

## CHAPTER VI

### CAPITAL IMPORTS AND THE FOREIGN DEBT

#### 1. MAIN DEVELOPMENTS

Medium- and long-term capital imports<sup>1</sup> were, at \$3.5 billion, roughly the same as in 1978. But given the rise in world prices during the year, the level actually declined in real terms. In fact, for the first time in three years it was insufficient to finance the sharply higher current account deficit, and so the economy had to resort to short-term capital imports to cover the balance. Despite the exacerbation of the deficit financing problem, the country's foreign exchange reserves continued to expand, and various indicators even point to an alleviation of the debt servicing burden. The financing problem was reflected by a shortening of the debt maturity schedule, which implies a rolling over of part of the current repayment burden to 1980.

In recent years U.S. government aid has fluctuated widely. This year such assistance shrank by about \$200 million, following an approximately \$500 million decline in defense imports; as a result, military grants fell appreciably, but this was partly offset by a small percentage increase in loans. The sizable growth of loans from this source over the past few years has placed the U.S. at the top of Israel's list of creditors, with a debt balance totaling some \$5.4 billion by the end of 1979.

The inflow of capital from Jewish sources, including the transfer of proceeds from the United Jewish Appeal and the sale of Israel Bonds, declined in 1979, while personal restitution receipts held steady in real terms. Investments from abroad shrank considerably, but medium- and long-term loans were moderately higher this year. Israeli investments abroad and transfer payments, which are capital export items, expanded strongly in 1979 to reach a level unmatched in any year before the foreign currency liberalization.

The private sector's basic deficit<sup>2</sup> swelled to unprecedented proportions, totaling \$1.2 billion by the end of 1979, compared with \$286 million a year before and \$250

<sup>1</sup> In this chapter total capital imports relate to unilateral transfers and medium- and long-term capital flows; they do not include short-term capital movements.

<sup>2</sup> The current account deficit of the private sector, minus its medium- and long-term capital imports.

Table

**FINANCING OF THE CURRENT**  
(\$)

	1976	1977	1978	1979
<b>A. Current account and long-term capital movements</b>				
Balance on current account	-3,200	-2,563	-3,349	-3,757
Thereof: Defense imports <sup>a</sup>	-1,555	-1,084	-1,612	-1,150
Unilateral transfers	2,210	2,082	2,400	2,281
Balance on current account and transfers	-990	-481	-949	-1,476
<b>Long-term capital movements</b>				
Investments from abroad, net	58	100	90	55
Independence and Development Loans	163	174	156	115
U.S. government loans	652	405	778	854
Other loans	174	-36	156	192
Total long-term capital movements	1,047	643	1,180	1,216
Total capital imports (including transfers)	3,257	2,725	3,580	3,497
Surplus of capital imports over deficit	57	162	231	-260
<b>B. Israeli investments abroad</b>	-12	-9	-108	-158
<b>C. Short-term credit, net (from the nonfinancial sector)</b>	3	-345	-170	496
<b>D. Financial sector</b>				
Foreign bank deposits	248	596	1,324	1,447
With Bank of Israel	5		-3	18
With commercial banks	243	596	1,327	1,429
Commercial banks loans to foreigners	64	93	110	-365
Bank of Israel loans	-171	13	-63	240
IMF loans	89	—	-14	-84
Subtotal	-18	106	33	-209
Foreign exchange reserves				
Change in reserves	-317	-979	-1,838	-974
Central monetary authorities	-174	-307	-1,013	-452
Other monetary institutions	-143	-672	-825	-522
Foreign currency valuation adjustments	53	127	209	59
Total change in reserves due to economic transactions	-264	-852	-1,629	-915
Total, financial sector	-34	-150	-272	323
<b>E. Allocation of Special Drawing Rights</b>	—	—	—	27
<b>F. Errors and omissions</b>	-14	343	321	-427

<sup>a</sup> F.o.b.

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ACCOUNT DEFICIT, 1976-79  
(million)

1978				1979			
I	II	III	IV	I	II	III	IV
-841	-841	-1,049	-618	-920	-801	-1,097	-939
-470	-371	-497	-274	-269	-320	-266	-295
571	588	611	630	718	556	419	588
-270	-253	-438	12	-202	-245	-678	-351
19	16	30	25	11	10	18	16
58	33	16	49	29	29	20	37
236	166	164	212	311	245	44	254
-10	75	-21	112	37	4	57	94
303	290	189	398	388	288	139	401
874	878	800	1,028	1,106	844	558	989
33	37	-249	410	186	43	-539	50
0	-18	-44	-46	-44	-57	-31	-26
-115	-113	65	-7	147	14	200	135
-391	368	325	1,022	140	479	50	778
-1	10	-11	-1	8	-8	—	18
-390	358	336	1,023	132	487	50	760
112	-6	29	-25	26	-17	-68	-306
103	20	-31	-155	-100	23	107	210
-33	-28	70	-23	-30	-11	-22	-21
182	-14	68	-203	-104	-5	17	-117
92	-177	-468	-1,284	-453	-150	194	-565
-210	36	-141	-697	-591	233	-12	-82
302	-213	-327	-587	138	-383	206	-483
62	-19	127	39	-56	-1	117	-1
154	-196	-341	-1,245	-509	-151	311	-566
-55	158	52	-426	-473	323	378	95
—	—	—	—	27	—	—	—
137	-63	176	71	158	-323	-7	-255

million at the end of 1977. Short-term credit from the nonfinancial sector also grew substantially this year, but still failed to cover all of the basic deficit. The private sector therefore had to purchase more foreign currency from the Bank of Israel in 1979 and even to borrow heavily from commercial banks.

The Bank of Israel's international reserves expanded by \$328 million during the year to stand at \$2.6 billion. At the same time the foreign debt rose by a formidable \$2.1 billion to hit the \$15 billion mark. This was accompanied by a noticeable worsening of the maturity schedule, with an exception increase in the amount of principal due for repayment of renewal in 1980. It should be noted, however, that a large percentage of the debt will be virtually automatically renewed. Principal and interest payments in 1979 totaled \$1.7 billion, up fractionally from the previous year's \$1.6 billion. These payments exerted less pressure on the economy's resources this year thanks to the expansion of output, the much larger short-term capital inflow, and the increase in the prices of the country's imports and exports on world markets.

At the beginning of the year \$27 million of Special Drawing Rights were allocated to Israel by the International Monetary Fund.

## 2. BACKGROUND TO CAPITAL IMPORT DEVELOPMENTS

Although medium- and long-term capital imports were unchanged in 1979, their composition changed somewhat. The amount going to the public sector fell moderately, while that to the private sector rose to about the same extent. The breakdown of each of the sectors' inflows also underwent a change this year. All unilateral transfer items of the private sector went up, with the total increase being 17 percent, while medium- and long-term foreign loans contracted. The opposite took place in the public sector: unilateral transfers fell at about the same rate as they expanded in the private sector, while foreign loans surpassed the 1978 figure.

The weight of the public sector's capital imports, which are influenced by non-economic considerations, declined slightly but still constituted some two-thirds of the total volume. U.S. government aid, which is related to the import of certain products to Israel, accounted for most of the inflow. With the drop in defense imports this year, U.S. military assistance sagged, but that for civilian purposes increased. The grant component of U.S. government aid was down sharply, while loans rose modestly. Capital imports from Jewish sources shrank for the fourth consecutive year, although to a relatively minor degree this time.

After expanding 26 percent in 1978, capital imports by the private sector rose only 6 percent this year to total \$1.2 billion. In this sector capital imports are largely influenced by economic considerations, and a number of factors apparently combined to keep down their growth.

On the one hand the foreign currency liberalization introduced at the end of 1977 has made it easier for foreigners and nonresidents to carry out transactions with Israeli residents, and on the other hand it has enabled the private sector to add to its portfolio a wider variety of assets linked to foreign currencies. The impact of liberalization can be clearly seen in two of the country's capital export items: Israeli investments abroad and Israeli transfer payments, both of which have shot up in the postliberalization period.<sup>3</sup>

In the course of the year a number of factors that tend to moderate the flow of capital to the economy grew stronger. These were the arresting of economic growth in the second half of the year and mounting expectations that policy steps were in the offing which would further slow economic activity, the softening of the real estate and housing markets, and the drop in real yields on domestic securities while those in foreign markets were moving up. In addition, the government took a series of steps which drove up the price of some foreign currency credits, which were already more expensive as a result of rising interest rates abroad.

Foreign investments in Israel as well as medium- and long-term loans to the private sector shrank appreciably in 1979. This is mainly explained by the aforementioned largely endogenous developments. In contrast, unilateral transfers to the private sector were higher this year; in part this was related to factors external to the Israeli economy, such as the relative strengthening of the German mark and the rise in the cost of living in that country, which resulted in a larger inflow of restitution receipts, and the sizable immigration from Iran, which increased immigrant transfers.

### 3. UNILATERAL TRANSFERS

Unilateral transfer receipts fell by about \$120 million from last year's level and covered only some 60 percent of the current account deficit, well below the long-term annual average of approximately 75 percent. On the face of it, the relative decline in such receipts, one of the most convenient forms of financing, was an undesirable development for the economy. However, an examination of the component items reveals a brighter picture than first meets the eye. Total transfers fell to \$2.3 billion following a sizable shrinkage of U.S. government grants, but private sector transfers were higher this year, in line with the trend evident since the liberalization of foreign currency control at the end of 1977.

U.S. government aid is subject to sharp year-to-year fluctuations, which appear even sharper when each of the components—grants and loans—is considered separately. The drastic drop in this year's grant total must be seen against the

<sup>3</sup> Before the foreign currency liberalization the official data on Israeli investments and transfers abroad were presumably biased downward.

**Table VI-2**  
**CAPITAL IMPORTS BY SOURCE AND SECTOR, 1976-79**  
(\$ million)

	1976	1977	1978	1979	1978				1979				
					I	II	III	IV	I	II	III	IV	
<b>Private sector</b>													
Unilateral transfers <sup>a</sup>	683.2	810.8	907.7	1,058.3	221.4	206.1	239.8	240.4	264.7	258.0	263.3	272.3	
Investments from abroad, net	57.8	100.1	89.6	55.3	18.7	16.4	29.7	24.8	10.9	10.6	18.0	15.8	
Net long-term loans	119.0	10.0	168.0	118.0	-25.0	109.0	5.0	79.0	31.0	18.0	8.0	61.0	
Total	<b>860.0</b>	<b>920.9</b>	<b>1,165.3</b>	<b>1,231.6</b>	<b>215.1</b>	<b>331.5</b>	<b>274.5</b>	<b>344.2</b>	<b>306.6</b>	<b>286.6</b>	<b>239.3</b>	<b>349.1</b>	
<b>Public sector</b>													
Unilateral transfers	1,526.6	1,271.2	1,493.8	1,224.4	350.3	382.0	371.1	390.4	454.3	298.5	156.6	315.0	
Long-term loans, net	869.3	533.5	921.5	1,044.0	309.3	164.4	153.7	294.1	346.8	259.7	113.6	323.9	
Total	<b>2,395.9</b>	<b>1,804.7</b>	<b>2,415.3</b>	<b>2,268.4</b>	<b>659.6</b>	<b>546.4</b>	<b>524.8</b>	<b>684.5</b>	<b>801.1</b>	<b>558.2</b>	<b>270.2</b>	<b>638.9</b>	
<b>Total capital imports</b>	<b>3,255.9</b>	<b>2,725.6</b>	<b>3,508.6</b>	<b>3,500.0</b>	<b>874.7</b>	<b>877.9</b>	<b>799.3</b>	<b>1,028.7</b>	<b>1,107.7</b>	<b>844.8</b>	<b>559.5</b>	<b>988.0</b>	
Less Israeli investments abroad	12.0	8.5	107.6	157.7	-0.2	17.8	44.3	45.7	43.8	56.7	31.1	26.1	
Total net capital imports	<b>3,243.9</b>	<b>2,717.1</b>	<b>3,473.0</b>	<b>3,342.3</b>	<b>874.0</b>	<b>800.1</b>	<b>755.0</b>	<b>983.0</b>	<b>1,063.9</b>	<b>788.1</b>	<b>528.4</b>	<b>961.9</b>	

<sup>a</sup> Includes nonprofit institutions.

**Table VI-3**  
**U.S. GOVERNMENT AID AND DEFENSE IMPORTS, 1972-79**  
(\$ million)

	Grants	Loans received	Loans repaid <sup>a</sup>	Total aid		Direct defense imports <sup>b</sup>
				Gross	Net	
1972	71	330	125	401	276	490
1973	820	369	118	1,189	1,071	1,253
1974	672	301	155	973	818	1,225
1975	642	1,361	148	2,003	1,855	1,846
1976	1,176	892	215	2,068	1,853	1,555
1977	977	656	253	1,633	1,380	1,084
1978	1,181	1,004	226	2,185	1,959	1,612
1979	903	1,081	232	1,984	1,752	1,150

<sup>a</sup> Principal only.

<sup>b</sup> Commodities valued f.o.b.

much lower direct defense import bill on the one hand and an increase in loans on the other.

Transfers to the National Institutions rose sluggishly in 1979, but there was a significant jump in the fourth quarter. A similar, but more moderate, seasonal pattern has been typical of this item in most years, owing to the intensification of the fund-raising campaigns among world Jewry toward the end of the calendar year, which coincides with the start of the tax year in the United States. A special, successful effort was apparently made as 1979 drew to a close, in view of Israel's mounting difficulty in financing its current account deficit.

Personal restitutions in the form of pensions were higher this year, while lump-sum payments were unchanged. Two factors accounted for all the increase in pensions: the relative rise of the German mark (in which the restitutions are paid) against the dollar (in which the receipts are recorded in the balance of payments), and the increase in West Germany's consumer price index, according to which the pensions are updated each year.

Immigrant transfers soared \$80 million, outpacing all other component items. Among the factors explaining this development were the larger immigration from Iran and the long-range impact of the relaxation of foreign currency control, which encouraged immigrants to convert a larger portion of their capital into Israeli pounds.<sup>4</sup>

<sup>4</sup> Immigrant transfers are recorded in the balance of payments when the money is actually converted into Israeli pounds.

Table VI-4  
 UNILATERAL TRANSFERS, 1976-79  
 (\$ million)

	1976	1977	1978	1979	1978				1979			
					I	II	III	IV	I	II	III	IV
Personal restitutions from West Germany	313.7	350.1	406.5	439.7	102.5	95.0	102.0	107.0	113.5	103.2	107.4	115.6
Lump-sum	57.5	46.3	47.9	47.9	11.6	9.9	14.0	12.4	11.8	9.7	12.3	14.1
Pensions	256.2	303.8	358.6	391.8	90.9	85.1	88.0	94.6	101.7	93.5	95.1	101.5
Personal transfers in cash	261.7	363.7	460.0	573.0	104.2	111.6	119.7	124.5	136.8	139.6	149.0	147.6
Immigrants	39.7	69.2	141.9	224.1	24.9	33.4	39.3	44.3	52.1	54.0	60.8	57.2
Others	222.0	294.5	318.1	348.9	79.3	78.2	80.4	80.2	84.7	85.6	88.2	90.4
Personal transfers in kind	14.0	15.3	17.6	26.1	3.9	3.9	4.6	5.2	5.1	5.2	6.2	9.6
Total personal transfers from abroad	589.4	729.1	884.1	1,038.8	210.6	210.5	226.3	236.7	255.4	248.0	262.6	272.8
Personal transfers to the rest of the world	29.0	51.0	75.0	90.0	14.0	24.0	18.0	19.0	22.0	20.0	22.0	26.0
Total net personal transfers	560.4	678.1	809.1	948.8	196.6	186.5	208.3	217.7	233.4	228.0	240.6	246.8
Institutional transfers	541.4	474.9	439.4	461.9	102.1	90.6	97.6	149.1	112.6	87.5	88.3	173.5
Nonprofit institutions	122.8	132.7	98.6	109.5	24.0	19.6	31.5	22.7	31.3	30.0	22.7	25.5
National Institutions	416.0	336.3	337.6	346.6	75.9	70.4	65.5	125.8	80.0	56.4	63.7	146.5
Transfers in kind	2.6	5.9	3.2	5.8	1.4	0.6	0.6	0.6	1.3	1.1	1.9	1.5
Intergovernmental transfers	1,108.0	929.0	1,153.0	872.0	273.0	311.0	305.0	264.0	373.0	241.0	91.0	167.0
Total transfers	2,209.8	2,082.0	2,401.5	2,282.7	571.7	588.1	610.9	630.8	719.0	556.5	419.9	587.3



Cash transfers by local residents also went up steadily in 1979, grossing some \$350 million as against \$318 million in 1978. Local resident transfers to the rest of the world (which form part of Israel's capital export) reached some \$90 million, following a steady increase since the foreign currency liberalization. This capital outflow reduced the year's net growth of local resident transfers to about \$16 million.

#### 4. FOREIGN INVESTMENTS

Net foreign investments in Israel tumbled from some \$100 million in 1977 and \$90 million in 1978 to a mere \$55 million this year. At the same time Israeli investments abroad shot up to nearly \$160 million, almost triple the figure for foreign investments in Israel. The net effect of these opposite flows was an approximately \$100 million investment abroad—an unprecedented phenomenon until the foreign currency liberalization.

Investments are considered to be more sensitive to economic influences than are other capital import items. Investment flows have become even more open to the impact of foreign and domestic economic developments since the foreign currency liberalization, which has increased the opportunities for Israeli investments abroad while simplifying the implementation and repatriation of foreign investments in Israel. This year's trends were apparently dictated primarily by domestic developments: the weakening of the real estate and housing markets, the decline in real yield on securities (both stocks and bonds) while those abroad were going up, and the growing feeling toward the end of the year that the government was mooting the adoption of measures to further slow the economy. All these factors impeded foreign investments in Israel and encouraged Israelis to place their money abroad.

The heavy net movement of investment capital out of the economy was due to the rapid liquidation of foreign investments in Israel, to the tune of \$73 million as compared with some \$30 million in 1978, and the doubling of domestic bank purchases of foreign securities to \$87 million. In the past two years Israelis invested \$265 million in foreign securities, in nominal terms more than twice the amount from the establishment of the State in 1948 until 1977.

#### 5. LONG- AND MEDIUM-TERM LOANS

Gross foreign long- and medium-term loan proceeds tapered off at last year's figure of some \$2 billion. A heavier government borrowing was offset by a decline among other borrowers. Loan repayments dropped in both the public and private sectors in 1979, pushing up net loan receipts by \$74 million to \$1,161 million.

Table VI-5  
**FOREIGN INVESTMENT IN ISRAEL AND ISRAELI INVESTMENT ABROAD 1976-79**  
 (\$ million)

	1976	1977	1978	1979	1978				1979				
					I	II	III	IV	I	II	III	IV	
<b>Investment in Israel by foreigners</b>													
In foreign currency	25.5	58.8	50.0	11.2	10.6	5.5	21.0	12.9	3.9	0.1	7.3	-0.1	
Investments	57.1	68.1	79.2	84.6	20.2	13.3	25.7	20.0	26.5	17.0	19.9	21.1	
Investments repatriated	-31.6	-9.3	-29.2	-73.4	-9.6	-7.8	-4.7	-7.1	-22.6	-16.9	-12.6	-21.3	
In Israeli currency from blocked accounts	-14.2	-13.2	—	—	—	—	—	—	—	—	—	—	
In Independence and Development Bonds	10.2	12.8	13.0	16.1	2.5	3.5	2.5	4.5	4.6	2.5	4.3	4.7	
In kind	28.3	33.7	18.8	19.3	3.7	5.5	4.2	5.4	0.3	5.8	4.2	9.0	
Total	<b>49.8</b>	<b>92.1</b>	<b>81.8</b>	<b>46.6</b>	<b>16.8</b>	<b>14.5</b>	<b>27.7</b>	<b>22.8</b>	<b>8.8</b>	<b>8.4</b>	<b>15.8</b>	<b>13.6</b>	
Reinvestment of profits	8.0	8.0	7.8	8.7	1.9	1.9	2.0	2.0	2.1	2.2	2.2	2.2	
Total, net	<b>57.8</b>	<b>100.1</b>	<b>89.6</b>	<b>55.3</b>	<b>18.7</b>	<b>16.4</b>	<b>29.7</b>	<b>24.8</b>	<b>10.9</b>	<b>10.6</b>	<b>18.0</b>	<b>15.8</b>	
<b>Israeli investments abroad</b>													
Direct	5.7	5.7	1.3	2.3	-0.2	0.2	-0.4	1.7	2.0	—	—	0.3	
Portfolio													
Private individuals	-2.2	-0.8	64.3	68.3	-11.7	3.6	36.2	36.2	36.2	18.5	11.2	2.4	
Banks	8.5	3.6	42.0	87.1	11.7	14.0	8.5	7.8	5.6	38.2	19.9	23.4	
Total	<b>12.0</b>	<b>8.5</b>	<b>107.6</b>	<b>157.7</b>	<b>-0.2</b>	<b>17.8</b>	<b>44.3</b>	<b>45.7</b>	<b>43.8</b>	<b>56.7</b>	<b>31.1</b>	<b>26.1</b>	
<b>Net foreign investment in Israel</b>	<b>45.8</b>	<b>91.6</b>	<b>-18.0</b>	<b>-102.4</b>	<b>18.9</b>	<b>-1.4</b>	<b>-14.6</b>	<b>-20.9</b>	<b>-32.9</b>	<b>-46.1</b>	<b>-13.1</b>	<b>-10.3</b>	

Table VI-6

## LONG- AND MEDIUM-TERM FOREIGN LOANS, 1976-79

(\$ million)

	1976	1977	1978	1979	1978				1979				
					I	II	III	IV	I	II	III	IV	
<b>Loans received</b>													
Government	1,284	1,034	1,504	1,610	447	302	313	442	477	400	261	472	
Thereof:													
Independence and Development													
Loans	347	355	400	411	108	95	72	125	92	108	99	112	
U.S. government	815	633	982	1,027	296	201	232	253	359	262	98	308	
Other	340	234	449	368	34	173	73	169	100	113	59	96	
Total	1,624	1,268	1,953	1,978	481	475	386	611	577	513	320	568	
<b>Loans repaid</b>													
Government	401	502	585	567	138	138	160	149	131	140	148	148	
Thereof:													
Independence and Development													
Loans	184	181	244	296	50	62	56	76	63	79	79	75	
U.S. government	165	234	201	207	59	33	69	40	60	33	64	50	
Other	221	224	281	250	59	64	68	90	69	95	51	35	
Total	622	726	866	817	197	202	228	239	200	235	199	183	
<b>Net loans received</b>													
Government	883	532	919	1,043	309	164	153	293	346	260	113	324	
Thereof:													
Independence and Development													
Loans	163	174	156	115	58	33	16	49	29	29	20	37	
U.S. government	650	399	781	820	237	168	163	213	299	229	34	258	
Other	119	10	168	118	-25	109	5	79	31	18	8	61	
Total	1,002	542	1,087	1,161	284	273	158	372	377	278	121	385	

U.S. government loans rose moderately to pass the \$1 billion mark in 1979. Such loans are intended primarily to finance specific imports (mostly defense), and are influenced only marginally by economic considerations. Noncivilian imports were smaller this year, and the aid package was adjusted accordingly by reducing grant payments. The proportion of loans, which are a less convenient component of U.S. government aid, thus went up slightly.

The uptrend in sales of Israel Bonds (the Development Loan) carried over through 1979, when the figure came to \$411 million as against \$400 million the year before. However, a heavier redemption of bonds sold in the past cut net proceeds from this source to \$115 million, the lowest figure recorded so far. The sluggish growth of gross receipts can be partly blamed on the widening interest rate differential between these issues and the rates on alternative investments in the world credit markets.

Nongovernment loan receipts (mostly medium-term) grossed \$368 million this year, well below the 1978 figure of \$449 million. The decline can apparently be at-

Table VI-7

**FOREIGN EXCHANGE RESERVES HELD AT THE BANK OF ISRAEL, 1979**  
(\$ million)

End of month	Gross reserves (1)	Foreign bank deposits (2)	Patach deposits (3)	Net reserves (1-2-3) (4)	Change in reserves		
					Before adjustment (5)	Exchange rate differentials (6)	Adjusted for differentials (8)
1977 December	1,571	10	202	1,359			
1978 December	2,679	8	429	2,242	883	164	719
1979 January	2,917	9	473	2,435	193	-32	225
February	2,945	6	500	2,439	4	6	-2
March	2,977	16	510	2,451	12	-17	29
April	2,867	16	413	2,438	-13	-31	18
May	2,857	7	412	2,438	—	-1	1
June	2,961	8	428	2,525	87	33	54
July	3,112	8	454	2,650	125	24	101
August	3,093	7	470	2,616	-34	3	-37
September	3,107	7	469	2,631	15	57	-42
October	3,041	7	483	2,551	-80	-63	-17
November	3,106	18	502	2,586	35	44	-9
December	3,120	13	537	2,570	-16	20	-36
Total					328	43	285

tributed to a series of steps taken by the Bank of Israel during the year<sup>5</sup> to restrain monetary expansion, which made some foreign credit dearer. Rising interest rates abroad probably also dampened borrowing from foreign sources.

#### 6. SHORT-TERM CAPITAL

As in 1974 and 1975, the long- and medium-term capital inflow was insufficient to cover the basic deficit in the balance of payments, and so the economy had to resort to short-term financing. The composition of such financing, however, differed noticeably from previous years. First of all, the Bank of Israel's international reserves expanded, whereas in 1974 they had been heavily depleted and continued downward at a slower pace in 1975. Secondly, whereas in the past the basic deficit was mostly covered from funds obtained from the private financial sector, no such financing was sought in 1979; the money raised by this sector was used to finance the purchase of assets and provide more bank credit to foreigners. Thirdly, for the

<sup>5</sup> At first an obligatory 20 percent deposit was imposed on foreign currency credits; this was replaced by administrative restrictions and subsequently by a 12 percent interest surcharge on part of such credit; in November 1979 administrative restrictions were reintroduced. These restrictions, however, did not apply to credit for financing the import of equipment or fuel, or to loans to shipping companies and airlines.

first time, short-term credit from the nonfinancial sector was sufficient this year not only to cover the basic deficit but also to finance activities not included in the current account and capital import.

Net liquid assets of the banking institutions fell by \$306 million in 1979, after a respectable growth in the two preceding years. At the same time commercial banks increased their credit to foreigners and nonresidents by \$365 million, and the Bank of Israel paid \$84 million on account of its liabilities to the International Monetary Fund.

Since the foreign currency liberalization the financial sector has greatly stepped up its overseas operations, as is reflected in both the magnitude of the capital movements and their fluctuations. While nonresidents' deposits in domestic banks have expanded steadily during this period, foreign bank deposits in local banks and deposits by Israeli banks abroad have traced a highly erratic path.

Foreign exchange reserves in the Bank of Israel continued upward in 1979, for the fourth year in a row, although more slowly than in 1977-78. During the year reviewed they rose by \$328 million to \$2.6 billion; 13 percent of the gain represented revaluation increments arising from the decline of the dollar against other currencies in which part of the reserves were held.

The reserves increased about as fast as imports in 1979, so that the ratio between net reserves and imports remained unchanged. As in 1978, the Bank of Israel's reserve holdings were adequate to cover 2.6 months of imports. This level of import coverage was roughly equal to what in various other countries is generally considered to be necessary for the orderly financing of imports; in 1976 and 1977 the level had been too low. The level of import coverage in 1972-79 is presented in the following table (all amounts in \$ million).

	1972	1973	1974	1975	1976	1977	1978	1979
Net Bank of Israel								
International reserve holdings	1,066	1,697	1,071	1,040	1,156	1,359	2,242	2,570
Imports of goods and services	3,336	5,414	7,031	7,841	7,766	8,227	10,084	11,883
No. of months of import coverage	3.8	3.8	1.8	1.6	1.8	2.0	2.7	2.6

Interest received on domestic deposits abroad (including that on the Bank of Israel's foreign exchange reserves) reached some \$400 million in 1979, nearly double the previous year's \$221 million and more than double the \$184 million recorded in 1977. The growth of deposits and the rise of interest rates abroad combined to yield this higher figure. Interest payments on foreign deposits in domestic

**Table**  
**FOREIGN CURRENCY ASSETS**  
(\$

	1976	1977	1978	1979
<b>A. Foreign assets in the Bank of Israel</b>				
1. Foreign currency balances	1,318.4	1,494.4	2,597.0	3,056.9
Gold	44.8	49.5	53.5	56.8
Gold quota in IMF	—	—	—	—
Special Drawing Rights	10.0	27.0	27.4	6.3
Total (1)	1,373.2	1,570.9	2,677.9	3,120.0
2. Bank of Israel liabilities				
Foreign banks	10.1	9.8	7.7	25.1
Patach <sup>a</sup>	206.8	202.0	429.0	537.0
Total (2)	216.9	211.8	436.7	562.1
3. Net reserves with the Bank of Israel	1,156.3	1,359.1	2,242.0	2,570.0
<b>B. Other monetary institutions</b>				
1. Assets				
Deposits abroad of other central monetary organizations	89.8	198.9	104.6	115.0
Commercial bank deposits	1,364.8	2,014.3	2,876.1	3,397.4
Other	16.1	38.7	1.5	2.0
Total, net <sup>a</sup>	1,470.7	2,251.9	2,982.2	3,514.4
2. Liabilities				
Foreign bank deposits and loans	1,571.5	2,069.4	2,899.3	3,287.0
Patach accounts in commercial banks	1,372.6	1,582.1	2,371.6	3,318.3
Total <sup>b</sup>	2,944.1	3,651.5	5,270.9	6,605.3
<b>C. Total assets in banking system</b>				
1. Assets (A1+B1)	2,843.9	3,822.8	5,660.1	6,634.4
2. Liabilities (B2+foreign banks)	2,954.2	3,661.3	5,278.6	6,630.4
3. Net assets	-110.3	161.5	381.5	4.0
4. Change in net assets	73.1	271.8	220.0	-377.5
Foreign currency valuation adjustments	-43.8	-16.7	83.9	71.6
5. Change in net assets due to economic transactions	29.3	255.1	303.9	-306.3

<sup>a</sup> According to the daily balance sheet of the Bank of Israel.

<sup>b</sup> As defined in the balance of payments.

## VI-8

## IN THE BANKING SYSTEM, 1976-79

(million)

1978				1979			
I	II	III	IV	I	II	III	IV
1,589.8	1,664.7	1,845.3	2,597.0	2,905.2	2,887.7	3,046.7	3,056.9
50.4	50.6	52.4	53.5	54.3	55.6	55.4	56.8
—	—	—	—	—	—	—	—
31.6	34.1	23.2	27.4	30.2	16.2	4.7	6.3
<b>1,671.8</b>	<b>1,749.4</b>	<b>1,920.9</b>	<b>2,677.9</b>	<b>2,989.7</b>	<b>2,959.5</b>	<b>3,106.8</b>	<b>3,120.0</b>
9.3	19.5	8.5	7.7	15.8	7.5	7.1	25.1
275.0	273.0	300.0	429.0	510.0	428.0	469.0	537.0
<b>284.3</b>	<b>292.5</b>	<b>308.5</b>	<b>436.7</b>	<b>525.8</b>	<b>435.5</b>	<b>476.1</b>	<b>562.1</b>
<b>1,387.5</b>	<b>1,456.9</b>	<b>1,612.4</b>	<b>2,242.0</b>	<b>2,451.0</b>	<b>2,525.0</b>	<b>2,631.0</b>	<b>2,570.0</b>
308.4	195.3	164.7	104.6	384.2	181.5	46.0	115.0
1,750.5	1,963.3	1,289.8	2,876.1	2,737.8	3,120.7	2,914.6	3,397.4
0.1	0.1	0.4	1.5	1.7	2.1	2.0	2.0
<b>2,059.0</b>	<b>2,158.7</b>	<b>2,454.9</b>	<b>2,982.2</b>	<b>3,123.7</b>	<b>3,304.3</b>	<b>2,962.6</b>	<b>3,514.4</b>
1,717.4	1,936.1	2,082.8	2,899.3	2,706.6	2,910.8	2,865.4	3,287.0
1,741.4	1,874.3	2,121.6	2,371.6	2,668.4	2,957.7	3,099.1	3,318.3
<b>3,458.8</b>	<b>3,810.4</b>	<b>4,204.4</b>	<b>5,270.9</b>	<b>5,375.0</b>	<b>5,868.5</b>	<b>5,964.5</b>	<b>6,605.3</b>
3,730.8	3,908.1	4,375.8	5,660.1	6,113.4	6,263.8	6,069.4	6,634.4
3,468.1	3,829.9	4,212.9	5,278.6	5,390.8	5,876.0	5,971.6	6,630.4
262.7	78.2	162.9	381.5	722.6	387.8	97.8	4.0
101.2	-184.5	84.7	218.6	341.1	-334.8	-290.0	-93.8
135.2	12.7	-69.1	5.1	27.6	7.9	-70.9	106.6
236.4	-171.8	15.6	223.7	368.7	-326.9	-360.9	12.8

banks also doubled in 1979, totaling \$376 million as against \$181 million in 1978 and only \$93 million the year before. Interest paid on foreign deposits in Israel outpaced the increase in receipts on Israeli deposits abroad, owing to the more rapid growth of foreign deposits in domestic banks.

## 7. THE EXTERNAL DEBT

The uninterrupted growth of the external debt continued apace in 1979, when the figure went up from \$12.9 billion at the end of 1978 to \$15 billion. Although this year's increase was the highest ever recorded in nominal terms, its significance diminishes greatly if account is taken of the real expansion of domestic output and the rise in world prices.<sup>6</sup>

Striking changes took place this year in the composition of the foreign debt by repayment dates, borrowing sectors, and type of creditor. The share of long-term obligations dropped to about 75 percent, after ranging as a rule between 80 and 90 percent. Short-term obligations accounted for 12 percent, well above the 1978 figure of 7.7 percent. The full impact of these sharp changes will only be felt in 1980, when the short-term debts come due for repayment or renewal. At the end of 1979 short-term liabilities totaled \$1.8 billion, up from about \$1 billion at the start of the year. Most of the increment represented the larger sum owed this year by fuel companies to banks and suppliers abroad, which jumped from \$361 million to \$932 million during the year.

Total government obligations rose by about \$1 billion to stand at \$11 billion; they accounted for 73 percent of the total debt balance in 1979, down from 77 percent in 1978. The government debt, most of which is in dollars, carries relatively low interest rates, and the grant element is large in comparison with other liability items and with other debtor nations. Topping the list of creditors is the U.S. government, with a figure of \$5.4 billion, more than a third of the total. The liability on account of the Development Loan (Israel Bonds) came to \$2.7 billion by the end of 1979, while that owed to the government of West Germany rose to \$1.2 billion. The weight of the U.S. government has been moving up rapidly in recent years, while that of the Development Loan has been on the decline due to the slow growth of sales and a heavier redemption.

The private debt rose by \$1.1 billion to reach \$4 billion by the end of 1979. This eclipsed the growth of government foreign liabilities, a situation that occurred only once before, in the early 1960s. Private liabilities carry less convenient terms than those owed by the government; they bear relatively higher interest rates, which in some cases are linked to the world credit market rates (e.g. the Eurodollar rate).

<sup>6</sup> After deflating the year-end external debt by the rise in export prices during the year, the figure is some \$130 million smaller than at the end of 1978.



Table VI-9

**FORECAST OF ISRAEL'S FOREIGN DEBT BY REPAYMENT DATE, 1970-79**  
(\$ million)

End of year	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
	<b>Repayment date</b>									
Up to one year	398	475	435	549	956	1,414	1,480	1,831	2,036	2,871
Thereof: Short-term loans	155	183	187	190	564	927	805	875	995	1,820
One to two years	195	223	263	329	504	490	785	1,066	885	1,384
Two to three years	174	202	241	351	423	511	850	1,211	1,110	1,074
Three to four years	136	159	268	327	439	628	725	1,106	832	803
Four to five year	117	193	238	369	481	530	813	815	644	622
Five years or more	1,602	2,178	2,636	3,168	3,447	4,044	4,717	5,078	7,375	8,245
Total	2,622	3,430	4,081	5,093	6,250	7,617	9,371	11,107	12,882	14,999
	<b>Percentage distribution by repayment date</b>									
Up to one year	15.2	13.8	10.7	10.8	15.3	18.6	15.8	16.5	15.8	19.1
Thereof: Short-term loans	38.9	38.5	43.0	34.6	59.0	65.6	54.4	47.8	48.9	63.4
One to two years	7.4	6.5	6.4	6.5	8.1	6.4	8.4	9.6	6.9	9.2
Two to three years	6.6	5.9	5.9	6.9	6.8	6.7	9.1	10.9	8.6	7.2
Three to four years	5.2	4.6	6.6	6.4	7.0	8.2	7.7	10.0	6.5	5.4
Four to five years	4.5	5.6	5.8	7.2	7.7	7.0	8.7	7.3	5.0	4.1
Five years or more	61.1	63.5	64.6	62.2	55.1	53.1	50.3	45.7	57.2	55.0
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
	<b>Cumulative percentage distribution</b>									
Up to one year	15.2	13.8	10.7	10.8	15.3	18.6	15.8	16.5	15.8	19.1
Up to two years	22.6	20.3	17.1	17.3	23.4	25.0	24.2	26.1	22.7	28.3
Up to three years	29.2	26.2	23.0	24.2	30.2	31.7	33.3	37.0	31.3	35.5
Up to four years	34.4	30.8	29.6	30.6	37.2	39.9	41.0	47.0	37.8	40.9
Up to five years	38.9	36.4	35.4	37.8	44.9	46.9	49.7	54.3	42.8	45.0
Five years or more	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table VI-10

**INDICATORS OF THE DEBT SERVICING BURDEN, 1970-79**  
(\$ million)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
1. Interest payments	141	147	179	262	389	530	552	620	750	860
2. Principal repayments (long- and medium-term)	248	330	432	420	469	534	622	726	866	817
3. Total debt servicing (1+2)	389	477	611	682	858	1,064	1,174	1,346	1,616	1,677
4. Exports of goods and services	1,402	1,875	2,222	2,784	3,634	3,825	4,566	5,664	6,735	8,126
5. Unilateral transfers	650	792	1,059	2,190	1,718	1,770	2,210	2,082	2,400	2,281
6. Ratio (3/4) (%)	27.7	25.4	27.5	24.5	23.6	27.8	25.7	23.8	24.0	20.6
7. Ratio (3/4+5) (%)	19.0	17.9	18.6	13.7	16.0	19.0	17.3	17.4	17.7	16.1

Table

**FOREIGN CURRENCY TRANSACTIONS**  
(**\$**)

	1976	1977	1978	1979
A. Current account deficit	-3,200	-2,563	-3,349	-3,757
1. Government deficit	-1,805	-1,418	-2,016	-1,388
2. Private sector deficit	-1,395	-1,145	-1,333	-2,369
B. Private sector capital import <sup>a</sup>	857	916	1,100	1,161
Surplus of capital import over private sector deficit (A2+B)	-538	-229	-233	-1,208
C. Commercial banking system and short-term capital flows				
1. Short-term private capital from the nonfinancial sector	35	-345	-20	533
2. Reduction of commercial bank balances	-141	-592	-800	-497
3. Loans received by banks from abroad and Patach accounts	243	596	1,327	1,429
4. Loans given by banks to foreign sector <sup>b</sup>	55	89	68	-452
5. Less public sector transfers to banks	101	-280	-164	-32
Total financing given by commercial banks and short-term capital flow	293	-532	411	981
D. Total calculated sales of foreign currency to Bank of Israel (B+A2+C)	-245	-761	178	-227
E. Errors and omissions	-14	343	321	-427
F. Actual sales to Bank of Israel <sup>c</sup>	-559	-748	-342	-919

<sup>a</sup> Excludes investment in foreign securities by domestic banks.

<sup>b</sup> Includes investment in foreign securities by domestic banks.

<sup>c</sup> There is an unexplained discrepancy between the figures for this item as presented here, which were obtained from the Foreign Department of the Bank of Israel, and the figures according to the balance of payments.

## VI-11

OF THE PRIVATE SECTOR, 1976-79  
(million)

1978				1979			
I	II	III	IV	I	II	III	IV
-841	-841	-1,049	-618	-920	-801	-1,097	-939
-543	-493	-551	-429	-317	-345	-315	-411
-298	-348	-498	-189	-603	-456	-782	-528
227	328	239	307	269	268	278	-346
-71	-20	-259	118	-334	-188	-405	-182
-109	4	76	9	149	68	199	117
282	-220	-286	-576	128	-388	247	-484
-390	358	336	1,023	132	487	50	760
100	-20	20	-33	20	-55	-88	-329
-57	-60	26	-73	-4	-11	-2	-15
-174	62	172	350	425	101	406	49
-245	42	-87	468	91	-87	-98	-133
137	-63	176	71	158	-323	-7	-255
-317	-112	-227	314	3	-147	-282	-493

Furthermore, the average maturity schedule is relatively shorter, a feature that was aggravated by this year's exceptional increase in short-term liabilities. By the end of 1979 they comprised nearly half the total private debt, compared with only 34 percent the year before.

A conventional yardstick of the current repayment burden is the share of the economy's foreign currency income on current account which goes to service the debt. This year, thanks to a relatively modest increase in debt services and a sharp increase in export proceeds, the ratio between them shrank to 21 percent, lower than in any other year in the 1970s. As regards the Israeli economy, which has always enjoyed a large volume of unilateral transfers, it is customary to use an additional indicator for measuring the current debt servicing burden, viz. the ratio of this burden to export proceeds plus unilateral transfers. This indicator also showed a significant decline this year in the impact of the current debt servicing burden on the balance of payments.

The forecast debt maturity schedule shows an unprecedented increase in the amount of principal falling due within the coming year. But net of short-term loans, a large proportion of which will be automatically renewed, principal repayments in 1980 will be roughly the same as in 1978—about \$1 billion; furthermore, after subtracting short-term debts, the maturity schedule is not much different from the 1978 forecast.

In 1978 fully 84 percent of the external debt was in dollars, 10 percent in German marks, and the remainder in other currencies. During the year private sector liabilities in marks fell from \$317 million to \$213 million, while those in dollars jumped from \$2.3 billion to \$3.4 billion. Government liabilities rose in both currencies in 1979, with those in DM going up more rapidly, thus bringing up their share in the total somewhat. The different behavior of these two sectors reflects their varying flexibility in tapping foreign sources of credit.