the 1979 edition of the above publication are as follows:

- a. Expected Effects of a Change in the Exchange Rate and Uncertainty on the Balance of Payments.
- b. Components of Inflation in a Real Demand and Inflation Model.
- c. The Level of Demands and Their Impact on the Inflation Rate in Israel, 1961-78.
- d. A Wage Equation for the Israeli Economy.
- e. Growth of Transfer Payments to Households, 1970-78.
- f. A Wage Function for Jewish Male Labor in Israel, 1968/69-1975/76.
- g. An Econometric Predictive Model for the Housing Construction Industry in Israel.

The following studies have also been completed but not yet published:

- a. The Economy of the Administered Areas in 1976 and 1977.
- b. The Financing of Industrial Companies Under Government Intervention: The Israeli Case, 1950-72.

BALANCE SHEET AS AT DECEMBER 31, 1978

and

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING DECEMBER 31, 1978

BANK OF
BALANCE SHEET AS
(IL

Assets

	Notes ^a	Dec. 31, 1978	Dec. 31, 1977
Foreign assets			
Gold, foreign exchange, and foreign securities	2	50,934	24,173
Other foreign currency assets		5,280	3,262
		56,214	27,435
Government debt			
Long-term debt	3	26,134	13,256
Provisional advances		4,156	9,552 ^b
		30,290	22,808
Loans and rediscounts			
In foreign currency		27,354	13,520
In IL		5,731	4,569
		33,085	18,089
Securities			
Marketable	4	3,900	2,741
Nonmarketable		1,214	29
		5,114	2,770
Participation in international financial institutions	5	257	215 ^b
Other accounts	6	1,975	1,169 ^b
		126,935	72,486

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

^b Reclassified.

ISRAEL

AT DECEMBER 31, 1978

(million)

Liabilities

	Notes	Dec. 31, 1978	Dec. 31, 1977
Banknotes and coins in circulation	7	9,747	6,860
Allocations of Special Drawing Rights	8	1,062	801
Foreign liabilities			
Liability to the IMF	9	1,852	1,440
Liability to international financial institutions		240	192
Foreign currency deposits of banks abroad		146	151
		2,238	1,783
Foreign currency deposits of the Government and National Institutions		6,439	2,214 ^b
Foreign currency deposits of banking institutions in Israel			
Against residents' deposits – restitution		50,150	32,763
Against residents' deposits – other		33,122	13,036
Against nonresidents' deposits		8,152	3,109
		91,424	48,908
Deposits of banking and financial institutions in Israel		10,716	9,150
Other deposits	10	1,298	1,071 ^b
Other accounts	11	3,991	1,679
Capital and general reserve		20	20
		126,935	72,486

PROFIT AND LOSS STATEMENT FOR THE YEAR ENDING DECEMBER 31, 1978
(IL million)

	Notes ^a	1978		1977 ^c	
		Income/expenses excl. exchange rate and devaluation differentials	Exchange rate and devaluation differentials ^b	Total	Total
Income					
Interest, exchange rate and devaluation differentials					
From investments abroad		2,376	9,947	12,323	13,710
From the government		1,723	6,458	8,181	6,087
From loans and rediscounts		2,111	4,421	6,532	5,872
Income from securities	15	1,477		1,477	795
Interest from banking institutions o/a liquidity deficiencies		325		325	53
Other income		4	89	93	114
Total income		8,016	20,915	28,931	26,631
Expenses					
Interest, exchange rate and devaluation differentials					
On foreign currency deposits of banking institutions in Israel	16	2,527	20,552	23,079	22,793
On IL deposits of banking and financial institutions in Israel		915		915	636
On foreign currency deposits of the government and National Institutions		329	921	1,250	857
On other deposits and liabilities		210	705	915	1,372
Administrative and general expenses ^d	15	379		379	197
Cost of printing banknotes and minting coins		151		151	73
Other expenses		28		28	20
Total expenses		4,539	22,178	26,717	25,948
Excess of income over expenses, before adjustment o/a previous years		3,477	-1,263	2,214	683
Less: Adjustments o/a previous years	13	298		298	
Excess of income over expenses		3,179	-1,263	1,916	
Less: Income from the government subject to matched timing	15 1a	908		908	462
Net profit		2,271	-1,263	1,008	221
Profit transferred to the government				1,008	221

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

^b Differentials deriving from the adjustment of assets and liabilities in or linked to foreign currency for changes in the exchange rate of the IL.

^c The comparative figures for 1977 have been reclassified and include exchange rate and devaluation differentials; see note 14.

^d For 1978 includes IL 71 million provision for employee pensions and severance pay; no provision was made in 1977.

NOTES TO THE FINANCIAL STATEMENTS

1. Main Accounting Policies

A. METHOD OF RECORDING AND PRESENTATION

Income and expenses are recorded on an accrual basis. Income from the government is recorded on an accrual basis, but is included in the net income of the Bank on a matched timing basis (i.e. matching the dating of entries in mutual accounts). The Bank includes in its net income for the financial year the sums charged to the government only when they are budgeted and paid by the government in the fiscal year ending the following March 31. Income receivable from the government after March 31 of the following year is shown in the Profit and Loss Statement as "Income from the government subject to matched timing" and is included in the Balance Sheet in "Other accounts" (liabilities).

Accrued interest and other income are included in "Other accounts" (assets), except for accrued interest and linkage differentials on domestic securities, which are included in the Balance Sheet in "Securities". Accrued interest and other expenses are included in "Other accounts" (liabilities).

B. FOREIGN CURRENCY ACCOUNTS

Assets and liabilities in foreign currency are converted into IL terms at the representative rates published by the Bank of Israel. The rate for the U.S. dollar on December 31, 1978 was IL 19.0151 and on December 31, 1977 – IL 15.3883.

Special Drawing Rights (SDR) are converted to IL on the basis of the SDR – U.S. dollar rate, i.e. IL 24.8094 per SDR on December 31, 1978 and IL 18.7051 on December 31, 1977.

C. GOLD

Gold is valued at the rate of SDR 35 per fine ounce.

D. FOREIGN SECURITIES

These are stated at their foreign currency cost (average weighted purchase price) or market value, whichever is lower – calculated separately for each type of security.

E. SECURITIES DENOMINATED IN IL

These are stated as follows:

Marketable bonds – at the adjusted value (nominal value plus accrued interest and linkage differentials) or market value, whichever is lower – calculated separately for each type of bond.

Treasury bills – at cost plus accrued interest.

Nonnegotiable bonds – at the adjusted value (nominal value plus accrued interest and linkage differentials).

Linkage differentials – (consumer price index) according to the last consumer price index published before the Balance Sheet date.

F. PARTICIPATION IN INTERNATIONAL FINANCIAL INSTITUTIONS

The participation is stated at cost, which is determined as follows:

For the part paid in foreign currency – the amounts are converted into IL at the exchange rate prevailing at the time of payment.

For the part paid in IL or still due – at the original amounts plus the increment required (in respect of the majority of this part) to maintain the value of the participation in foreign currency; see note 5.

G. PREMISES AND EQUIPMENT

Bank premises and equipment (included in "Other accounts") are recorded at cost net of accumulated depreciation. Depreciation is calculated (according to the straight-line method) at the following annual rates:

Premises – 1.5%; 2%

Equipment – 10%; 20%

In previous years investments in premises and equipment were charged to expenses in the year the investments were made; see note 13.

H. PENSIONS, SEVERANCE PAY, AND VACATION FOR EMPLOYEES

In 1978 provision for employees' pensions, severance pay, and vacations was included in liabilities ("Other accounts"). In previous years this was charged to expenses when payment was actually made; see note 13.

The provision for pensions and severance pay was determined on the basis of actuarial estimates for December 31, 1978 and December 31, 1977.

Domestic securities in an amount equal to such provision have been earmarked against the liability on account of pensions and severance pay. Income from these securities is carried in the Profit and Loss Statement against the increase in the liability on account of pensions and severance pay.

2. Gold, Foreign exchange, and foreign securities

This item includes IL 521 million in holdings of Special Drawing Rights in the International Monetary Fund (on December 31, 1977: IL 415 million).

3. Government debt

The long-term debt consists mainly of (a) IL 25,004 million linked to the basket of foreign currencies, bearing unlinked interest of 5 percent per annum and repayable over the years 1983–2002 (on December 31, 1977: IL 13,004 million, linked to 50% of the rise in the exchange rate of the U.S. dollar); interest and linkage differentials are payable on December 31 of each year. (b) U.S. \$ 33 million (on December 31, 1977 this debt was included in "Provisional advances").

4. Securities

Marketable securities consist of: (a) IL 3,671 million of government bonds, mostly linked to the consumer price index; the cost of these bonds is IL 2,100 million, and their market value IL 4,126 million (on December 31, 1977: IL 2,534 million, IL 1,678 million, and IL 2,709 million, respectively). (b) IL 229 million in treasury bills (on December 31, 1977: IL 207 million).

Non-marketable securities include IL 1,197 million of compulsory government loan certificates purchased from the public in accordance with the Government Loans "Sundry Provisions" Law, 5738–1977; the cost of these bonds is IL 975 million.

Securities in the amount of IL 591 million were earmarked against the liability on account of pensions and severance pay for employees; see note 1(h).

5. Participation in international financial institutions

These institutions are the International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Finance Corporation (IFC), and Inter-American Development Bank (IDB).

This item consists of: (a) IL 228 million paid in IL or still due; (b) IL 29 million paid in foreign currency (on December 31, 1977: IL 186 million and IL 29 million, respectively).

With respect to the major portion of the participation paid or due in IL the Bank of Israel is committed to maintain the foreign currency value of its participation; consequently the figure has been adjusted for changes in the exchange rate of the IL.

6. Other accounts (assets)

This item consists mainly of: (a) IL 1,563 million in interest and other income receivable, of which IL 998 million is in foreign currency (on December 31, 1977: 1,001 million and IL 385 million, respectively). (b) IL 202 million outstanding liability of the Israel-British Bank Ltd. (in liquidation) in respect of payments guaranteed by the Bank of Israel (on December 31, 1977: IL 123 million); this sum is net of provision for doubtful debts. (c) IL 161 million in premises and equipment, net of accumulated depreciation.

7. Banknotes and coins in circulation

The figure in the Balance Sheet includes commemorative and special coins with a nominal value of IL 66 million (on December 31, 1977: IL 49 million), but does not include gold commemorative coins, with a nominal value of IL 44 million, whose gold content exceeds their nominal value (on December 31, 1977: IL 44 million).

8. Allocations of Special Drawing Rights

This represents 43 million SDR allocated to Israel by the International Monetary Fund.

9. Liability to the IMF

This item reflects the total liability to the IMF – IL 6,938 million (on December 31, 1977: IL 3,872 million), net of Israel's quota in the Fund in the amount of IL 5,086 million (on December 31, 1977: IL 2,432 million).

Total liabilities break down as follows (December 31):

	IL million		SDR million	
	1978	1977	1978	1977
Drawings on credit tranche	1,852	1,440	75	77
Drawing on reserve tranche	1,271	608	51	33
Balance of quota due	3,815	1,824	154	97
Total	6,938	3,872	280	207

In 1978 Israel's quota in the IMF was increased from 130 million to 205 million SDR.

10. Other deposits

This item consists of a IL 252 million deposit of the U.S.-Israel Binational Science Fund (on December 31, 1977: IL 252 million) and two deposits of the U.S.-Israel Binational Industrial Research and Development Fund, in the sum of IL 250 million (on December 31, 1977: IL 250 million) and \$ 33 million (on December 31, 1977: \$ 33 million).

11. Other accounts (liabilities)

The main subitems are: (a) Interest and other expenses payable – IL 1,617 million, of which IL 1,379 is in foreign currency (on December 31, 1977: IL 811 million and IL 525 million, respectively); (b) Income from the government subject to matched timing (see note 1A) – IL 1,737 million (on December 31, 1977: IL 829 million); and (c) Provision for pensions and severance pay – IL 591 million.

12. Contingent liabilities

The contingent liabilities are as follows: (a) Uncalled amounts of shares and participations subscribed to international financial institutions – IL 2,287 million (on December 31, 1977: IL 1,851 million); (b) Documentary credits – IL 502 million (on December 31, 1977: IL 471 million); (c) Other liabilities – IL 283 million (on December 31, 1977: IL 196 million).

13. Accounting changes

In 1978 the accounting treatment of investments in premises and equipment (see note 1G) and liability for pensions, severance pay and vacations of employees was revised (note 1H). As a result of these changes the net profit for 1978 was reduced by IL 445 million, of which IL 298 million relates to prior years (this sum is presented in the Profit and Loss Statement as "Adjustments o/a previous years").

14. Income and expenses for 1977

The comparative data in the 1977 Profit and Loss Statement have been reclassified and include exchange rate and devaluation differentials. The reclassified figures are presented below (in IL million):

	Income/expense excl. exchange rate and devaluation differentials	Exchange rate and devaluation differentials	Total
Income			
Interest, exchange rate and devaluation differentials			
From investments abroad	1,243	12,467	13,710
From the government	1,089	4,998	6,087
From loans and rediscounts	1,360	4,512	5,872
Income from securities	795		795
Interest from banking institutions o/a liquidity deficiencies	53		53
Other income	78	36	114
Total income	4,618	22,013	26,631
Expenses			
Interest, exchange rate and devaluation differentials			
On foreign currency deposits of banking institutions in Israel	567	22,226	22,793
On IL deposits of banking and financial institutions in Israel	636		636
On foreign currency deposits of the government and National Institutions	55	802	857
On other deposits and liabilities	133	1,239	1,372
Administrative and general expenses	197		197
Cost of printing banknotes and minting coins	73		73
Other expenses	20		20
Total expenses	1,681	24,267	25,948
Excess of income over expenses	2,937	-2,254	683
Less: income from the govern- ment subject to matched timing	462		462
Net profit	2,475	-2,254	221

15. Income from securities

This includes IL 908 million income from securities subject to matched timing (in 1977: IL 462 million); this is deducted from "Income less expenses" – see note 1A.

This item does not include income for 1978 in the amount of IL 181 million from securities held against the liability on account of pensions and severance pay. This sum partly covered the increase in the above mentioned liability (see note 1H).

16. Interest on foreign currency deposits of banking institutions in Israel

This item does not include IL 1,688 million interest on restitution deposits covered by the government (in 1977: IL 942 million).

BANK OF ISRAEL

THE GOVERNOR, DEPUTY GOVERNORS, AND MEMBERS OF THE
ADVISORY COMMITTEE AND ADVISORY COUNCIL
31 MAY 1979

Governor

A. GAFNY

Deputy Governors

E. SHEFFER

Z. SUSSMAN

Advisory Committee

D. HOROWITZ, *Honorary Chairman**
M. MOSEVICS, *Chairman*
Y. BADER, *Vice-Chairman*
CH. M. BASOK
E. I. JAPHET
J. LEVINSON
B. NAHIR
D. RECANATI
E. REINER
Z. SUSAYEFF

Advisory Council

M. MOSEVICS, *Chairman*
Y. BADER, *Vice-Chairman*
M. BANCOVER
CH. M. BASOK
A. BEN-YAKAR
N. FEINGOLD
M. GOLDBERG
E. IZAKSON
E. I. JAPHET
I. KARGMAN
J. LEVINSON
A. MEIR
I. MITELMAN
B. NAHIR
J. NEEMAN
D. RECANATI
E. REINER
Z. SUSAYEFF
B. VINIZKI

* Died in August 1979

MEMBERS OF THE COMMITTEE FOR THE PLANNING
OF BANKNOTES AND COINS

A. WITKON, *Chairman*
M. ARAD
J. BEN-ARIEH
A. BIRAN
R. DAYAN
D. GAD
D. GENACHOWSKI
N. KARP
G. KEICH
A. KINDLER
G. LEHRMAN
F. NAKHLA
E. NAVI
D. REISINGER
S. ROSENFELD
G. ZIFRONI
J. ZIM

MEMBERS OF THE ADVISORY COMMITTEE ON
MATTERS RELATING TO BANKING BUSINESS

O. MESSER, *Chairman*
D. BAWLY
D. BEN-DROR
C. BERMAN
M. DIGA
D. GOLAN
H. HAFT
A. HALPERIN
E. I. JAPHET
E. A. KIRSHNER
J. LEVINSON
Y. MACHT
S. MAGRISO
M. MANN
A. MEIR
M. OLENIK
D. RECANATI
D. SHOHAM
A. SIVAN