CHAPTER VIII

MONEY AND CAPITAL MARKETS

I. GENERAL ANALYSIS

1. MAIN DEVELOPMENTS

Developments in the money and capital markets in the year reviewed were dominated by a very large liquidity injection, generated primarily by an extraordinary growth of the public sector's demand surplus.[1] At the same time the Bank of Israel continued its tight credit policy, which led to a further real contraction of bank credit (although to a lesser extent than in 1980) and a rise in real interest rates on short-term credit.[2] Given the further improvement in the terms offered by the various savings schemes, this combination of a huge injection and a restrictive credit policy engendered a heavier demand for financial assets. Total purchases of such assets expanded 15 percent in real terms, the net outcome of a real 67 percent increase in liquid medium- and long-term assets and a 32 percent real decline in liquid asset accumulation (see Table VIII-1).[3]

Inflation was toned down this year, especially in the first half. The main monetary factors were the more buoyant demand for financial assets (in particular those for medium and long terms) and the continued curbing of bank

[1] The liquidity injection is defined here as the total financing of the public sector's demand surplus, namely short-, medium-, and long-term capital mobilized, less credit granted to the private sector, plus the injection of money. A narrower definition is the injection of money plus the sale of tradable government bonds, while the narrowest concept is the injection of money alone.

[2] In this chapter real values were calculated using the consumer price index as a deflator (unless otherwise indicated).

[3] Liquid asset accumulation is defined here as the increase in the money supply as customarily defined (currency plus demand deposits), negotiable certificates of deposit, Patam local residents' foreign currency deposits, and tradable government bonds held by the public. Because of the relatively low transactions costs involved and the highly elastic supply of tradable bonds and Patam (due to the policy of stabilizing the real secondary market prices of bonds, as well as the policy of maintaining a fairly constant real exchange rate), there is a large degree of substitutability between such bonds and Patam on the one hand and money holdings on the other. In view of this, the Bank of Israel has in recent years used the change in total liquid assets as one of its principal indicators for analyzing monetary developments.

credit. However, the principal reasons for the lower rate of inflation were apparently the heavier subsidization of basic products and fuel and the cutting of indirect taxes during the year. These fiscal measures had a direct and immediate dampening impact on prices, while the inflationary effect of the liquidity injection resulting from these steps (which operated with a lag of several months) was moderated by the accumulation of financial assets and to a smaller degree by private sector purchases of foreign currency and the drop in import prices.

Table VIII-1

INDICATORS OF MONETARY EXPANSION, 1981

(IS billion)

	Flows, 1981			Flows relative to monetary base (%)		Percent real increase [a]	
	Total	1st half	2nd half	1980	1981	1980	1981
1. Liquidity injection generated by public sector demand surplus [b]	24.1	5.8	18.3	1.57	3.59	63	96
2. Medium- and long-term credit flows (net) [c]	15.6	6.6	9.0	1.63	2.32	-10	25
3. Estimated short-term credit flows [d]	7.3	2.4	4.9	1.99	1.09	15	-58
4. Liquidity absorbed through private sector purchases of foreign currency [e]	10.0	-0.9	10.9	1.23	1.49	-22	-12
5. Purchases of financial assets by the public [f]	34.6	14.2	20.4	4.00	5.16	39	15
6. Thereof: [g]							
a. Liquid assets	9.8	3.3	6.5	1.90	1.46	105	-32
Thereof: Money	5.5	2.3	3.2	0.97	0.82	101	-28
b. Financial shares [h]	2.8	0.8	2.0	0.33	0.42	—	1
c. Medium- and long-term financial assets	22.0	10.1	11.9	1.77	3.28	-7	67

[a] Deflated semiannually by the consumer price index.

[b] Public sector injection plus total capital mobilized by the sector (see Table VIII-8).

[c] Most of the credit is provided directly by the government or in accordance with its directives.

[d] Estimated increase in Bank of Israel rediscounts (mainly on account of directed credit) and in commercial bank credit (see lines 2 and 6 in Table VIII-7).

[e] As defined in Table VIII-7.

[f] The discrepancy between this item and the total of the liquidity injections in lines 1 to 4 is due to other factors, unidentified sources, and errors and omissions.

[g] From Table VIII-A5.

[h] Shares of the insurance, finance, and bank group.

SOURCE: Bank of Israel calculations.

Despite the huge real growth of the public sector's demand surplus in the year reviewed, purchases of financial assets by the private sector increased more modestly in real terms than in 1980 (see Table VIII-1). This is explained primarily by the sharp real decline in short-term credit flows, one of the principal sources for the expansion of financial asset purchases. The contraction of such credit far outweighed the additional money put into the economy by the public sector through its lending to the private sector. What is more, in contrast to the precipitous real drop in private sector purchases of foreign currency in 1980 (a contributory factor in the larger acquisition of financial assets that year), the absorption of liquidity through foreign currency purchases decreased more moderately in 1981.

Total financial assets of the public rose 15 percent in real terms in 1981, compared with 19 percent the year before (see Table VIII-2).[4] The public's liabilities also rose, as credit was increasingly allocated on indexed terms. The public's wealth expanded more mildly this year (15 percent vs. 20 percent in 1980).[5] The increase in wealth in 1980 was one of the reasons for the growth of demands in the year reviewed, which first became evident in the second half of 1980.

The monetary developments in 1981, which, as stated, were influenced by the government's fiscal measures and the Bank of Israel's stringent credit policy, did not trace an even path. In the first six months taxes were reduced on durable consumer goods, most of which are imported, while subsidies were increased on basic products and fuel. The trimming of imposts greatly stimulated purchases of highly taxed goods, thereby producing a larger revenue from this source (see Chapters II and V). In addition, the lagged adjustment of basic product and fuel prices for their increased cost did not find expression during this period in a large-scale liquidity injection: the government's disbursements of these price supports were made several months after the upping of the subsidies, being concentrated in the second half of 1981 and the first months of 1982. Moreover, the subsidization policy, coupled with the restriction of credit, led in the first half of the year to the dampening of the injections directly related to the rate of inflation (e.g. that generated by the payment of cost-of-living adjustments). As a result of this combination of factors, the real liquidity injection attributable to the government's demand surplus was not much higher than in the same period last

[4] Besides the accumulation of such assets, their real expansion is stimulated by the real interest paid on nontradable assets (most of them long-term, such as savings schemes and social insurance funds) and the real increase in the market value of tradable assets.

[5] The growth of the public's wealth in 1981 may have reflected to some extent its expectation of a stiffening of the tax burden after it was eased in the course of the year reviewed. If this was true, the public probably regarded part of its financial asset accumulation not so much as an increase in its wealth as a kind of reserve for the payment of future taxes.

Table VIII-2

MONETARY DEVELOPMENTS AND INDICATORS OF THE COST OF SHORT-TERM CREDIT, 1979-81

(IS billion)

	End-year balances			Percent annual increase			
				Nominal		Real	
	1979	1980	1981	1980	1981	1980	1981
A. Monetary developments							
1. Liquid assets [a]	24.4	61.3	123.5	151	102	8	—
2. Liquid assets and bank shares [a]	30.6	83.8	193.1	174	130	18	14
3. Medium- and long-term assets [a]	52.7	146.3	341.9	178	134	19	16
4. Total financial assets [a]	83.3	230.1	535.0	176	133	19	15
5. Commercial bank credit (excl. oil) to private nonfinancial sector [b]	18.1	37.9	69.2	110	83	-10	-9
6. Net financial wealth of private nonfinancial sector [c]	**51.5**	**144.0**	**334.9**	**180**	**133**	**20**	**15**
	Percentages, at annual rates						
B. Actual real cost of short-term credit [d]							
1. Overdraft accounts	-11	19	34				
2. Nondirected foreign currency credit	9	16	38				
3. Total short-term credit (directed and nondirected)							
a. Before tax	-4	5	17				
b. After tax	-33	-34	-24				

[a] As detailed in Table VIII-14.
[b] As detailed in Table VIII-13.
[c] As detailed in Table VIII-9.
[d] As defined in Table VIII-11.

year (see Figure VIII-1). After the absorptive effect of the tax cuts on durables had run its course, and with the start of the government's payments on account of basic commodity and fuel price supports, the public sector's deficit engendered a much larger liquidity injection in the second half of 1981, when it swelled to triple its level in the first six months. The disparate size of the injection in the two halves of 1981 was one of the causes of the dissimilar pace of inflation during the year (see below).

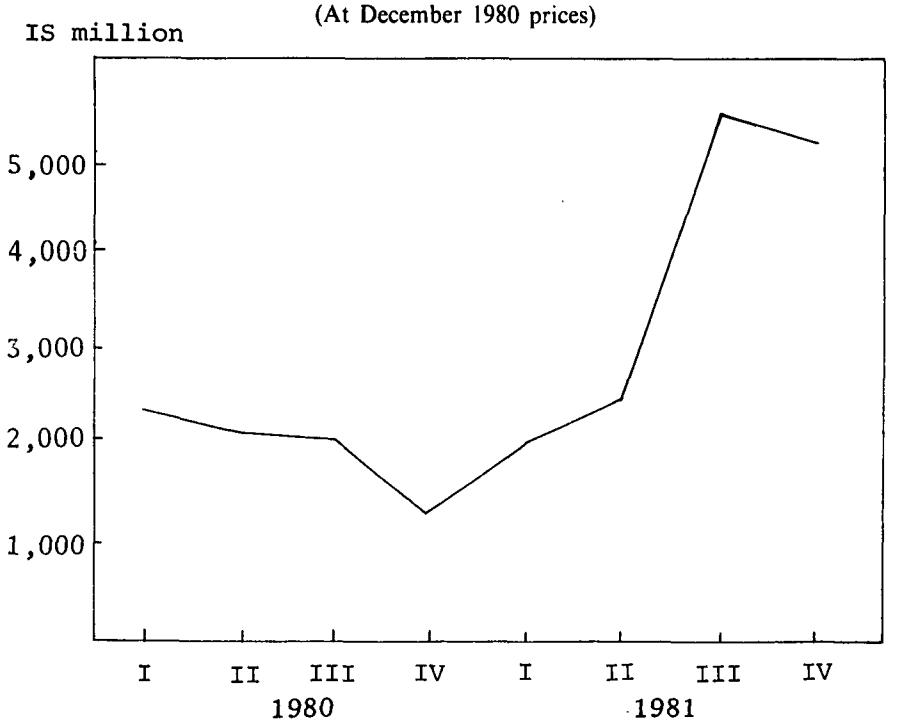
The manner of financing the public sector deficit also varied in the course of 1981. In the first quarter the principal source was an increased mobilization of medium- and long-term capital, in particular through new savings schemes, which are more liquid than the veteran schemes, while in the last

nine months the deficit was mostly financed through a huge liquidity injection. Over the year as a whole the amount of money put into the economy from this source was almost 3.5 times its level in 1980 (see Table VIII-8).

In contrast to previous years, directed credit in the form of rediscounts did not contribute to the expansion of liquidity (in fact it even siphoned out about IS1 billion). This can be attributed to the Bank of Israel's measures to arrest the growth of directed credit.

The absorption of liquidity through the private sector's purchases of foreign currency also differed in the two halves of 1981. In the first six months the government followed a policy of trimming imposts on highly taxed commodities (the bulk of which are imported), and this had an absorptive effect (through purchases of foreign currency to finance the import of such goods). However, during this period (in which various forces acted to moderate the injection) this effect was offset by the short-term capital inflow, ascribable in part to large-scale repayments to the Diamond Fund. As a result of these developments, the balance of payments did not contribute to the absorption of liquidity in the first half of the year; in fact it was responsible for injecting about IS1 billion (see Table VIII-1). Along with the sizable injection in the

Figure VIII-1
LIQUIDITY INJECTION ENGENDERED BY PUBLIC SECTOR DEMAND SURPLUS, 1980-81
(At December 1980 prices)



second half of the year, there was a much heavier purchase of foreign currency by the private sector (including debt repayment). The net outcome was an approximately IS11 billion absorption during this period. In 1981 as a whole the amount pumped out through purchases of foreign currency shrank 12 percent in real terms, which was less than last year's decline (22 percent).

The injection as most broadly defined (that generated by the financing of the public sector deficit), less the absorption through private sector purchases of foreign currency, came to about IS14 billion, as against IS700 million in 1980. The injection in its narrower definition (the government injection plus Bank of Israel rediscounts), less the amount absorbed through purchases of foreign currency, was larger than in 1980—roughly IS6 billion as againt IS4 billion.

The expansionary effect of the injection outweighed the contractionary effect of the tight short-term credit policy. It should be emphasized, however, that the credit squeeze dampened domestic demands, whether through its impact on the high marginal cost of nondirected (free market) credit (see Tables VIII-2 and VIII-4), or because of the diminished availability of bank credit. The development of bank credit in 1981 was a result of the continued implementation of the stringent credit policy introduced by the Bank of Israel in the middle of 1979. In 1981 this policy was reflected by the targeting of nominal credit growth at 5 percent a month, with inflation expected to run at 6 percent a month. During the year short-term bank credit (excluding that for financing oil imports) shrank 9 percent in real terms. In contrast to 1980, when such financing grew more or less as targeted, in the year reviewed it deviated from the target path (mainly because of the strengthening of the dollar against the European currencies). In the first six months it increased faster than the general price level; during the rest of the year the real downtrend reasserted itself, and the level during this period was similar to that in the second half of 1980. Along with the setting of nondirected credit ceilings, the Bank of Israel acted to slow the expansion of directed credit, reducing the rates of financing in the export funds and fixing a quota for the diamond industry, which led to a 37 percent real squeeze in the balance of such credit.

The lively demand of the public for financial assets continued in the year reviewed, as reflected by a real 15 percent growth in total holdings. The liquid assets component did not change in real terms in 1981, but if we add bank shares, which are highly liquid, this component expanded 14 percent in real terms, compared with 17 percent in 1980 (see Table VIII-2). A striking feature of the financial assets portfolio was a further rise in the weight of bank shares: they accounted for 13 percent of the portfolio at the end of 1981, reflecting the persistence of their upward momentum which has been evident for more than two years. In addition, the public continued to enjoy the more attractive terms offered by the various medium- and long-term savings instru-

ments (a shorter maturity and increased flexibility). The rates of return on most of the assets were less volatile this year, so that the portfolio as a whole was more liquid.

The public's liabilities were influenced by the tightening of short-term credit and the expansion of long-term credit this year (see the section on credit). A noteworthy development was the switch to indexed credit, which helped to reduce capital gains from borrowed funds granted on unlinked terms and at a subsidized interest rate.

2. MONETARY DEVELOPMENTS, INFLATION, AND ECONOMIC ACTIVITY

The main difference between the year reviewed and 1980 was a shift in the direction of fiscal policy, notably with regard to the adjustment of controlled commodity prices for rising costs. Whereas in 1980 subsidies on these items were slashed, this year witnessed a very heavy subsidization, which tailed off a bit from the third quarter on.

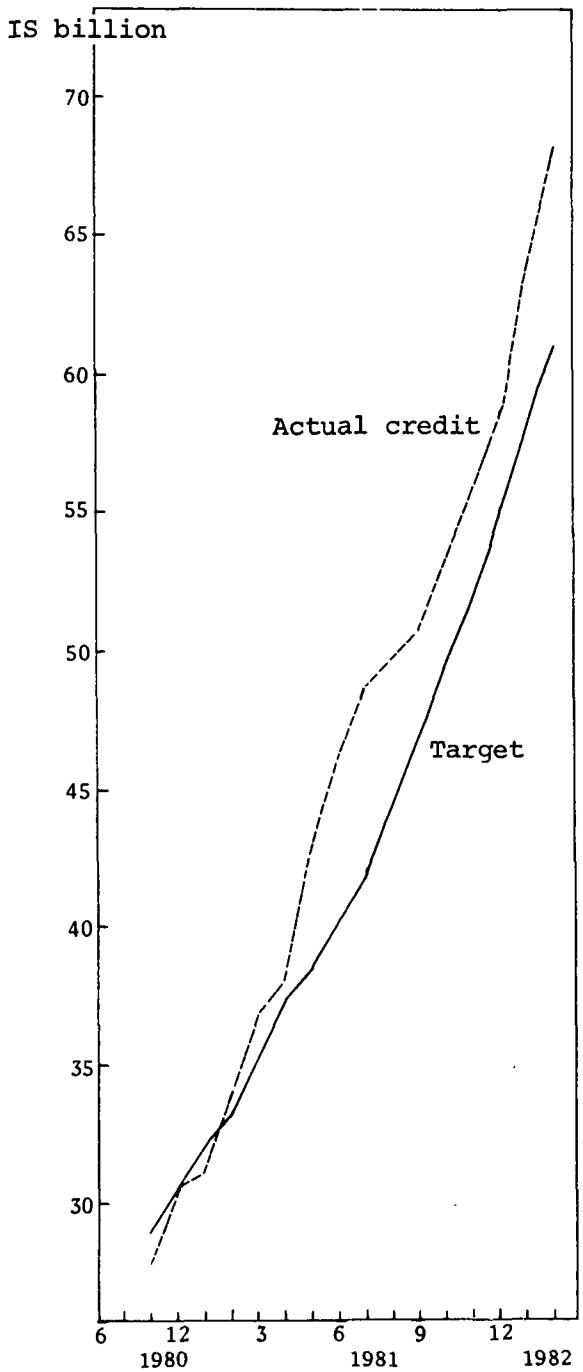
This policy led to a huge real increase in the liquidity injection generated by the public sector demand surplus. But despite the strong potential inflationary impact of this development, it did not outweigh in the course of the year the immediate moderating effect of the enlarged subsidies on prices. As a result, the annual rate of inflation, as measured by the consumer price index, fell to approximately 100 percent, compared with 111 and 133 percent in 1979 and 1980 respectively.

From the monetary aspect this development may be explained by two major factors: First, while the subsidies were raised in the first half of 1981, most of the actual disbursements of the price supports were made in the second half. The moderating effect of the lagged payments on the rate of inflation was reinforced by the tight credit policy, which *inter alia* restricted the possibility of borrowing against future payments. Secondly, the improvement of savings terms this year caused much of the liquidity injection to be diverted to the acquisition of financial assets. This eased inflationary pressures in the short run, but in the long term it may have an opposite effect. This is because the more attractive savings terms will increase the future interest payment burden of the public sector on the one hand, and dampen private sector investment and economic growth on the other. In the long run this combination of factors is likely to intensify inflationary pressures and further erode the balance of payments. At any rate, policymakers feel that it is impossible to persist in the raising of subsidies without aggravating inflation and the balance of payments problem.[6]

[6] Besides the adverse effect of a heavier subsidization policy on inflation and the balance of payments in the the long run, it militates against efficient resource allocation.

Figure VIII-2

ACTUAL AND TARGET GROWTH OF TOTAL CREDIT (EXCL. DIAMONDS AND OIL), SEPT. 1980 TO FEB. 1982



Beginning in September prices of controlled items were periodically adjusted and fuel was desubsidized. These price adjustments had an immediate impact on inflation, which reached a 109 percent annual rate by the second half of the year (116 percent in the last quarter), as opposed to 94 percent in the first half of 1981. The policy of adjusting prices to rising costs was continued in 1982, and in the early months inflation was back to its level in 1979 and 1980.

In addition to the hiking of subsidies on controlled items and the lowering of taxes on durables, tax brackets were updated four times in the course of 1981 (in January, April, July, and October). These measures and the continued restriction of bank credit had a contrasting effect on the scope and character of economic activity in 1981: on the one hand, the tax and subsidy policy helped to stimulate economic activity, particularly private consumption, where the growth compensated for the previous year's overcontraction; on the other hand, the real curtailment of bank credit moderated the expansion of domestic demands in the short run, whether because of the high marginal interest rates or because of the diminished availability of credit. The dampening effect of the credit squeeze on economic activity was felt primarily in inventory investment, as evidenced by the running down of stocks in 1981.[7]

The stringent credit policy had a moderating effect on economic activity and demands, even though the real decrease of credit was small relative to the sizable liquidity injection. This can be partly attributed to the fact that the tax structure was not adjusted to the high rate of inflation. With the escalation of inflation in recent years, tax considerations motivated firms to increasingly resort to bank credit for financing current operations while using their equity capital to purchase financial and other assets providing a hedge against inflation. Under these conditions the tightening of credit tends to weigh relatively more heavily on the financing of current activity. The liquidity injection attributable to the present tax structure contributes more to the growth of demand for financial assets than to the expansion of activity of the real sectors.

While from the fiscal aspect 1981 differed from the previous two years, there was no marked change in the structure and functioning of Israel's monetary system. It continued to be characterized by a situation in which the rise of prices is responsible for much of the nominal monetary expansion necessary for the continuation of the inflationary process. There are two main reasons for this.

(a) A significant part of the nominal injections resulting from the government's activities and the provision of cheap credit for export, investment, etc. is adjusted for the rise of prices, and it largely reflects the downward rigidity

[7] An additional factor that contributed to the low inventory level in 1981 was the prevailing uncertainty concerning the tax laws.

Table VIII-3

ESTIMATED INFLATION TAX ON THE MONETARY BASE AND THE CREDIT SUBSIDY, 1976-81 [a]

(IS million, at Dec. 1980 prices)

	Average monetary base (tax base) (1)	Rate of tax [b] (2)	Gross tax [c] Amount (1x2) (3)	Gross tax [c] Percent of GNP [d] (4)	Total subsidy on short- and long-term credit [e] Amount (5)	Total subsidy on short- and long-term credit [e] Percent of GNP [d] (6)	Gap between inflation tax and credit subsidy Amount (3-5) (7)	Gap between inflation tax and credit subsidy Percent of GNP [d] (8)
1976	10,512	0.29	3,063	2.6	12,129	10.4	-9,066	-7.8
1977	11,910	0.30	3,561	2.8	11,910	9.4	-8,349	-6.6
1978	10,269	0.34	3,500	2.5	10,816	7.9	-7,316	-5.3
1979	7,583	0.66	4,995	3.5	18,290	12.7	-13,295	-9.3
1980	5,384	0.71	3,816	2.6	14,025	9.5	-10,209	-6.9
1981	4,606	0.50	2,309	1.4	9,759	6.1	-7,450	-4.7

[a] Revised data.

[b] The tax rate equals the percentage rise in prices during the year, less interest paid on the narrow monetary base on account of liquid asset deposits with the Bank of Israel. This is the rate of inflationary erosion of the real monetary base during the year.

[c] The estimated inflation tax on the private sector monetary base is assumed to be equal to the inflationary erosion of the monetary base, i.e. long-term equilibrium (which does not necessarily hold at every point in time).

[d] At current prices.

[e] The subsidy component of long-term credit is a mid-period estimate of the current disbursements on account of the subsidy. It is calculated as the average real balance of total subsidized long-term credit (nonindexed) granted by the government, multiplied by the difference between the rate of price increase plus 4 percent real interest p.a. and the weighted interest on the outstanding credit balance. The subsidy component of short-term credit is estimated by multiplying the real balance of the rediscount component of directed credit in Israeli currency by the difference between the effective average interest rate on overdraft accounts and the discount rate on directed credit in Israeli currency.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

of the public sector's real deficit. This adjustment of nominal injections permits the realization of inflationary expectations and thus tends to perpetuate the high inflation.

(b) The high rate of financial linkage, and in particular its asymmetrical nature (while most of the public's financial assets are fully linked, a large part of its liabilities is not linked at all and bears a subsidized nominal interest) create a situation in which monetary expansion becomes automatic, thereby permitting the persistence and intensification of inflation.

Along with the escalation of the price advance, the weight of inflation-proof assets in the public's portfolio has moved up steadily. This represents part of the inflation-proofing and adjustment mechanisms adopted by the public—a process reflected by the erosion of the "inflation brakes", i.e. by the elimination of various nominal rigidities which tend to stabilize the rate of inflation.[8] The shift to linked assets has sharply depressed the private sector's real monetary base over the years, i.e. it has reduced the inflation tax base. The inflation tax on the monetary base has increased with the acceleration of inflation,[9] but since a large percentage of the public sector's real expenditure has also risen with the inflation rate, the problem of financing the public sector deficit in the long run has not been alleviated. A pertinent example is the subsidy element in the various types of cheap credit, which has swelled with the aggravation of inflation, while the private sector's liabilities to the public sector have remained unlinked. In recent years the total credit subsidy was probably greater than the aforementioned inflation tax, a fact which underscores the danger of an exacerbation of the problem of financing the budget deficit (in the long term) because of the asymmetrical system of linkage (see Table VIII-3). The linkage of medium- and long-term credit to the private sector, which got underway in 1979, is a step in the right direction: it reduced the subsidy component of cheap credit already in 1980 and even more so in 1981. Implementation of the recommendations for adjusting the system of taxation to inflationary conditions will allow the advantages of the new method of allocating credit to be more fully exploited.

3. MONETARY POLICY

As in the two preceding years, the Bank of Israel's monetary policy in 1981 focused on restraining the growth of short-term bank credit. This policy was adopted following the real expansion of this item by some 30 percent between 1975 and 1979. The main tool used was the periodic setting of quotas on the volume of nondirected credit in Israeli and foreign currency. The quotas were based on the nominal growth targets for total short-term bank credit (excluding oil and diamonds), which were designed to prevent the full adjustment of such credit to inflation without causing it to contract to such an extent as to depress activity in the real sectors.

Following the linkage of approximately half of all nondirected credit and

[8] These include *inter alia* the slow adjustment of inflationary expectations, various prices, and especially the exchange rate. These tend to stabilize inflation through a combination of wealth effects, liquidity effects, and the diversion of demands (to the balance of payments, for instance).

[9] In recent years the monetary base has grown increasingly sensitive to inflation, i.e. the accelerated rise of prices reduces inflation tax receipts on the margin.

Table VIII-4

ESTIMATED COST OF NONDIRECTED BANK CREDIT, 1979-82

(Percentages, at annual rates)

	Nominal cost				Nominal cost, deflated by estimated expected rate of inflation [c]		
	Average effective cost of overdraft facitities [a] (1)	Cost of excess drawings on overdraft accounts (2)	Interest on nondirected foreign currency credit, in $ terms [b] (3)	Estimated expected rate of inflation [c] (4)	Average effective cost of overdraft facilities [d] (5)	Cost of excess drawings on overdraft accounts (6)	Interest on nondirected foreign currency credit [e] (7)
1979							
I	63	95	17	68	-3	16	-19
II	69	107	28	80	-6	15	17
III	92	138	30	99	-4	20	23
IV	133	188	34	129	2	26	10
1980							
I	171	252	36	142	12	45	17
II	159	231	32	133	11	42	12
III	179	251	29	124	25	57	16
IV	197	256	35	140	24	48	28

1981							
I	174	233	34	145	12	36	28
II	170	225	35	109	29	55	51
III	172	225	36	90	43	71	60
IV	167	221	33	100	34	61	30
1982							
I[f]	148	220	32	119	13	46	20

[a] Data of the Department of the Examiner of Banks. Consists of the basic interest rate, commitment fees, value-dating, and the higher interest charged for drawings in excess of approved credit ceilings.

[b] Based on data of the Department of the Examiner of Banks. Consists of the basic interest rate on dollar credits granted during the quarter for a three-month period, plus the interest charged by the Bank of Israel at annual rates.

[c] The average rise in the consumer price index in the current and the previous quarter. Since this average increase does not necessarily reflect the inflationary expectations at every point in time, the interest listed here (column 5) should be regarded as only an indicator of the real interest facing the public (see the section on credit).

[d] The nominal cost (column 1) deflated by the estimated expected rate of inflation (column 4).

[e] The interest on nondirected foreign currency credit (column 3), inflated by the average rise in the exchange rate of the dollar in the current and the previous quarter, and deflated by the estimated expected rate of inflation.

[f] Provisional data.

most of the directed credit to the dollar, attainment of the credit policy objectives depends to a great extent on the government's management of the exchange rate in relation to a basket of foreign currencies[10] and on the movement of the dollar in relation to that basket. Because of the changes that occurred in the exchange rate of the sheqel during 1981 and the real increase in the dollar rate (with the strengthening of the dollar against European currencies), the amount of credit allocated deviated from its target path, rising in real terms in the first half of 1981 (see the section on credit for a detailed discussion). The Bank of Israel took steps to redress this deviation: initially it fixed ceilings for the months of August–December, but when it became apparent that this would squeeze credit too sharply, the ceilings were raised, the freeze extended, and the banks permitted to offset the deviation.

In addition to establishing credit ceilings, the Bank of Israel acted to retard the growth of directed credit. In continuation of the policy adopted in 1980, financing rates in the export funds were again trimmed (at the beginning of the year and in September), and the amount of credit provided by the Diamond Fund was reduced through the fixing of a quota and the raising of the interest rate (from 10 percent in 1980 to 13.5 percent). In view of the global recession in diamonds, these measures sharply depressed the amount of finance from this source.

The concentration of monetary policy on the restriction of short-term bank credit reflects the constraints confronting the monetary authorities under the prevailing conditions. On the one hand, the Israeli economy is characterized by huge liquidity injections, which originate in the sizable persistent government deficit and the large volume of directed export credit provided. On the other hand, the sale of bonds to the public in open-market operations does not play an important role in monetary policy, since the government, in its desire to continue raising money from the public through the flotation of new bond issues, limits the extent to which the Bank of Israel can change bond prices in the secondary market. In this situation, tradable government bonds have become near-money. The same applies to Patam (local residents' foreign currency deposits). Liquidity absorption could probably be increased by selling foreign currency to the public for balance of payments purposes, but apprehension over a possible deterioration in the current account has prompted the Bank of Israel to follow, since March 1979, a policy of stabilizing the real exchange rate, thereby keeping Patam accounts highly liquid and making it increasingly worthwhile to hold them also for transactions purposes.

[10] This basket is a weighted average of five currencies (U.S. dollar, pound sterling, Deutsche mark, French franc, and Dutch guilder), and reflects the volume of Israel's trade (excluding diamonds) with these countries.

Table VIII-5

TURNOVER VELOCITY OF DEMAND DEPOSITS AND MONETARY AGGREGATES, 1977-81

	Average turnover velocity of demand deposits in IS[a] (1)	Annual average turnover velocity of monetary aggregates relative to domestic uses[b]		
		Money supply (2)	Money supply and unlinked deposits (3)	Total liquid assets[c] (4)
1977	38.75	9.87	9.00	6.00
1978	45.22	12.02	9.40	2.80
1979	69.19	17.20	13.56	3.21
1980	104.29	22.32	16.94	3.14
1981	160.97	27.02	19.14	3.42

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

[b] Total domestic uses excluding direct defense imports (as defined in Table VIII-B2), divided by the annual average balance of the monetary aggregates.

[c] All the assets in column (3), plus tradable bonds held by the public and Patam deposits (which were introduced toward the end of 1977).

SOURCE: Velocity of demand deposits—Department of the Examiner of Banks, *Banking Statistics*; money supply and unlinked deposits—Table VIII-A1; total liquid assets—Table VIII-A4; domestic uses (excluding direct defense imports)—Table II-1.

Because they are restricted in employing direct means of liquidity absorption, the monetary authorities have chosen bank credit as the principal monetary policy instrument in view of its important role in the realization of the policy objectives and the fact that it is subject to central bank control. However, this policy has several significant disadvantages:

(a) In view of the limited short-term substitutability between bank credit and alternative sources of funds, this policy has led to a steep rise in real interest rates, hurting both established businesses and new firms, which have not yet earned profits and hence are not able to deduct interest expenses for tax purposes.

(b) The restrictive policy has concentrated on nondirected credit, which is subject to fixed ceilings. In determining these ceilings account has been taken of the expected growth of directed export credit, but the close connection between such credit and the anticipated expansion of exports makes it hard for the Bank of Israel to keep total credit growth within the planned limits. The Bank's gradual reduction of directed credit has alleviated, but not fully solved, this problem.

(c) Because of the continued large public sector liquidity injection, the

quantitative curtailment of credit has tended to increase the banks' liquidity reserves in relation to their deposits, creating an incentive for them to transfer funds other than in the form of credit—viz. through the purchase of shares of subsidiary companies, which in turn transfer funds to others. The credit curbs have also contributed to the emergence of a "gray market," over which the Bank of Israel has no direct control, and have thereby narrowed the scope within which monetary policy can operate effectively.

Along with its dampening effect on economic activity, the stringent credit policy has been an important factor in slowing inflation in the last three years, although it is not yet clear to what extent it has affected the activity of the real sectors or retarded the rise of prices.

To sum up, a policy of monetary restraint can unquestionably play a key role in restraining inflation, provided it is coordinated with fiscal developments. A disinflationary policy must therefore be based on both a reduction of the public sector demand surplus and on regulating the growth of total credit. Without a significant pruning of the public sector demand surplus, no long-term significant cooling of inflation is to be expected, even if in the future more direct monetary instruments are employed, such as open-market operations.

II. THE PUBLIC'S WEALTH AND ITS SOURCES

1. SOURCES OF MONETARY EXPANSION

Changes in the financial assets and liabilities of the public have stemmed from three principal sources (see Table VIII-6):[11]

(a) Net payment flows (on goods and services account and transfers) between the private sector on the one hand and the public and foreign sectors on the other. These flows represent the private saving that augments financial wealth.

(b) Flows connected with the creation and payment of liabilities between the private nonfinancial sector and other sectors. These flows are mainly effected through the financial intermediaries, which also channel most of the funds originating in the public and foreign sectors.

(c) The revaluation of liabilities between the various sectors as a result of both formal linkage devices and changes in the subjective evaluation of various liabilities. The latter may find a measurable expression in the market (e.g. tradable securities), but they also include changes in the subjective

[11] Various statistical difficulties preclude a classification fully consonant with economic definitions. These difficulties are also mirrored in the quality of the data and in unexplained residuals.

Table VIII-6

CHANGES IN THE FINANCIAL WEALTH OF THE PRIVATE NONFINANCIAL SECTOR, 1980-81

(IS billion, at current prices)

	1981			Percent annual real increase[a]	
	Total	1st half	2nd half	1980	1981
1. Liquidity injection generated by public sector demand surplus	24.1	5.8	18.3	63	96
2. Private sector import surplus on goods and services	8.6	5.2	3.4	-58	27
3. Flows of liabilities between the public and other sectors	19.1	13.6	5.5	-19	-18
a. Development and other credit from the public sector[b]	8.8	3.6	5.2	18	-15
b. Credit from the Bank of Israel[c]	-1.3	-2.5	1.2	-24	—
c. Credit from domestic sources of financial intermediaries, other factors, and unidentified sources[d]	17.0	7.5	9.5	54	55
d. Net flow of liabilities from abroad[e]	-5.4	5.0	-10.4	—	—
4. Purchases of assets by the public (1-2+3)	34.6	14.2	20.4	39	15
				Percent of financial wealth at beginning of year	
5. Revaluation of financial items in assets portfolio[f]	249.2	102.5	146.7	2.34	1.73
6. Total change in the public's financial assets (4+5)	283.8	116.7	167.1	2.50	1.97
7. Revaluation of the public's liabilities[f]	73.8	32.7	41.1	0.59	0.51
8. Total change in the public's liabilities (3+7)	92.9	46.3	46.6	0.82	0.65
9. Change in financial wealth of the public (6-8)	190.9	70.4	120.5	1.68	1.33

[a] Deflated semiannually.

[b] Includes net government credit to the private nonfinancial sector, less net long-term capital raised for local authorities and the National Institutions (see Table VIII-A11, lines 6 and 8).

[c] Directed credit in Israeli and foreign currency.

[d] Other Bank of Israel income and expense accounts, Bank of Israel credit to the commercial banking system, items related to security and real estate transactions between the public and financial intermediaries, and errors and omissions.

[e] Calculated as the difference between the import surplus of the private sector net of unilateral transfers and the sector's net purchases of foreign currency.

[f] Valuation changes during the period due to linkage and exchange rate differentials, variations in market prices of tradable assets, and changes in liabilities on account of long-term credit due to its subsidy component.

evaluation of future payments which cannot be measured directly.[12]

The year reviewed witnessed an enormous increase in the liquidity injection engendered by the public sector demand surplus, from some IS5 billion in 1980 to approximately IS24 billion—a real growth of close to 100 percent. At the same time, the private sector's balance of payments deficit on current account (as defined in Table VII-1) rose 27 percent in real terms, after a real 58 percent decline the year before. The amount of money put into the economy by the public sector expanded considerably in the last two years, with only part of the increment being siphoned out through the balance of payments current account. The continuation of this process constitutes a potential source for the aggravation of inflation in the future, and its prevention requires a marked reduction of the public sector demand surplus.

Examination of the private sector's current account and capital movements reveals that, in contrast to 1980, there was no significant derived capital outflow this year.[13] In total capital movements (short- and long-term) there was a $66 million capital outflow, compared with $148 million in 1980 (see Table VII-26). In short-term capital movements (which are largely of a monetary character) there was a derived outflow of only $17 million, which reflected contrary trends in the two halves of 1981. The first six months, when the expansion of liquidity was restrained, saw a derived $566 million net inflow, due primarily to a sizable repayment of credit to the Diamond Fund (approximately $75 million) and the import of capital by the commercial banking system, which apparently was partly related to the banks' intervention in the equity market.

During the second half of the year, which was marked by a greatly expanded liquidity injection, there was a $582 million short-term capital outflow (roughly $100 million of it originated in repayments of foreign credit by diamond industrialists). Short-term capital movements are sensitive to the gap between the cost of short-term credit in Israeli currency (most of which is in the form of overdrafts) and the anticipated cost of credit in foreign currency (in most cases dollars), which is dependent on the expected changes in the dollar exchange rate. The growth of capital imports in the course of the year was consistent with the changes in the spread between these costs, assuming that the strengthening of the dollar in relation to the currency basket was unex-

[12] Tables VIII-6 and VIII-9 attempt to measure the flow of future payments on account of the private sector's unlinked liabilities. However, we do not deal with changes in the estimated future receipts generated by linked medium-and long-term assets, it being assumed that the public evaluates them according to their adjusted value (i.e. including accrued linkage increments and interest thereon, even though these cannot be immediately realized).

[13] The differences between derived and recorded capital movements are described in the section on the short-term capital account in Chapter VII. Short-term capital movements include debt repayment.

Table VIII-7

CHANGES IN LIQUID FINANCIAL ASSETS, 1980-81

(IS million)

	1980	1981	1980		1981	
			1st half	2nd half	1st half	2nd half
1. Contribution of public sector to liquid financial assets (basic injection) [a]	**6,133**	14,571	2,452	3,681	3,359	11,212
a. Public sector injection	4,916	17,235	2,716	2,200	4,607	12,623
b. Net sale of tradable bonds to the public [b]	1,217	-2,664	-264	1,481	-1,248	-1,416
2. Directed Bank of Israel credit (mostly through the export funds)	3,556	-652	1,671	1,885	-2,230	1,578
3. Sale or purchase (-) of foreign currency by the private sector[c]	-4,456	-10,025	-1,552	-2,913	857	10,882
4. Other factors[d]	-290	-850	56	-346	-1,801	951
5. Net exogenous injection (1+2+3+4)	**4,934**	**3,044**	**2,627**	**2,307**	**185**	**2,859**
6. Increase due to domestic banking activities [e]	3,602	7,963	1,658	1,944	4,669	3,294
7. Purchase of liquid financial assets [f]	8,536	11,007	4,285	4,251	4,854	6,153
8. Revaluation of Patam deposits and bonds	28,373	51,165	8,898	19,475	21,127	30,038
Thereof: O/a acquisitions during the period	2,065	2,613	1,117	948	1,781	832
9. Total change in liquid financial assets[f] (7+8)	**36,909**	**62,172**	**13,183**	**23,726**	**25,981**	**36,191**

[a] The injection generated by the demand surplus, as presented in Table VIII-8, is estimated as the public sector's contribution to liquid financial assets, plus its net long-term capital market operations.

[b] Includes the sale of dollar bonds; the estimated contribution to liquid financial assets therefore has a downward bias.

[c] Includes the commercial banks' participation in the export funds.

[d] Consists mainly of the absorption or injection generated by various items in the Bank of Israel's statement of income and expenses, such as receipts and payments of interest, fines for liquidity deficiencies, and the special loan to banking institutions.

[e] Residually calculated.

[f] Includes nonresident deposits permitted to certain categories of Israeli residents; the data on the private sector's foreign currency transactions (line 3) have been adjusted accordingly. Bond purchases differ from the data presented in Table VIII-A5, since here they include purchases by the commercial banks.

SOURCE: Table VIII-A3.

pected (information from the forward markets support this assumption—see Chapter VII, section 4 for a detailed discussion). It should be pointed out that part of the derived capital movements (such as the repayment of credit to the Diamond Fund) can be attributed to changes in institutional arrangements and the existence of administrative restrictions (see Chapter VII, section 5). The low reliability of the capital movement estimates, both the derived and the balance of payments figures, should also be emphasized.

The private nonfinancial sector's contribution to asset creation through the receipt of various types of credit from the system of financial intermediaries amounted to IS19 billion in 1981, compared with IS11.7 billion in 1980—a real drop of nearly 18 percent (see Table VIII-6). This was an outgrowth of the Bank of Israel's credit policy (the setting of ceilings and the cutting of directed credit, particularly in the Diamond Fund). By contrast, long-term credit flows expanded this year (see the section on credit). With the increasing allocation of long-term credit on linked terms, instead of on unlinked terms and at a subsidized interest rate, the contribution of the subsidy element to asset creation fell off 33 percent in real terms owing to the growing real erosion of credit balances. Nevertheless, because of the asymmetry of the present tax system (interest and linkage differentials are recognized as a deductible expense, while part of the firms' income is tax-exempt), an increase in the public's liabilities still augments its financial wealth. The adoption of the proposed changes in taxation under inflationary conditions presumably would go a long way toward correcting this distortion.

Purchases of financial assets with the liquidity injected by the public sector demand surplus, plus the net credit flows and less the amount absorbed through the balance of payments current account totaled IS34.6 billion in 1981 (see Table VIII-6), as opposed to IS13.5 billion the year before—a real growth of 15 percent. The increased accumulation of such assets is chiefly explained by the introduction of savings schemes featuring a shorter maturity and the large volume of share issues by commercial banks (see Table VIII-B4). Liquid asset accumulation (which is more closely connected with the development of prices and economic activity) slumped 32 percent in real terms this year, mainly because of a IS5.3 billion disinvestment in tradable bonds (see Table VIII-A5).

The rest of the change in the public's financial assets portfolio (i.e. besides purchases) represented the automatic revaluation of linked assets and the variation in the market value of tradable assets and liabilities. The contribution of linkage increments and the shift in the relative price of tradable assets to the total appreciation of financial assets (excluding accumulation) did not change significantly this year (linkage accounted for 87 percent and the variation in the market value of tradable assets for 13 percent of the total appreciation). The slowing of inflation had, of course, a contractionary effect on the linkage component, but the effect of the relative price change was smaller yet;

Table VIII-8

ESTIMATED PUBLIC SECTOR DEMAND SURPLUS, 1979-81[a]

(IS million, at current prices)

			1981			Percent real increase	
	1979	1980	Total	1st half	2nd half	1980	1981
1. Net capital mobilized by the govt. through bond sales[b] and receipt of deposits	2,326	5,978	18,344	5,745	12,599	-2	44
2. Net govt. credit to the private sector[c]	1,800	4,919	8,817	3,636	5,181	18	-15
3. Net long-term financial resources raised by the public sector (1-2)	**526**	**1,059**	**9,527**	**2,109**	**7,418**	**-49**	**360**
4. Public sector injection[d]	1,480	4,916	17,235	4,607	12,628	103	44
5. Injection generated by public sector demand surplus[e]	1,537	5,163	24,067	5,768	18,299	63	96

[a] The estimate here differs from that in the national accounts (see the chapter on the public sector) owing to the inclusion of several financial items in the demand surplus as defined in the national accounts, as well as to advance payments for services.

[b] Tradable and special bond issues.

[c] Excludes government credit to local authorities; includes net credit received by local authorities and the National Institutions from the private sector, but not the changes in their short-term credit balances.

[d] The change in Bank of Israel credit to the government and government foreign currency conversions, less transfers between the government and the Bank of Israel.

[e] Calculated as the sum of lines 3 and 4, less early redemption of Israel Bonds, which are included in the public sector injection (line 4) and do not constitute one of the sources of financing the demand surplus.

SOURCE: Table VIII-A11; Bank of Israel calculations.

Table VIII-9

ESTIMATED WEALTH OF THE PRIVATE NONFINANCIAL SECTOR, 1979-81[a]

(IS billion, at current prices)

End of year	1979	1980	1981 Jan.	1981 Dec.	Percent real increase[b] 1979	1980	1981
A. Financial assets	82.5	220.3	357.0	504.1	-2.7	14.6	13.5
1. Liquid assets	23.9	59.6	83.8	118.5	-12.2	7.0	-1.4
2. Shares of financial concerns	6.3	25.1	44.7	74.0	-10.7	70.9	46.1
3. Medium- and long-term assets	52.3	135.6	228.5	311.6	3.5	11.3	14.0
B. Liabilities	31.0	76.3	122.7	169.2	0.5	5.6	9.9
1. Short-term	20.1	48.1	76.2	94.4	10.5	2.7	-2.7
2. Long-term	10.9	28.2	46.5	74.8	-13.9	10.8	30.6
Thereof: Subsidy component	5.8	10.0	10.8	13.4	5.1	-26.8	-33.3
C. Net financial wealth (A-B)	**51.5**	**144.0**	**243.3**	**334.9**	**-4.4**	**20.1**	**15.4**
D. Other wealth[c]	188.9	431.1	—	929.3	14.0	-2.0	6.9
E. Total wealth (C+D)	**240.4**	**575.1**	—	**1,264.2**	**9.5**	**3.0**	**9.0**

[a] The financial and other wealth of the private nonfinancial sector, which comprises households and nonfinancial firms, is estimated as the difference between its claims on the public sector, Bank of Israel, rest of the world, and the system of financial intermediaries. The financial intermediaries are defined here as the commercial banks, credit and savings cooperatives, mortgage banks, investment banks, financial institutions required to report on their operations to the Examiner of Banks, insurance companies, and provident and pension funds. This group accounts for the overwhelming proportion of financial intermediation in Israel. Owing to statistical limitations, financial institutions not required to report on their activities are not defined as financial intermediaries, and are included in the private nonfinancial sector. Because of the definition of financial intermediaries used in this table, the data here differ from those on assets and liabilities of the public appearing in other tables in this chapter. For a more detailed presentation of the items in this table see Table VIII-A3.

[b] Deflated by the consumer price index.

[c] Physical assets and compulsory loans. Physical assets here comprise durable goods, residential buildings, and structures and equipment owned by firms. Raw materials and other inventories of firms and households should also be included, but the relevant data were not available when this chapter was written.

SOURCE: Bank of Israel estimates.

the main reason for the latter development was this year's more moderate growth in the real return on financial shares. There was a higher real revaluation of liabilities in 1981, due both to the increased weight of indexed credit in total liabilities and to the large weight of credit linked to the dollar, which rose faster than the rate of inflation.

2. CREDIT TO THE PUBLIC

(a) Type of Credit and Major Trends

Credit to the public[14] falls into three main categories:

(1) Credit for domestic activities, extended by the Israeli banking system and its overseas offices, chiefly for the short-term financing of business transactions.[15]

(2) Directed short-term export credit granted through the banking system. This is intended primarily to finance the various stages of the export process (imports, production, and shipments), but part of it is used for maintaining diamond stocks.[16]

(3) Long- and medium-term credit, mostly for financing nondwelling investment and the purchase of private housing.

Besides the contribution to asset creation of the net fund flows related to the granting of credit and the weight of such finance in the public's net financial wealth, credit fulfills a very significant function in that it finances current productive activity as well as investment in residential and nonresidential buildings and equipment.[17]

Examination of the financing of current activity mainly necessitates an analysis of the average level of short-term credit (for the domestic market and exports), while for nondwelling and dwelling investment it is necessary to analyze long-term credit flows. However, one must not disregard the credit flows within the business sector itself and the substitutability of various types

[14] Credit to the public, as discussed here, consists of credit granted for various periods by the commercial banking system in Israel and its offices abroad, by the system of financial intermediaries (defined in this Report as the "institutional structure of the capital market") for long and medium terms, supplementary long- and medium-term finance granted under special arrangements, in particular by the government, and credit from earmarked foreign deposits. Excluded from this definition are certain types of foreign credit (notably supplier credit), credit flows between private nonfinancial units, and credit to local authorities.

[15] This consists of nondirected credit in Israeli and foreign currency and directed credit in Israeli currency (whose outstanding balance is small). Part of the nondirected foreign currency credit is for financing preferred activities, such as the import and stockpiling of oil. The discussion below excludes credit for oil, which is used to finance stocks whose size is determined by the government and has only a limited effect on domestic activities. In principle, that part of the oil credit which is passed on to consumers should probably be included in credit to the public and the balance treated as credit to the government.

[16] Unlike decisions regarding oil stocks, those concerning diamond stocks are taken solely by the business sector, and so credit to the diamond industry should be treated as credit to the private sector. Moreover, it should be noted that during certain periods at least the method of financing diamond stocks resulted in surplus funds, which were used for other purposes.

[17] This does not imply that part of the credit is not diverted, directly or indirectly, to financing other activity, including the purchase of financial assets by households or business.

Table VIII-10

MAIN INDICATORS OF CREDIT GROWTH, 1979-81 [a]

(IS billion, at current prices)

				Percent of activity financed by credit[b]		
	1979	1980	1981	1979	1980	1981
1. Commercial bank credit, excl. oil—average balance	12.5	25.1	52.7	17.2	15.3	13.7
2. Gross long- and medium-term credit[c]	4.7	10.2	24.7	40.7	41.7	43.3
a. To households	1.3	2.9	7.9	34.7	27.9	32.9
b. To the business sector	3.3	4.9	16.2	41.8	49.6	48.9
3. Long- and medium-term credit, less repayments	2.8	5.9	15.6			
4. Total credit (1+3)	**15.3**	**31.0**	**68.3**	**21.0**	**18.9**	**17.7**

[a] Excludes credit to local authorities and the National Institutions.

[b] Lines 1 and 4—relative to total uses (less direct defense imports); line 2—relative to fixed investment; line 2a—relative to private dwelling investment; and line 2b—relative to fixed nondwelling investment.

[c] Includes credit to the public through the National Institutions which cannot be classified by economic sector (see Table II-A3).

SOURCE: Bank of Israel calculations.

of credit (this finds partial expression in the conversion of short- into long-term credit). The most appropriate way to determine the total liquidity available to the various sectors would probably be to add the average short-term credit flows to the net long- and medium-term flows.[18] This indicator shows that the ratio of total credit to domestic uses (excluding defense imports), which the credit is intended to finance, continued to decline in the year reviewed, but at a mild rate—from 18.9 percent in 1980 to 17.7 percent (see Table VIII-10).

The Bank of Israel's credit policy during the last two years and the linkage of long- and medium-term loans sharply pushed up real interest rates in the economy. A similar trend is evident in the real cost of credit after tax (see Table VIII-11). Interest rates after tax are much lower than pretax rates, and in real terms are even negative for all types of credit.

The high real cost of nondirected credit is due, among other things, to the distortional tax system, which stimulates demand for credit because of tax considerations. The real posttax rate of interest faced by economic units (which are allowed to deduct interest payments from taxable income when the credit finances nontaxable activities) is well below the cost of credit before tax. However, the possibility of deducting financing costs on tax-free activities does not exist for households or for firms that do not have to pay tax because of losses, special tax concessions, and the like. The real cost faced by these units is the pretax cost, and the high real interest rates saddles them with a heavy financing burden.

(b) **Short-Term Bank Credit**

The real contraction of short-term bank credit, a trend apparent for the past two-and-a-half years, continued in 1981 but a little more moderately than in the previous year (see Table VIII-13). Excluding the financing of oil imports, the volume shrank 9 percent in real terms, compared with 10 percent in 1980. The difference between the two years is more pronounced if we omit credit provided by the Diamond Fund, which fell off steeply in 1981: excluding diamonds and oil, the level inched down 1 percent in real terms, as opposed to 15 percent in 1980. There was also a difference in the development of credit in the course of the year: in 1980 it decreased steadily, whereas in 1981 it expanded during the first half and contracted in the second.

The development of short-term credit deviated from its planned path in

[18] Justification for this method may be found in the fact that most of the credit for domestic activity and exports is renewed within one year, and so it resembles long- and medium-term credit. An exception is linked credit for financing domestic activity. It should be borne in mind, however, that adding stocks and flows for comparison with a domestic activity index is problematic.

Table VIII-11

ANNUAL REAL COST OF CREDIT BEFORE AND AFTER TAX, 1979-81[a]

(Percentages)

	Before tax			After maximum tax deductions[b]		
	1979	1980	1981	1979	1980	1981
1. Nondirected short-term bank credit						
Overdraft accounts	-11	19	34	-36	-27	-17
In Israeli currency, indexed[c]	7	7	7	-25	-25	-25
In foreign currency	9	16	38	-30	-31	-15
2. Directed credit						
In Israeli currency	-45	-39	-28	-49	-50	-43
In foreign currency	-8	-3	18	-35	-36	-22
3. Total short-term credit[d]	-4	5	17	-33	-34	-24
4. Long-term credit[e]						
For housing	-32	-18	-13			
Industrial development loans	-26	-9	-6	-29	-18	-16

[a] Defined as the nominal cost of credit deflated by the actual rise in prices. This definition differs from the one used in Table VIII-4, which is based on estimated inflationary expectations.

[b] Assuming that interest on credit has been recorded as an expense for tax purposes and that the tax rate is 60 percent; for development loans the tax is assumed to be 30 percent.

[c] Assuming a 100 percent annual inflation rate during the period of the loan, with principal and interest paid at the end of the period.

[d] Weighted by the components of short-term credit (see Table VIII-12).

[e] Assuming an 80 percent average annual price rise during the period of the loans. The cost of such credit has been estimated by weighting linked and unlinked loans actually granted.

SOURCE: Bank of Israel calculations.

1981. The targeting of nominal growth during a certain period (designed to reduce total credit to the public in real terms)[19] is based on projected inflation rates and levels of economic activity, whereas the actual growth is influenced by the actual inflation rate (a fairly large percentage of the credit is linked to the consumer price index), exchange rate fluctuations (about half of the nondirected credit and most of the directed export credit is linked to foreign currency), the movement of the dollar against the currency basket (most of the foreign currency credit is linked to the dollar), and the actual level of economic activity.

[19] The credit targets relate to total credit to the public, excluding oil imports and diamonds.

Table VIII-12

DISTRIBUTION OF SHORT-TERM CREDIT BY TYPE, 1979-81

	IS billion	Percent		
	1981	1979	1980	1981
Nondirected credit, excl. oil	37.1	100	100	100
Overdraft facilities and excess drawings on overdraft accounts	10.0	22	24	27
Indexed Israeli currency credit	7.1	14	18	19
Other Israeli currency credit[a]	2.5	6	7	7
Foreign currency credit[b]	17.5	58	51	47
Total short-term credit	71.7	100	100	100
Nondirected	37.1	56	49	52
Directed	34.6	44	51	48

[a] Nonindexed fixed-term credit in Israeli currency.
[b] Includes credit from Israeli bank branches abroad.

These factors combined to cause a real expansion of credit during the first half of 1981, contrary to plan (see Figure VIII-2). To redress this deviation, the Bank of Israel set ceilings on nondirected credit for the months of August-December with the aim of arresting nominal growth during the last quarter of the year. This demonstrated the limitations of the present tight credit policy, which is based on the imposition of ceilings on nondirected credit alone (which accounts for less than half of all bank credit to the public). Toward the middle of the period it became clear that the ceilings would depress credit too sharply; the ceilings were therefore raised, the freeze was extended, and banks were allowed to offset the deviation.

During the past two years the real (expected) cost of short-term credit rose appreciably (see Table VIII-4). This reflected both the rapid adjustment of nominal interest rates for inflation (including compensation for the delayed adjustment on account of previous years) and the curbing of the growth of bank credit. In 1981 the nominal cost of overdraft facilities was in fact slightly reduced, but if inflationary expectations diminished still more because of the measures taken to slow inflation, the real cost of such credit actually rose. In any case, it is clear that, as in 1979 and 1980, the average cost of overdraft facilities was very high (see Table VIII-4).[20] It should be emphasized,

[20] Deflating the nominal cost of overdraft facilities by the wholesale price index of industrial output gives a lower real interest rate (about 20 percent).

however, that this also reflected the much greater flexibility of this form of credit for the borrower as opposed to fixed-term credit. Moreover, during the past three years it accounted for only about 25 percent of total short-term credit. Nondirected credit in Israeli currency, which is linked to the consumer price index, is relatively cheap (about 7.5 percent in real terms), and to some extent is a substitute for overdraft facilities;[21] in recent years this component has been on the rise, and by the end of 1981 it constituted close to 19 percent of total short-term credit.

The real cost of nondirected credit in foreign currency was also high in 1981 (approximately 30 percent in dollar terms), and probably even exceeded the cost of overdraft facilities.[22]

Although it remained negative, the real cost of directed credit rose steeply in the year reviewed (see Table VIII-11). This is explained primarily by the fact that some 75 percent of the credit was linked to foreign currency (mostly to the dollar), and in 1981 the sheqel depreciated 2.6 percent in real terms against the dollar.

Short-term credit as a whole also become much dearer this year in real terms, both before and after tax, although the posttax cost remained negative.

In addition to fixing ceilings, the Bank of Israel took other action to gradually reduce the volume of directed export credit. It cut the rates of financing in the export funds twice during the year, and adjusted the interest rates to bring them more into line with those on overdraft accounts and the going rates in the international exchange markets. These steps were taken in response to the continued growth in the export share of the product; if the rates of export financing had not been trimmed, the stringent credit policy would have necessitated a greater reduction in nondirected credit. Another measure taken was the raising of the price and the establishment of a quota on credit extended through the Diamond Fund; because of the worldwide slump

[21] The increased cost of overdraft facilities in 1981 is also indicated by the change in the relative demand for indexed credit, which to some extent is a substitute for it. Since indexation increments were added to the credit quotas in the year reviewed, it would be reasonable to assume that had demand remained relatively flat, the weight of indexed credit would have dropped. That it did not do so was due to the proportionally greater demand for such finance in 1981, from which it follows that its relative price declined. Since overdraft accounts carry a fixed rate of interest, the price of this form of credit obviously rose.

[22] The estimated real interest on nondirected credit in foreign currency depends on the measurement of inflationary expectations. If these expectations are measured as the average of the inflation rates in the current and the previous quarter, the real cost of nondirected foreign currency credit was higher than that of overdraft accounts (see Table VIII-4). On the other hand, if it is assumed that the expectations regarding the dollar's depreciation did not differ from the expectations concerning the currency basket, an opposite picture emerges (see Chapter VII, the section on net short-term capital imports).

Table VIII-13

COMMERCIAL BANK CREDIT TO THE PUBLIC, 1980-81

	Balance at end of 1981 (IS billion)	Percent increase over previous year						
		Dec. levels		Annual average	1980		1981	
		1980	1981	1981	1st half	2nd half	1st half	2nd half
Credit for financing domestic activities [a]	35.1	81	93	114	16	56	56	25
Thereof:								
Nondirected credit in Israeli currency	17.8	106	112	137	48	38	61	32
Nondirected credit in foreign currency	16.8	65	79	105	-9	81	50	19
Directed export credit	34.1	145	74	103	56	57	36	28
Excl. diamonds	23.0	134	109	121	52	54	46	43
Diamond Fund	11.1	160	29	78	62	61	23	5
Credit for oil imports	17.7	259	105	141	114	68	90	8
Total bank credit, excl. diamonds and oil	58.1	98	99	119	27	56	51	32
Total bank credit, excl. oil	69.2	110	83	110	33	56	45	26
Total bank credit	**86.9**	**128**	**87**	**116**	**50**	**51**	**53**	**22**

[a] Includes linkage increments on the linked portion of nondirected credit in Israeli currency and credit from Israeli bank branches abroad; excludes credit for oil imports; includes IS400 million in directed credit for financing domestic activities. The definition here differs from that in other Bank of Israel publications and in Table VIII-A10, in that in this table credit for financing domestic activities does not include local authorities and the National Institutions.

SOURCE: Table VIII-A10; credit to local authorities and the National Institutions is from the report on the sectoral distribution of credit.

in this industry, this step resulted in a real 37 percent contraction of such finance. The amount of credit from this source (which in 1980 accounted for roughly 45 percent of total directed credit) is not directly connected with the volume of exports, but is related primarily to the value of the industry's stocks. Because of this, and the fact that during certain periods there was a surplus of such funds which was used for financial activities, the Bank of Israel decided in the latter part of 1981 to relate the amount of credit to the level of production. The various measures adopted with respect to directed credit unquestionably facilitated the conduct of an overall restrictive credit policy, but they were insufficient to eliminate the difficulties and distortions arising from the concentration of credit policy on the fixing of ceilings for nondirected credit alone. Nonetheless, it appears that under the prevailing conditions there is no simple alternative to the present credit policy (see the section on monetary policy in part I).

(c) Long-Term Credit

The flow of gross long- and medium-term credit reached approximately IS25 billion in 1981, compared with IS10 billion the year before. The ratio of such funds to the investment they were intended to finance continued upward (see Table VIII-10): the investment financing rates in the business sector during the past two years were higher than in 1979, and to some extent they reflected the substitution of long- and medium-term credit for short-term bank credit (the growth of which is curbed under present policy) for financing working capital requirements.[23] The real cost of long- and medium-term credit was also much lower than that of free market credit in 1981, even though the real interest rates on long- and medium-term credit moved up moderately this year, reflecting the increase in the weight of linked credit (see Table VIII-11). The linked portion of total industrial development loans rose from less than 80 percent in 1980 to around 90 percent.

Total credit to households shot up from IS3 billion in 1980 to approximately IS8 billion. Most of the growth was in housing loans, which expanded following the revival of demand for homes, mainly at the beginning of the year. The linked portion of directed housing credit (which in the past was given on unlinked terms by the government) rose in 1981 to about 65 percent of total directed credit for purchasing homes, as against 50 percent in 1980 and only 15 percent in 1979 (when such loans were first linked). The fact that a growing proportion of the credit is linked did not deter the public from resorting to such funding, owing to the easy repayment terms. The ratio of

[23] Another example of the use of long-term funds for financing current operations was the issue of dollar-linked securities by industrial and service firms, in the amount of some IS300 million and IS700 million in 1980 and 1981 respectively.

housing credit to housing investment went up significantly in 1981, reaching 33 percent as opposed to 28 percent the year before. After adjusting for the increase in the consumer price index, the expansion of such credit amounted to 3 percent.

3. THE PRIVATE NONFINANCIAL SECTOR'S WEALTH

The private nonfinancial sector holds an extensive portfolio of assets (financial and physical) and liabilities, which constitute mutual obligations between it and the system of financial intermediaries, the public sector, and the foreign sector. According to the estimates presented in Table VIII-9, the public's financial and other wealth amounted to IS1,264 billion at the end of 1981, 5.3 times the gross national product. The public's total wealth rose 9 percent in real terms, compared with 3 percent in 1980. This year's gain was mainly due to an appreciable 15 percent real growth in financial wealth; the latter was fueled primarily by a rise in the private sector saving rate and by the real expansion of the sector's income following a moderately better performance of the economy this year. The increase in financial wealth reflected a real 13 percent expansion of financial assets (15 percent last year). A large percentage of the asset growth was due to a real rise in the market value of financial shares and to the large volume of new issues (see the section on the capital market). Financial shares accounted for nearly half of the real increase in net financial wealth. The public's liabilities were up 10 percent in real terms this year, after rising 5.5 percent in 1980.

In contrast to last year, there was also a real increase in the value of physical assets, including durable goods, homes, nonresidential structures, and equipment owned by the private nonfinancial sector.[24] This can be attributed to the revived demand for durable goods and the rise in dwelling prices following a cyclical upswing in demand for homes, mainly at the beginning of the year. Nevertheless, there was a continued shift in demands this year from physical to financial wealth. There were two principal reasons for this: (a) The improvement in recent years in the terms of the various financial savings channels: the introduction of approved schemes featuring a shorter period of saving, the continued advance in real yields (particularly in the case of bank shares), and implementation of a policy ensuring relative stability in the real prices of most liquid assets (the reference is to the Bank of Israel's open-market operations in tradable bonds and its devaluation

[24] Physical wealth does not include land, raw material stocks, and such valuables as works of art, jewelry, etc.

Table VIII-14
FINANCIAL ASSETS OF THE PUBLIC, 1976-81 [a]
(Balances in IS billion)

End of year	1981	Weight in total assets (%)				Percent annual real increase	
		1976	1978	1980	1981	1980	1981
A. Liquid assets	123.5	33	27	27	23	8	0
1. Money	12.5	8	6	3	2	-15	-12
2. Pazak and CDs	6.5	2	1	1	1	21	45
3. Patam deposits [b]	65.4	7	10	12	12	9	13
4. Bonds [c]	39.1	16	10	10	8	15	-17
B. Bank shares	69.6	3	6	10	13	56	53
Total liquid assets and bank shares	**193.1**	**36**	**33**	**36**	**36**	**18**	**14**
C. Medium-term assets	172.0	25	27	32	32	15	18
1. Nonbank shares	36.2	3	3	5	7	261	45
2. Restitution deposits	37.5	11	10	9	7	-16	-5
3. Savings schemes and linked deposits	98.3	11	14	18	18	12	21
D. Long-term assets [d]	169.9	39	40	32	32	23	14
Thereof:	535.0	100	100	100	100	19	15
Money, Pazak, and CDs (A1+A2)	19.0	10	7	4	4	-8	2
Foreign currency assets	108.3	18	21	22	20	-3	5

[a] In this table the "public" excludes the government, Bank of Israel, and commercial banks. For lack of data no adjustment was made for the rest-of-the-world sector; i.e. financial assets of foreigners were not deducted and foreign financial assets of Israeli residents were not added. There is some double-counting in this table, since the measurement of financial assets includes liabilities and financial assets of financial institutions.

[b] The growth of Patam deposits in 1981 as measured here may be downward-biased because of the reclassification in December 1981 of Patach foreign residents' deposits, which are included in Patam.

[c] Total bonds issued to noninstitutional investors, less bonds in the Bank of Israel's and commercial banks' portfolio; includes tradable bonds of the type sold to the public which were held by social insurance funds and other institutional investors.

[d] Social insurance fund assets and the life insurance reserve.

SOURCE: Table VIII-A4.

policy), which tends to stabilize the real exchange rate of the sheqel. (b) Under conditions of rapid inflation, the existing tax system makes financial investments more profitable than those in real activity, since it discriminates in favor of profits deriving from financial asset holdings.[25] The more attractive savings terms offered of late and the distorting effects of the tax system are, under present conditions, increasingly crowding out private sector investment, thereby affecting the economy's growth potential.[26]

It is still unclear how long the shift from physical to financial assets can go on before it heightens inflationary pressures. This depends, among other things, on the extent to which the public views the growth of the financial component of its assets portfolio as an increase in its wealth. It is important to note that even if the entire increment is treated as an increase in wealth, its effect on the public's behavior can be expected to be spread over several periods.

4. FINANCIAL ASSETS[27]

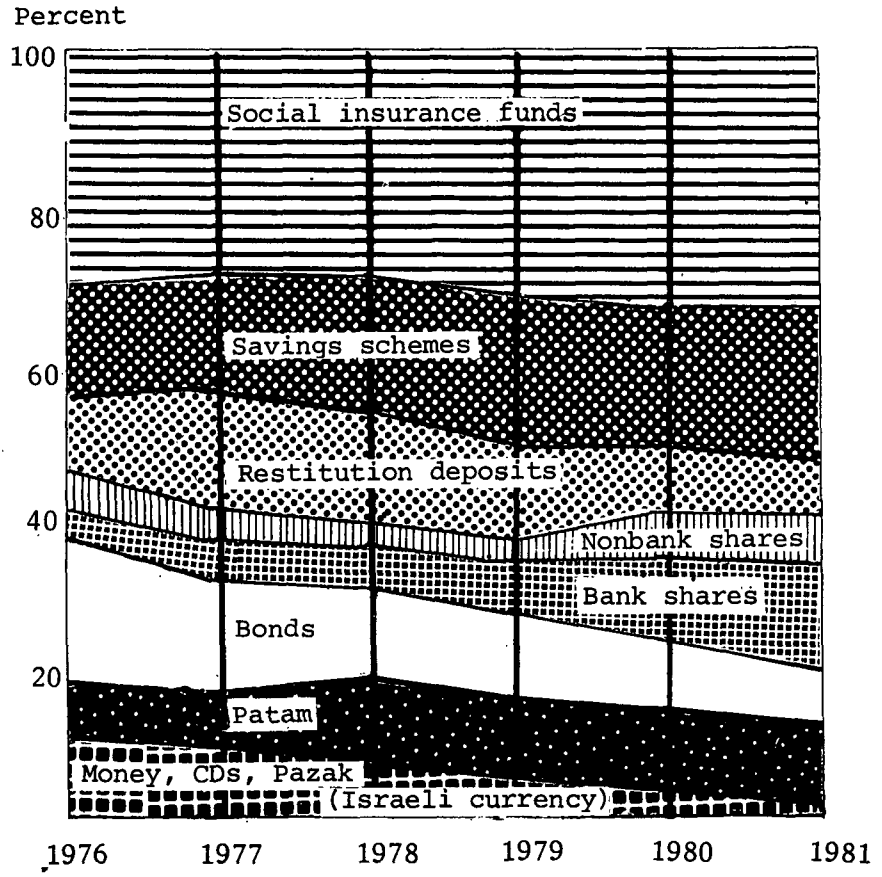
Total financial asset holdings expanded at a real 15 percent rate in 1981, which was less than in the previous year (see Table VIII-14). As regards the composition of the portfolio, the most prominent developments were the decline in the weight of liquid assets (for the second consecutive year) and the rising weight of bank shares. These shares are highly liquid, thanks to the policy adopted by most of the commercial banks of intervening in the market to stabilize their prices (for a detailed discussion see the section on the share

[25] This discrimination results from the fact that in most cases nominal profits are subject to tax, whereas profits from financial investments are tax-exempt. Although attempts have been made to increase the profitability of the real sectors' activity through special tax arrangements (such as inventory tax relief), from the aspect of economic efficiency they cannot equal the adjustment of the tax system to inflationary conditions. In early 1982 a bill was tabled in the Knesset which is designed to reduce the discrimination in the existing tax system and thereby help to achieve a more efficient resource allocation and renewed growth.

[26] Evidence of the crowding out of the private sector in 1981 was the increased resort of the public sector to medium- and long-term sources for financing its demand surplus (see Table VIII-8).

[27] There is a discrepancy (small in quantitative terms) between the definition of financial assets in this section and that in the section on wealth. It stems from the difference between the definition of the "public" in Table VIII-14 and the definition of the "private nonfinancial sector" in Table VIII-9 (see the note to Table VIII-A8 for a more detailed explanation).

Figure VIII-3
FINANCIAL ASSETS PORTFOLIO OF THE PUBLIC, 1976-81



market below). There were no significant changes this year in the weights of medium- and long-term assets. The portfolio continued to become more liquid: in addition to the shortening of the period of medium- and long-term savings and the increased flexibility of their terms, the diminished volatilility of their rates of return increased the liquidity of liquid and tradable assets.

The weight of the money supply as customarily defined (currency in circulation plus demand deposits) continued downward in real terms, although at a slightly lower rate than in the previous year (12 vs. 15 percent). This trend is explained by the existence of money substitutes, such as negotiable certificates of deposit and to a lesser extent Patam (local residents' foreign currency deposits), tradable bonds, and even bank shares, which are also held for transactions purposes. Even when inflationary expectations stabilize, the public tends to continue reducing its money holdings because of the rising return on near-money.

Table VIII-15

RATES OF RETURN ON FINANCIAL ASSETS AND THEIR STANDARD DEVIATIONS, 1979-81

(Percentages)

	Real return during the year			Monthly standard deviation		
	1979	1980	1981	1979	1980	1981
Money supply	-53	-57	-50	1.7	1.5	1.4
Negotiable certificates of deposit[a]						
Before tax	-35	-25	-5	1.7	1.5	1.6
Less tax deducted at source[b]	-41	-36	-18	1.7	1.5	1.3
Dollar deposits						
Demand	-13	-8	2	2.4	2.5	3.9
Time[c]	-7	0	14	2.4	2.5	3.9
Restitution deposits (DM)	-4	-12	-1	3.5	4.2	3.7
Linked bonds	-7	10	-8	3.2	3.8	2.4
Mutual funds specializing in indexed bonds	-7	11	-3	2.6	3.4	4.9
Shares						
All shares	-25	63	26	7.4	9.3	7.5
Bank shares	-4	41	32	4.9	9.0	5.3
Nonbank shares[d]	-58	110	19	18.0	22.0	20.8
Savings schemes—yield to maturity	1	2	3			
Social insurance funds—yield to maturity	4	4	4			

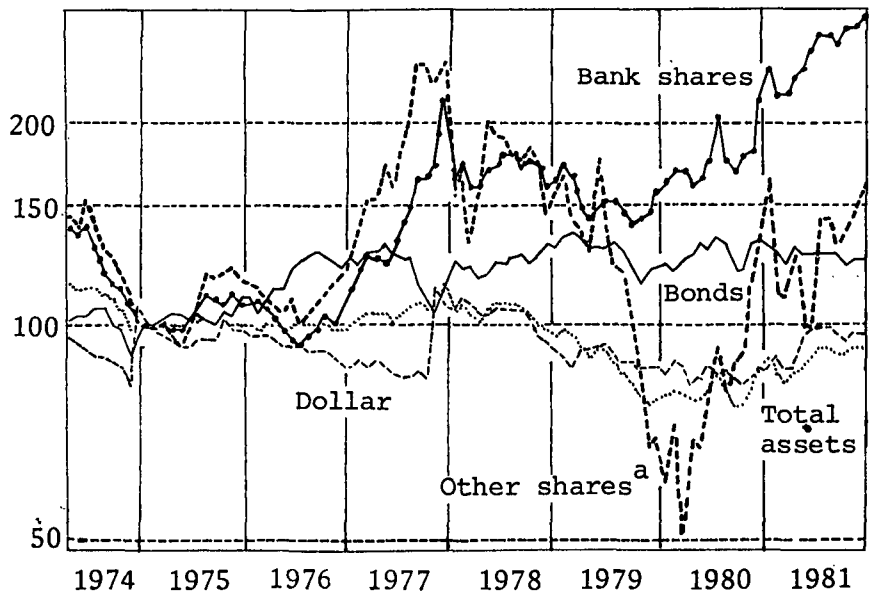
[a] The return varies considerably between customers.
[b] Since August 1981 the at-source tax deduction is 15 percent.
[c] Less tax deducted at source.
[d] The rates of return and standard deviations have been calculated from a derived index of total shares and commercial bank shares, with the weights updated at the beginning of the year.
SOURCE: Bank of Israel calculations.

CDs (including time deposits) shot up 45 percent in real terms in 1981, but their weight in the portfolio remained low. The growth of this asset was stimulated by its increased net return, a result of the cutting of the tax rate and the lowering of the required liquid cover from 18 to 14 percent (see Table

VIII-15). In addition, the real return became less volatile, and the minimum investment in this asset contracted in real terms because of inflationary erosion.

The marked growth of CDs offset the drop in money, and the aggregate of money, CDs, and time deposits showed a 2 percent real increase this year, after shrinking 8 percent in real terms in 1980. Another liquid asset, Patam (local resident's foreign currency deposits) expanded 13 percent in real terms, mainly because the dollar (to which most Patam deposits are linked) outpaced the rise in the consumer price index. Patach foreign currency deposits held by Israeli residents also expanded strongly this year.[28] By contrast, the public's tradable bond holdings declined 17 percent in real terms. This was due *inter alia* to the booming equity market, the real growth of savings scheme deposits following the introduction of a two-year plan at the beginning of 1981, and the dollar-linked schemes offered to the public at the end of the year.

Figure VIII-4
OVERALL REAL RATE OF RETURN INDEX FOR FINANCIAL ASSETS, 1974-81
(Dec. 1974=100)



Semilogarithmic scale.

[a] Derived from the index of total shares and the index of bank shares, using weights for the end of the previous calendar year.

SOURCE: Bank of Israel calculations based on Tel Aviv Stock Exchange data.

[28] In 1981 such deposits grew by 58 percent in real terms. We cannot fully explain this development, but it may have stemmed to some extent from the reclassification of part of the foreign residents' deposits as local residents' deposits.

Table VIII-16

DEVELOPMENTS IN THE SECURITIES MARKET, 1979-81

	1979	1980	1981 Total	1981 Jan.-June	1981 July-Dec.
A. Bonds					
1. Net issues of tradable bonds (IS billion, at Dec. 1981 prices)[a]	1.0	3.6	-4.3	-2.0	-2.3
2. Overall real rate of return on indexed bonds (%)[b]	-5.7	10.4	-8.0	-13.8	-2.6
3. Stock Exchange trade (IS billion, at Dec. 1981 prices)[a]	12.5	10.5	13.9	6.0	7.9
4. Annual rate of turnover of listed bonds (%)[c]	19.0	15.3	21.4	—	—
B. Shares (and convertible securities)					
1. Issues (IS billion, at Dec. 1981 prices)[a]	1.4	4.2	7.7	3.0	4.7
2. Percent annual increase in issues, at constant prices (annual rates)	-79.0	200.0	83.3	42.9	123.8
3. Overall real rate of return (%)[b]	-23.7	62.9	25.8	5.7	49.8
4. Stock Exchange trade (IS billion, at Dec. 1981 prices)					
On the floor	16.1	36.5	63.8	27.5	36.2
On and off the floor	46.9	93.0	179.5	84.5	95.1
5. Annual rate of turnover of listed shares and convertible securities (%)[c]	37.8	60.0	66.2	—	—
C. Total securities market					
1. Total issues (IS billion, at Dec. 1981 prices) (A1+B1)	2.4	7.8	3.4	1.0	2.4
2. Weight of bonds in total Stock Exchange trade (%)	43.6	21.6	18.1	18.0	18.2
3. Weight of securities in the financial assets portfolio,[d] at end of period (%)	25.0	31.0	32.0	29.0	32.0

[a] The prices have been deflated monthly.

[b] The half-yearly changes in 1981 are at annual rates.

[c] The total volume of Stock Exchange trade divided by the annual average stock of securities.

[d] As defined in Table VIII-14.

SOURCE: Central Bureau of Statistics, Tel Aviv Stock Exchange, and Bank of Israel calculations.

III. COMPONENTS OF THE CAPITAL MARKET

1. THE SHARE MARKET

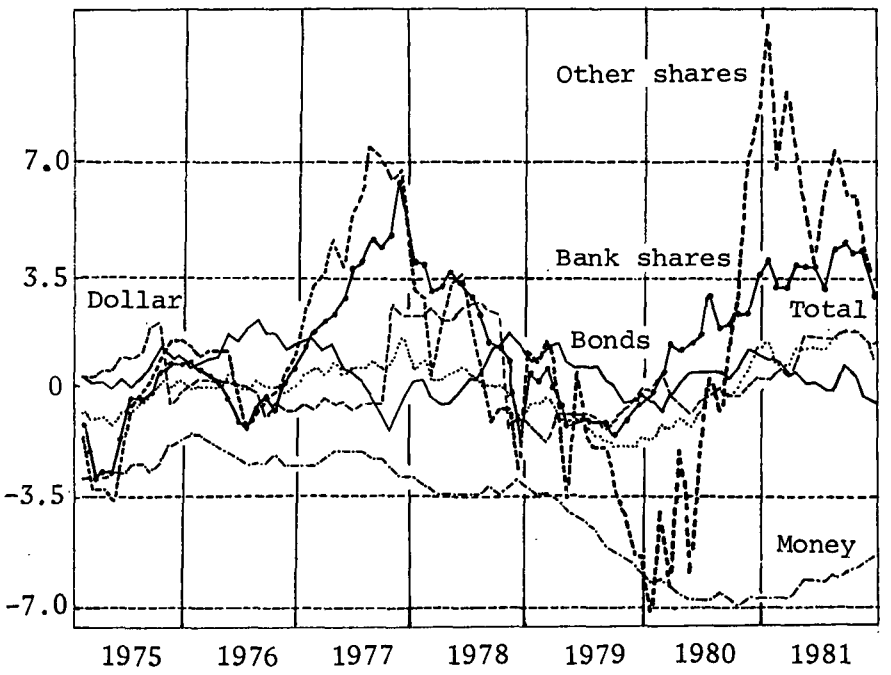
The share market boom, which got underway in the second half of 1979, continued in the year reviewed, when the real market value of equities soared approximately 50 percent to reach IS109 billion, compared with IS36 billion in 1980 (see Table VIII-B3). Share prices advanced 26 percent in real terms, and new issues amounted to IS6 billion—a real increase of 83 percent over 1980; roughly 65 percent of the total was accounted for by commercial banks. The real volume of transactions continued upward, and the annual rate of turnover of listed shares also rose (see Table VIII-16). During the year the trend of commercial bank shares increasingly diverged from that of the other groups (see Figure VIII-4).

At the end of 1981 the market value of bank shares came to IS71 billion—almost two-thirds of the value of all equities (see Table VIII-B8) and almost double that of the public's tradable bond holdings. Since the middle of 1979, when most of the banks began to intervene in the market in order to regulate the prices of their shares, the real annual return on these equities has averaged approximately 40 percent, and in 1981 it came to 32 percent (see Table VIII-15). These assets are also highly liquid, as reflected by the minor fluctuations around their expected trend, with only a few nominal price declines being recorded.[29] It was the need to enlarge their equity capital, which had been severely eroded by inflationary taxation, and to allow *inter alia* the expansion of their overseas operations that prompted the banks to offer an attractive asset; by their active intervention the banks transformed their shares into a liquid, high-earning asset able to compete effectively with other short-term linked assets traded in the capital market.[30] Demand for such equities by the public and social insurance funds surged, helping to sustain the advance of their prices. Another factor fueling demand on the part of firms lies in the tax advantage of holding shares, rather than bonds or foreign

[29] The real monthly standard deviation, which is a measure of risk, was 5.3 percent for bank shares, compared with 20.8 percent for other shares. The risk associated with an investment in bank shares was, however, still higher than that of other liquid assets: 2.4 percent for indexed bonds and 3.9 percent for dollar-linked deposits (see Table VIII-15 and Figure VIII-6).

[30] The banks' intervention in secondary market trade in their shares not only moderates random fluctuations in the shares' quotations, but apparently determines to a large extent their rate of increase.

Figure VIII-5
12-MONTH MOVING AVERAGE OF REAL RATES OF RETURN ON FINANCIAL ASSETS, 1975-81
(Percentages)



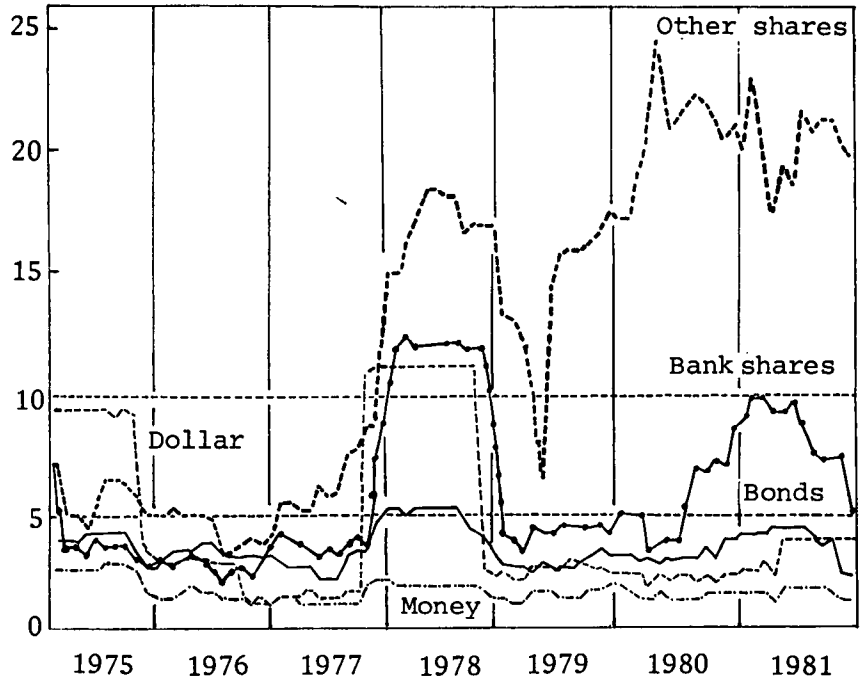
NOTE: See Figure VIII-4.

currency deposits, when the investment is financed by borrowing:[31] the financing costs involved in equity purchases are deductible for tax purposes, but not those connected with the acquisition of bonds or Patam. The sale of these shares is also boosted by the banking institutions' wide-ranging marketing network and their influence over other institutions operating in the capital market.

In 1981 the banks demonstrated their ability to support their shares. In February and March the market turned bearish, with the dumping of a large volume of equities sharply depressing prices. But while nonbank share quotations tumbled, those of commercial banks fell mildly owing to the banks' massive intervention (with the help of funds from abroad). The banks' intervention has in recent years led the investing public to expect their shares

[31] In 1980 the law was amended to eliminate this preferential treatment, but the effectiveness of this change is as yet unclear. In February 1982 a bill was tabled to prevent the taxation of inflationary (i.e. nominal rather than real) profits; among other things, it would reduce the profitability of buying shares with borrowed funds.

Figure VIII-6
STANDARD DEVIATIONS OF 12-MONTH MOVING AVERAGE OF REAL RATES OF RETURN ON FINANCIAL ASSETS, 1975-81
(Percentages)



NOTE: See Figure VIII-4.

to be quite liquid and to yield a high return, with the result that demand has shifted from other financial assets to these securities. The banks, for their part, have succeeded in fulfilling these expectations by stepping in to prop up their shares. As a consequence, their price level is not necessarily determined by the banks' business performance.

The equity market setback in the early part of the year reviewed stemmed from a cyclical decline in prices after an unusually steep real increase during 1980, which accelerated toward the end of that year. Another factor was the altering of the public's assets portfolio: a formidable growth of savings scheme deposits with the introduction of new plans featuring a shorter maturity and more flexible terms, and the increased acquisition of durable goods following the reduction of their relative price through indirect tax cuts. The prices of industrial, investment, and real estate shares dipped 20-30 percent in February and March, and their returns turned negative during the first half of the year, in glaring contrast to the bank shares' positive 18 percent yield (see Table VIII-B7). The picture was reversed in the second half of 1981, with nonbank shares picking up smartly in real terms and bank shares

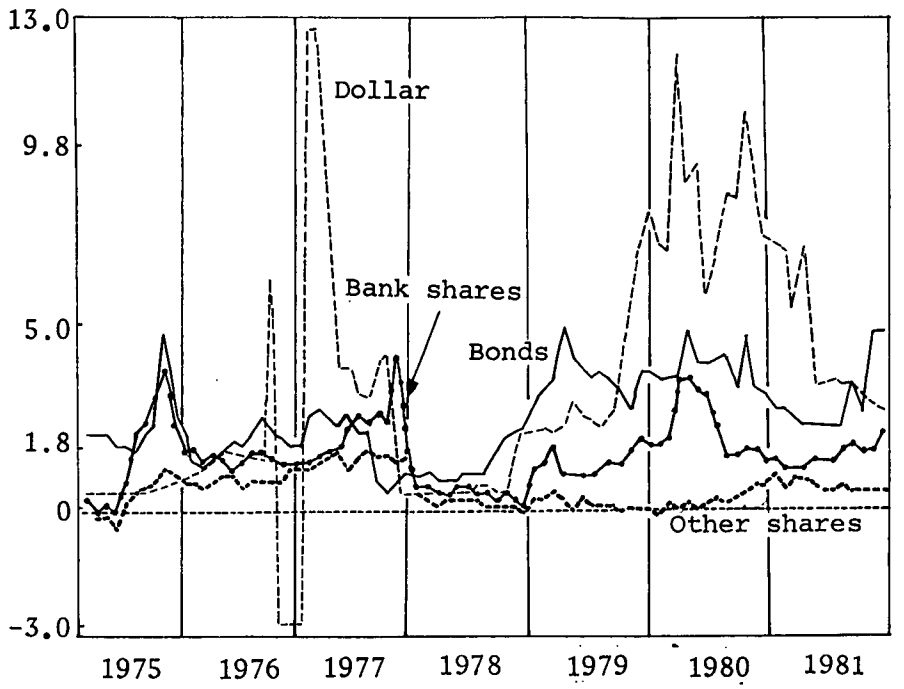
rising at a relatively moderate rate, a trend that carried over into early 1982.

A striking development this year was the large volume of new industrial issues, which added up to IS630 million, or 11 percent of total new issues, as against 4 percent in 1980. It is reasonable to assume that the restraining of short-term credit growth and the increased cost of long-term borrowing made it more worthwhile to raise capital through the issue of securities.

During the year reviewed the shares of 24 companies, amounting to some IS750 million all told, were listed on the Tel Aviv Stock Exchange. A large percentage of the listings included options. The issue of such paper enabled existing shareholders to take advantage of a loophole in the tax laws whereby companies were allowed to keep profits earned in previous years without paying tax. In November 1981 this loophole was closed.

As in 1980, Stock Exchange trade on and off the floor expanded in real terms, with the proportion of off-the-floor transactions continuing to rise. The annual rate of turnover of listed shares traded on and off the floor moved

Figure VIII-7
RISK-RETURN RATIO OF VARIOUS FINANCIAL ASSETS RELATIVE TO MONEY, 1975-81[a]



NOTE: See Figure VIII-4.

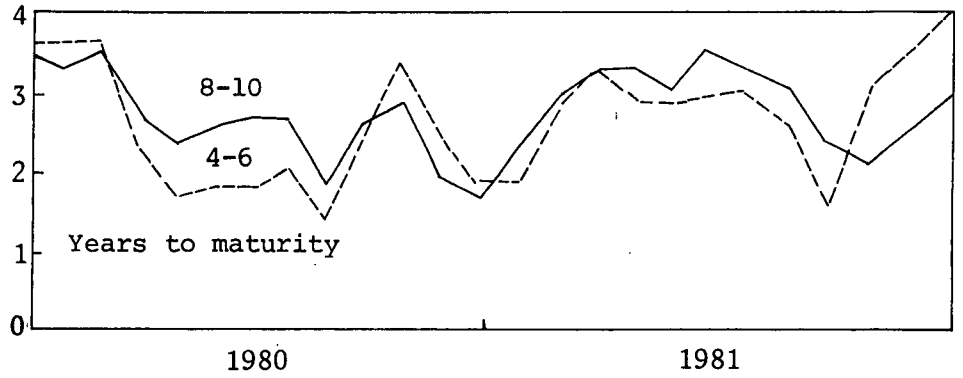
[a] The risk-return ratio relative to money is defined as the difference between the real monthly return on a financial asset and that on money, divided by the difference between the standard deviations of their real returns.

up from 1.5 in 1980 to 1.8.[32] There was a sharp upsurge in transactions during the February crisis, when roughly a quarter of the trading value of the listed shares was turned over.

2. THE BOND MARKET

The bond market remained depressed during 1981, overshadowed by the boom in equities. The ebbing demand for such securities in recent years is a direct result of the competition of alternative assets; in 1981 there was a IS3.4 billion disinvestment in bonds and a negative overall real return of approximately 8 percent. The volume of trade on the Stock Exchange floor grew in real terms, and the rate of turnover rose from 0.15 in 1980 to 0.22.[33] The year reviewed saw a heavier intervention in the market by institutional investors, particularly social insurance funds and commercial banks, for which tradable bonds serve as cover for their savings schemes. The proportion of such paper held by banks reached 31 percent by the end of 1981, compared with only 22 percent at the end of 1979 (see Table VIII-B4).

Figure VIII-8
NET REAL YIELDS TO MATURITY OF INDEXED BONDS, MONTHLY, 1980-81
(Percentages)



SOURCE: Table VIII-B11.

[32] This datum differs from the one appearing in Table VIII-16, which relates solely to Stock Exchange trade on the floor. On the volume of trade see Table VIII-B6.

[33] The annual rate of turnover is calculated by dividing the volume of trade by the annual average stock of bonds; despite its limitations, this measure serves as an indicator of the actual degree of liquidity of the asset.

The Bank of Israel's bond-market intervention policy underwent a change during the year surveyed (see Table VIII-B10). During the first half it intervened to only a limited degree, but after bond prices sank 11 percent at a real annual rate, it began to participate much more actively in the trade. This greatly toned down the price fluctuations,[34] with the result that bonds began to yield a positive real return. In the second half of the year the Bank accounted for almost half of total bond market transactions. This intervention reached its peak during December, when the figure reached 72 percent,[35] with net purchases by the Bank rising to IS900 million as investors switched to shares. The Bank wound up the year with a net purchase of IS1.4 billion, compared with a IS200 million net sale the year before.

In an effort to step up the mobilization of capital through tradable bonds, the yield to maturity of new issues was raised in mid-1981 by discounting their selling price to 96 percent of face value. However, the extra yield (some 0.4 percent per annum) failed to induce a net purchase by the public. Returns in the secondary securities market were generally higher during most months of the year, and in some months they reached 3.5 percent.[36]

In sharp contrast to the slump in the index-linked bond market, bonds pegged to foreign currencies yielded a high real return (approximately 11 percent), owing to the strengthening of the dollar during the year. In 1981 manufacturing firms issued $52 million of foreign-currency-linked bonds.[37] These securities, which carry a variable interest rate adjusted half-yearly, were issued because of the credit squeeze and the fact that they cost the firm less than other sources of foreign currency.[38] The Bank of Israel issued a IS60 million series on similar terms. Much of the demand for these bonds comes from mutual funds, whose investment in foreign currency bank deposits is restricted.

[34] The risk of investing in bonds, measured by the monthly standard deviations, dropped from 3.7 in December 1980 to 2.4 during the second half of 1981 (see Figure VIII-6 and Table VIII-14).

[35] The degree of Bank of Israel intervention in 1981 is measured as its total transactions (purchases plus sales) relative to the volume of trade in the market. Under the method previously employed, the maximum possible intervention was 50 percent, assuming that the Bank of Israel was a party to every transaction conducted in the market.

[36] The yield to maturity is biased upward somewhat, since it does not take into account the loss of one monthly index increment when the bond is redeemed (see Table VIII-B11).

[37] A striking feature this year was the flotation of a bond issue linked to a basket of foreign currencies and even of one linked to SDRs (IMF Special Drawing Rights). Trade in these securities, however, was thin, owing to the relatively small amount issued.

[38] For tax reasons it is advantageous to firms to issue foreign currency bonds, since they are approved issues (see the Bank of Israel Annual Report for 1980, p. 276).

3. MUTUAL FUNDS

The public's holdings of mutual fund shares shrank 17 percent in real terms in 1981. The funds' assets amounted to IS22.8 billion at year's end, and their weight in the total portfolio of assets of the type in which the funds invest fell from 15.7 percent in 1980 to 11 percent (see Table VIII-B12).[39] This year redemptions of mutual fund certificates exceeded sales by IS2.4 billion, with most of the disinvestment occurring in the first quarter of the year, when share prices plummeted.[40]

This year's performance of the mutual fund industry is explained by the bond market slump (over 60 percent of its assets are invested in such paper) and the continuing boom in equities. As in the past, the public preferred to acquire a large proportion of its bonds through the mutual funds (42 percent), while for the most part buying shares directly (the funds accounted for only 6 percent of the total market value of such securities this year).

The industry earned a 4.6 percent real return during 1981, with the figure varying among the different funds according to their area of specialization. Funds specializing in index-linked bonds showed a negative return of 3.3 percent, compared with -8 percent for a direct investment in these securities. Funds investing in foreign currency and shares earned a high real return, as did a direct investment in such assets (see Table VIII-B7). However, the risk of an investment in these funds (measured by the real monthly yield fluctuations) is greater than that of a direct investment in the assets concerned. Competition between the funds, which is reflected primarily in their yields, has apparently induced fund managers to aim for a high return at the expense of additional risk.

At the end of 1981 the money market funds ceased operating according to their original setup, and since the beginning of 1982 they are required to charge a small commission (0.5 percent, as against 1-2 percent in the other funds). The high volatility of their yield (8.6 percent) in comparison with other liquid investments (see Table VIII-15) apparently diminished the

[39] This aggregate consists of tradable bonds held by the public, demand and time deposits in foreign currency, and shares listed on the Tel Aviv Stock Exchange. The decreased weight of the mutual funds in this aggregate resulted to some extent from the restrictions placed on their investment in foreign currency deposits (see the Bank of Israel Annual Report for 1980, p. 278).

[40] The advantage of investing in mutual fund shares, which can be sold when the market turns soft, was demonstrated during this period. It is formally possible for the funds to postpone the redemption of participation certificates in these circumstances, after obtaining the approval of the Securities Authority. The mutual funds have not as yet exercised this right, and it is unclear to what extent the general public is aware of its existence.

attraction of the money market funds, and their weight in the industry sank from 17 percent at the end of August 1980, shortly after they were launched, to 6 percent at the end of 1981.

4. SOCIAL INSURANCE FUNDS AND LIFE INSURANCE COMPANIES

The public's accumulation in social insurance funds expanded 10 percent in real terms in 1981, about the same rate as in the previous year. The weight of the funds in the public's assets portfolio held steady at approximately 30 percent, and the public's savings through this channel came to IS158 billion at the end of 1981 (see Table VIII-17).

There were two major developments this year:

(a) This subsector continued to become more liquid with the growing shift to funds involving a shorter investment period (advanced study schemes) and the rising percentage of provident fund accounts approaching maturity and thereby becoming available for withdrawal.

(b) The social insurance funds greatly stepped up their transactions in shares and tradable bonds, giving a strong boost to secondary market trade. They purchased IS800 million worth of newly issued commercial bank shares, which represented approximately 20 percent of total bank issues this year.

Returns on social insurance funds are influenced by two major factors: (a) the yield on the funds' investment, the bulk of which is placed in nontradable bonds bearing 5-6 percent interest;[41] and (b) reduction of the tax on current contributions, which augments the effective yield in accordance with the marginal tax paid by each fund member.

No significant changes occurred in the first factor in 1981, although yields probably edged up a bit because of the funds' intensified activity in the secondary securities market. As to the second factor, two contrasting influences were at work this year: (a) The adjustment of tax brackets (in April 1981) by more than the rate of inflation lowered the marginal tax rates; this reduced the value of the tax concessions on social insurance contributions, exerting a dampening effect on yields. (b) The maximum contribution entitled to tax concessions was raised 13 percent in real terms, bringing up the effective return.[42]

[41] Pension funds earn an extra half percent. The return to social insurance fund members is somewhat lower because of management costs and the loss of one monthly index increment when the bonds are redeemed; at the present rates of inflation this amounts to approximately 0.5 percent per annum. On the other hand, the discount at the time of purchase (disagio) adds 0.2 percent per annum to the yield.

[42] For example, the additional average annual yield in the case of provident fund savings

Table VIII-17

LIABILITIES AND ACCUMULATION OF SOCIAL INSURANCE FUNDS AND LIFE INSURANCE COMPANIES, 1979-81

(IS billion)

	Liabilities to the public, at Dec. 1981 prices			Net accumulation	Percent real increase in accumulation[a]		
	1979	1980	1981	1981	1979	1980	1981
Social insurance funds							
Pension	44.9	52.0	58.5	1.1	76	5	-24
Provident	49.6	64.3	71.3	4.6	0	10	0
Thereof: Financial sector	35.9	52.4	59.6	3.6	-7	13	-3
Severance pay	10.5	11.7	12.7	1.1	63	-2	60
Advanced study	2.4	4.2	6.2	1.8	14	26	63
Other funds	0.8	0.8	1.9				
Total	**112.4**	**138.8**	**157.7**	**8.6**	**16**	**10**	**10**
Insurance companies							
Life insurance reserve[b]	8.9	10.3	12.2	1.5	11	-5	6
Total balance sheet of insurance companies	18.1	19.7	22.7				

[a] Deflated semiannually by the consumer price index.

[b] Less reinsurance.

SOURCE: Central Bureau of Statistics and Bank of Israel calculations.

Analysis of the net accumulation shows, as in the past, considerable interfund variations (see Table VIII-B16). A number of institutional changes during the past few years led to some growth in the pension funds.[43] In 1981 there was no real increase in contributions despite a 10 percent real wage rise. On the other hand, pension payments were up 16 percent in real terms, apparently because of an increase in the number of members reaching retirement age.

Net provident fund accumulation was slower than in previous years, due

comes to 5.9 percent, assuming a 7.5-year saving period and a 35 percent marginal tax rate. In the advanced study schemes the period of saving ranges between 1.5 and 3 years on average. In these schemes the extra annual return attributable to the tax credit ranges from 10 to 21 percent. It should be noted that there is a ceiling on the tax concessions, which is updated from time to time.

[43] See the Bank of Israel Annual Report for 1980.

partly to a 30 percent real increase in withdrawals.[44] Advanced study schemes continued to swell as contributions expanded along with real wages. Although permission was granted in 1980 for members to draw on the amount credited to their account after six years for any purpose, without loss of entitlement to tax concessions on employer and employee contributions, there was no big increase in withdrawals in the year surveyed. This change in withdrawal terms probably encouraged savers to defer the exercise of their right to some future date.

The public's accumulation in life insurance companies expanded at a real 6 percent rate in 1981, after declining 5 percent the year before. This form of saving accounted for only 4 percent of total financial asset accumulation in 1981. This year's larger accumulation resulted from a 10 percent growth in premium receipts, which was partly offset by a real 20 percent increase in payments to policyholders. It seems that the public has switched to some extent to other savings channels.

[44] This may have been due to withdrawals from severance pay funds, which are lumped together with provident funds because of classification difficulties. The real increase in withdrawals from severance pay funds in 1981 was consistent with the slump in the labor market.

Table VIII-A1

MONEY SUPPLY AND UNLINKED ISRAELI CURRENCY DEPOSITS OF THE PUBLIC, 1979-81

(Balances in IS million)

End of period	Money supply				Unlinked deposits			Total	
	Unadjusted for seasonality			Seasonally adjusted					
	Currency in circulation (1)	Demand deposits (2)	Total (1+2) (3)	Total (4)	Negotiable certificates of deposit (5)	Time deposits in IS (Pazak) (6)	Deposits against liabilities in IS (7)	IS million (3+5+6+7) (8)	Percent increase over previous period (9)
1979	1,205	2,338	3,543	3,460	447	341	67	4,398	30.8
1980	2,128	4,878	7,006	6,835	1,884	344	305	9,540	116.9
1981	4,392	8,102	12,494	12,974	5,854	669	1,628	20,645	116.4
January	2,223	5,016	7,239	7,372	1,927	348	197	9,711	1.8
February	2,446	5,035	7,481	7,681	2,328	337	385	10,531	8.4
March	2,714	5,817	8,531	8,339	2,451	357	475	11,814	12.2
April	2,873	5,410	8,283	8,308	3,010	448	394	12,135	2.7
May	3,026	5,475	8,501	8,375	2,493	475	2,313	13,782	13.6
June	3,218	6,120	9,338	9,246	3,125	471	370	13,305	-3.5
July	3,686	6,362	10,048	10,139	3,859	475	480	14,862	11.7
August	3,775	7,842	11,617	11,502	4,897	525	510	17,550	18.1
September	4,143	7,232	11,375	11,065	3,838	575	468	16,257	-7.4
October	4,211	7,118	11,329	11,667	4,330	599	440	16,697	2.7
November	4,241	8,012	12,253	12,567	4,757	624	753	18,387	10.1
December	4,392	8,012	12,494	12,974	5,854	669	1,628	20,645	12.3

SOURCE: Department of the Examiner of Banks, *Banking Statistics;* monthly balance sheet of the banking institutions; State Loans Administration.

Table VIII-A2

THE MONETARY BASE BY COMPONENT, 1979-81

(Balances in IS million)

End of period	Currency in circulation (1)	Liquid assets of banking institutions (2)	Narrow monetary base (1+2) (3)	Liquidity exemptions (4)	Recognized liquidity deficiencies (5)	Broad monetary base (3+4+5) (6)	Percent increase in broad monetary base (8)
1979	1,205	1,093	2,298	464	3	2,765	22.0
1980	2,128	2,415	4,543	657	6	5,206	88.3
1981	4,392	5,235	9,627	1,222	62	10,911	109.6
January	2,223	3,517	5,740	677	302	6,719	29.1
February	2,446	2,178	4,624	631	63	5,318	-20.8
March	2,714	2,601	5,315	581	13	5,909	11.1
April	2,873	3,244	6,117	767	24	6.909	16.9
May	3,026	1,678	4,704	799	25	5,528	-20.0
June	3,218	3,383	6,601	840	23	7,464	35.0
July	3,686	3,678	7,364	1,089	22	8,475	13.5
August	3,775	5,079	8,854	1,135	30	10,019	18.2
September	4,143	2,360	6,503	1,170	31	7,704	-23.1
October	4,211	3,271	7,482	1,216	65	8,763	13.8
November	4,241	4,949	9,190	1,253	62	10,505	19.9
December	4,392	5,235	9,627	1,222	62	10,911	3.9

SOURCE: Liquid assets of banking institutions—monthly balance sheet of the banking institutions; liquidity exemptions and recognized deficiencies—Department of the Examiner of Banks, *Banking Statistics*.

Table

SOURCES AND COMPONENTS OF CHANGES

(IS

	Jan.	Feb.	Mar.
1. Basic public sector injection[a]	618	-800	386
Thereof: Government	450	-807	237
2. Bank of Israel injection	272	-1,226	-989
Directed Israeli currency credit	144	-245	-124
Directed foreign currency credit	-211	-976	-818
Credit to banks	0	0	0
Other factors[b]	339	-5	-47
3. Total exogenous injection (1+2)	890	-2,026	-603
4. Private sector sales of foreign currency	207	991	685
5. Change in narrow liquid asset base (3+4)	**1,097**	**-1,035**	**82**
6. Liquidity exemptions and recognized deficiencies	20	-46	-50
7. Change in broad liquid asset base (5+6)	**1,117**	**-1,081**	**32**
Change in broad monetary base	1,218	-1,162	640
Increase in Patam time and demand deposits	404	32	-458
Bond purchases (net)	-342	-114	-151
8. Change in liquidity deficiencies	1,366	-1,196	-135

[a] The public sector injection as customarily defined, plus net proceeds from the direct sale of bonds to the public.

[b] Consists mainly of the absorption or injection through the Bank of Israel's income and expense accounts (such as interest paid on liquid assets in Israeli and foreign currency, fines

VIII-A3

IN THE LIQUID ASSET BASE, 1981

million)

April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
-528	919	2,764	2,682	2,754	1,535	1,340	1,104	1,797
-584	786	2,689	2,572	2,540	1,336	1,134	853	1,428
864	-411	160	891	-372	-19	293	609	1,467
734	147	197	1,106	156	104	240	181	39
-655	-703	225	-640	-572	320	-642	138	838
0	0	-253	0	0	0	0	0	0
785	145	-9	425	44	-443	695	290	590
336	508	2,924	3,573	2,382	1,516	1,633	1,713	3,264
-158	-1,077	-519	-3,244	-2,129	-2,727	-133	-1,979	-4,108
178	**-569**	**2,405**	**329**	**353**	**-1,211**	**1,500**	**-266**	**-844**
186	32	41	249	46	35	46	36	-31
364	**-537**	**2,446**	**578**	**399**	**-1,176**	**1,546**	**-230**	**-875**
988	-1,382	1,939	1,012	1,536	-2,316	1,026	1,744	403
-225	777	952	-79	-929	853	802	-1,207	80
-399	-154	-222	-355	-208	287	-283	-765	-1,359
1,181	-3,107	2,741	193	783	-2,122	535	1,497	-1,836

for liquidity deficiencies, etc.), the absorption or injection through Patam restitution deposits, and discrepancies between the balance sheets of the commercial banks and that of the Bank of Israel.

SOURCE: Bank of Israel calculations.

Table

FINANCIAL ASSETS OF

(Balances in

End of period	1979	1980
A. Liquid assets	24.4	61.3
1. Money	3.5	7.0
2. Pazak and CDs	0.8	2.2
3. Patam deposits[c]	11.3	28.7
4. Bonds[d]	8.8	23.4
4'. Thereof: In foreign currency	1.2	2.8
B. Bank shares	6.2	22.5
Total liquid assets and bank shares	**30.6**	**83.8**
C. Medium-term assets	26.9	72.3
1. Nonbank shares	1.5	12.4
2. Restitution deposits	10.0	19.6
3. Savings schemes and linked deposits	15.4	40.3
D. Long-term assets[e]	25.8	74.0
E. Total financial assets	**83.3**	**230.1**
Thereof:		
1. Money and CDs (A1+A2)	4.3	9.2
2. Foreign currency assets (A3+C2+A4')	22.5	51.1
3. Linked short- and medium-term assets (A4+C3-A4')	23.0	60.9

[a] In this table the "public" excludes the government, Bank of Israel, and commercial banks. For lack of data no adjustment was made for the rest-of-the-world sector; i.e. financial assets of foreigners were not deducted and foreign financial assets of Israeli residents were not added. There is some double-counting in this table, since the measurement of financial assets includes liablities and financial assets of financial institutions.

[b] Calculated from unrounded data.

VIII-A4

THE PUBLIC, 1979-81[a]

IS billion)

1981		Weight in total assets (%)		Percent real increase over previous period[b]				Percent real increase in annual average balance	
					1981				
June	Dec.	1980	1981	1980	Total	June	Dec.	1980	1981
87.3	123.5	27	23	8	0	2	-2	-4	3
9.3	12.5	3	2	-15	-12	-4	-7	-28	-12
3.6	6.5	1	1	21	45	16	25	-17	27
46.2	65.4	12	12	9	13	15	-2	13	9
28.2	39.1	10	7	15	-17	-14	-4	-11	-1
3.7	5.4	1	1	2	-6	-8	1	—	-5
38.5	69.6	10	13	56	53	23	25	25	71
125.8	**193.1**	**36**	**36**	**18**	**14**	**7**	**6**	**4**	**18**
105.0	172.0	32	32	15	18	4	13	5	4
14.3	36.2	5	7	261	45	-17	75	—	60
25.2	37.5	9	7	-16	-5	-8	3	-11	-14
65.5	98.3	18	18	12	21	16	4	15	14
109.9	169.9	32	32	23	14	7	7	—	—
340.7	**535.0**	**100**	**100**	**19**	**15**	**6**	**8**	**5**	**12**
12.9	19.0	4	4	-8	2	0	2	-26	-3
75.1	108.3	22	20	-3	5	5	0	1	-1
90.0	132.0	26	25	13	8	6	2	—	9

[c] Includes foreign residents' deposits permitted to be held by certain categories of Israeli residents.

[d] Total bonds issued to noninstitutional investors, less bonds in the Bank of Israel's and commercial banks' portfolio; includes tradable bonds of the type sold to the public and held by social insurance funds and other institutional investors.

[e] Includes social insurance fund assets and life insurance reserve.

SOURCE: Bank of Israel calculations.

Table VIII-A5

ASSET ACQUISITIONS BY THE PRIVATE NONFINANCIAL SECTOR, 1979-81

(IS million, at current prices)

				1980		1981	
	1979	1980	1981	1st half	2nd half	1st half	2nd half
Money supply	828	3,462	5,488	1,367	2,095	2,332	3,156
Time deposits and CDs[a]	196	1,440	4,295	626	814	1,369	2,926
Tradable bonds[b]	-803	-1,182	-5,300	-779	-403	-2,915	-2,385
Foreign currency deposits[c]	1,316	2,151	5,289	2,419	-268	2,536	2,753
Shares of financial concerns[b, d]	-57	1,208	2,790	479	729	795	1,995
Restitution deposits	-164	-370	-861	-806	436	-806	-55
Linked and other deposits in financial institutions	297	611	1,822	305	306	1,211	611
Savings schemes[e]	954	1,888	10,969	830	1,058	5,459	5,510
Social insurance funds	1,411	3,674	8,584	1,314	2,360	3,583	5,001
Life insurance	288	636	1,477	268	368	625	852
Total asset accumulation	**4,266**	**13,518**	**34,553**	**6,023**	**7,495**	**14,189**	**20,364**

[a] The change in the balance during the period.

[b] Transactions in tradable securities in the secondary market between the private nonfinancial sector and the system of financial intermediaries, in particular social insurance funds and the commercial banking system. Because of the difference in definition, the data are not identical with those for this item in Table VIII-7.

[c] Demand deposits, time deposits, and nonresidents' deposits held by Israeli residents.

[d] Includes purchases of original-issue shares of the insurance, finance, and bank group, less dividends of the private nonfinancial sector.

[e] Savings schemes administered by commercial banks and financial institutions.

SOURCE: Bank of Israel calculations.

Table VIII-A6

ESTIMATED CONVERSION OF PATAM RESTITUTION DEPOSITS, 1979-81

(IS million)

	Personal restitution receipts (1)	Accrued interest (2)	Currency valuation changes (3)	Total potential increase (1+2+3) (4)	Actual increase (5)	Amount converted into IS (4-5) (6)	Conversion rate (%)	
							A[a] (6/4) (7)	B[b] (6/[1+2]) (8)
1979	1,145	332	4,785	6,262	4,953	1,309	21	89
1980	2,401	941	9,036	12,378	9,607	2,771	22	83
1981	4,780	2,676	16,030	23,486	17,844	5,642	24	76
January	436	118	-183	281	-193	474	168	102
February	278	25	1,242	1,545	1,406	139	9	46
March	297	335	794	1,426	475	951	67	150
April	351	130	335	816	651	165	20	34
May	336	71	1,853	2,260	2,032	228	10	56
June	377	331	1,348	2,056	1,222	834	41	118
July	409	120	131	660	677	-17	—	—
August	400	87	1,538	2,025	1,488	537	27	110
September	419	445	2,543	3,407	2,341	1,066	31	123
October	448	165	2,908	3,521	3,497	24	1	4
November	559	160	2,707	3,426	2,863	563	16	78
December	560	689	793	2,042	1,385	657	32	53

[a] This calculation assumes that the recipients treat currency valuation changes in the same manner as restitution and interest receipts.

[b] This calculation assumes that the recipients treat currency valuation changes as capital gains on the deposits.

SOURCE: Personal restitution receipts and currency valuation changes—Controller of Foreign Exchange; interest on Pazak and Tamam—Bank of Israel balance sheet; actual increase—monthly balance sheet of the banking institutions.

Table VIII-A7

CHANGES IN THE FINANCIAL WEALTH OF THE PRIVATE NONFINANCIAL SECTOR, 1979-81

(IS million, at current prices)

				1980		1981	
	1979	1980	1981	1st half	2nd half	1st half	2nd half
1. Liquidity injection generated by the public sector demand surplus	1,537	5,163	24,067	2,438	2,725	5,768	18,299
2. Private sector import surplus on goods and services	3,506	3,333	8,641	1,348	1,985	5,173	3,468
3. Net flows of liabilities	6,235	11,688	19,127	4,933	6,755	13,594	5,533
a. Development and other net credit from the public sector [a]	1,800	4,919	8,817	1,595	3,324	3,636	5,181
b. Credit from the Bank of Israel [b]	2,180	3,598	-1,270	1,748	1,850	-2,538	1,268
c. Liabilities of domestic financial intermediaries [c]	1,504	4,967	17,030	2,363	2,604	7,452	9,578
d. Net flows of liabilities with the foreign sector [d]	751	-1,796	-5,450	-773	-1,023	5,044	-10,494
4. Purchase of assets by the public (1-2+3)	4,266	13,518	34,553	6,023	7,495	14,189	20,364
5. Revaluation of assets [e]	38,159	124,265	249,261	41,194	83,071	102,562	146,699
6. Total change in financial assets (4+5)	42,425	137,783	283,814	47,217	90,566	116,751	167,063

7. Revaluation of liabilities [e]	10,208	32,598	73,764	19,891	12,707	32,729	41,035
8. Total change in liabilities (7+3)	16,443	45,286	92,891	24,824	20,462	46,323	46,568
9. Change in net financial wealth (8-6)	**25,982**	**92,497**	**190,923**	**22,393**	**70,104**	**70,428**	**120,495**

[a] Includes net government credit to the private nonfinancial sector, less net long-term capital raised for local authorities and the National Institutions (see Table VIII-A11, lines 6 and 8).

[b] Directed credit in Israeli and foreign currency.

[c] Other Bank of Israel income and expense accounts, Bank of Israel credit to the commercial banking system, items related to security and real estate transactions between the public and financial intermediaries, and errors and omissions.

[d] Calculated as the difference between the import surplus of the private sector net of unilateral transfers and the sector's net purchase of foreign currency.

[e] Changes during the period due to linkage differentials, variations in market prices of tradable assets, and changes in liabilities on account of long-term credit due to its subsidy component.

Table

ESTIMATED WEALTH OF THE PRIVATE

(IS million at current prices,

Assets	1978	1979	1980	1981
Liquid assets [a]	**16,201**	**30,205**	**84,693**	**192,456**
Money supply	2,715	3,544	7,006	12,494
Time deposits and CDs	628	833	2,314	6,779
Foreign currency deposits (incl. time deposits)	4,937	11,205	28,361	64,736
Tradable bonds	4,583	8,317	21,907	34,492
Shares of financial intermediaries	3,338	6,306	25,105	73,955
Medium-term financial assets [b]	**12,075**	**26,461**	**61,575**	**141,789**
Earmarked deposits of the public	695	1,424	2,946	7,189
Savings schemes and long-term linked deposits	6,372	15,076	39,157	97,227
Patam restitution deposits	5,008	9,961	19,472	37,373
Long-term financial assets	**11,810**	**25,845**	**74,026**	**169,863**
Deposits in social insurance funds	10,869	23,938	68,931	157,703
Life insurance	941	1,907	5,095	12,160
Other wealth	**78,325**	**188,895**	**431,120**	**929,333**
Compulsory loans	4,830	9,620	21,000	40,280
Physical assets	73,495	179,275	410,120	889,053
Durables	9,525	18,033	39,366	82,348
Residential buildings	30,380	89,182	193,929	434,535
Nonresidential structures and equipment	33,590	72,060	176,825	372,170
Total assets	**118,411**	**271,406**	**651,414**	**1,433,441**

[a] The differences between this item and the liquid assets item in Table VIII-14 stem from the difference in the definition of "the public" and the "private nonfinancial sector" (see Table VIII-9). Time deposits and CDs consist of deposits in commercial banks and other financial institutions. Foreign currency deposits consist of demand and time deposits in the banking system, nonresident deposits of Israeli residents, Patam local residents' deposits, and importers' deposits. Tradable bonds are total bonds issued to the public less bonds held by the Bank of Israel, commercial, investment, and mortgage banks, other financial institutions required to report to the Examiner of Banks, and insurance companies; they do not include dollar-linked bonds issued by the business sector. Shares of financial intermediaries consist of shares issued by commercial banks, mortgage banks, specialized financial institutions, and insurance companies.

VIII-A8

NONFINANCIAL SECTOR, 1978-81

end-of-year data)

Liabilities	1978	1979	1980	1981
Short-term liabilities [c]	**8,605**	**20,111**	**48,099**	**94,384**
Nondirected credit				
Israeli currency	2,088	3,465	8,566	18,851
Foreign currency	2,142	5,305	13,013	27,440
Directed credit				
Israeli currency	1,010	1,714	3,805	6,714
Foreign currency	2,740	6,597	16,284	27,869
Credit from abroad				
(supplier and direct)	625	3,030	6,431	13,510
Medium- and long-term liabilities [d]	**6,006**	**10,943**	**28,241**	**74,847**
Long-term Israeli currency credit	3,427	3,735	12,465	43,182
Long-term foreign currency credit	2,468	6,970	15,376	30,965
Securities held by financial intermediaries	111	238	400	700
Total liabilities	**14,611**	**31,054**	**76,340**	**169,231**
Net wealth [e]	103,800	240,352	575,084	2,464,210

[b] The differences between this item and the corresponding item in Table VIII-14 stem from the inclusion here of earmarked deposits of the public, as well as savings schemes and linked deposits in investment and mortgage banks (in addition to the savings schemes and linked deposits in commercial banks). The data on savings schemes include the accrued value of the grant and not the full amount recorded at the time the accounts were opened.

[c] Nondirected Israeli currency credit comprises credit from the commercial banking system and short-term credit from mortgage banks (to building contractors), less credit to local authorities. Nondirected foreign currency credit includes credit from the banking system in Israel, *inter alia* for oil imports. Credit from abroad is granted by overseas branches of Israeli banks, suppliers, and others (excludes credit to local authorities).

[d] The subsidy component of long-term Israeli currency credit is estimated as the present value of the stream of repayments according to the actual inflation rate. In this calculation repayments are spread over six years (the estimated average period of the loans), with interest on the stock of loans weighted accordingly.

[e] Calculated as the difference between total assets and total liabilities of the private nonfinancial sector; includes the estimated subsidy component of long-term Israeli currency credit.

SOURCE: Bank of Israel calculations.

Table

LINKED ASSETS OF THE PUBLIC IN THE BANKING

(IS

End of period	Approved savings scheme deposits		Linked long-term deposits [a]
	Total (1)	Principal (2)	(3)
1979	14,491	5,722	912
1980	37,183	11,903	3,155
1981	90,398	27,498	7,885
January	38,964	12,437	3,623
February	44,796	15,343	3,915
March	49,574	18,777	4,451
April	52,054	19,150	4,784
May	57,728	19,634	5,106
June	59,806	19,968	5,657
July	61,633	20,421	5,822
August	65,504	20,876	5,977
September	68,244	21,288	6,420
October	74,117	21,925	6,727
November	82,790	24,297	7,061
December	90,398	27,498	7,885

[a] Includes linkage increments.

[b] Includes valuation adjustments due to changes in the external value of the various currencies. The data can be translated into foreign currency terms by dividing by the relevant exchange rate. Includes nonresident deposits of local residents.

[c] At market prices; excludes bonds held by the commercial banks and the Bank of Israel;

VIII-A9

SYSTEM AND ITS BOND AND SHARE HOLDINGS, 1979-81

million)

Foreign currency deposits (Patam) [b]			Tradable shares [d]		Total linked assets (1+3+4+5 +6+7) (9)
Restitution (4)	Other (5)	Tradable bonds [c] (6)	Total (7)	Bank shares (8)	
10,027	11,331	8,780	8,101	6,538	53,642
19,634	28,696	23,420	36,207	23,323	148,295
37,477	65,361	39,145	108,762	71,507	349,028
19,444	30,298	23.050	42,852	27,829	158,231
20,847	32,572	23,090	40,556	29,383	165,776
21,322	33,000	23,560	41,496	29,436	173,403
21,973	35,119	26,960	47,389	32,247	188,279
24,005	42,080	26,150	48,568	35,316	203,637
25,227	46,187	28,210	54,571	39,773	219,658
25,904	47,876	29,639	65,374	45,237	236,248
27,392	49,692	31,411	70,748	49,979	250,724
29,733	52,279	35,921	77,979	54,529	270,576
33,230	55,571	36,352	91,521	61,643	297,518
36,093	59,500	37,836	99,778	66,263	323,058
37,477	65,361	39,145	108,762	71,507	349,028

includes bonds held by social insurance funds and other institutional investors.

[d] At market prices; includes shares held by commercial banks, which amounted to IS1,291 million at the end of 1980 and IS2,981 million at the end of 1981.

SOURCE: Monthly balance sheet of the banking institutions and calculations of the Tel Aviv Stock Exchange and Bank of Israel.

Table

OUTSTANDING CREDIT TO THE PUBLIC

(Balances in IS million,

End of period	Credit in Israeli currency (1)	For financing exports: Foreign currency credit, excl. diamonds (1+2) (2)	For financing exports: Total export credit, excl. diamonds (3)	For financing exports: Diamond Fund (4)	For financing exports: Total export credit (5)
1979	1,430	3,280	4,711	3,316	8,027
1980	3,369	7,649	11,018	8,634	19,653
1981					
January	3,477	8,056	11,533	9,060	20,594
February	3,248	8,664	11,912	9,095	21,007
March	2,988	8,980	11,968	9,113	21,082
April	3,935	9,706	13,641	9,116	22,757
May	4,099	10,693	14,792	9,801	24,593
June	4,308	11,825	16,133	10,624	26,758
July	5,591	12,065	17,656	10,286	27,942
August	5,827	12,648	18,475	10,058	28,533
September	6,007	13,476	19,483	10,576	30,059
October	6,252	13,685	19,936	10,581	30,517
November	6,442	15,011	21,453	10,829	32,282
December	6,281	16,744	23,025	11,119	34,144

[a] Includes indexation increments.
[b] Includes credit from Israeli bank branches abroad.

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FROM THE BANKING SYSTEM, 1979-81

at current prices)

For financing domestic activities					Total credit to the public, excl. diamonds and oil (3+10) (11)	Total credit to the public (5+9) (12)
Directed Israeli currency credit (6)	Nondirected Israeli currency credit [a] (7)	Nondirected foreign currency credit [b] (8)	Total (6+7+8) (9)	Total, excl. oil (10)		
283	4,356	8,532	13,171	10,721	15,431	21,197
435	9,421	18,456	28,311	19,649	30,668	47,964
413	9,679	19,897	29,990	20,194	31,727	50,583
392	10,828	20,853	32,073	22,240	34,152	53,080
393	12,655	21,898	34,946	24,665	36,633	56,028
399	12,686	23,578	36,664	24,608	38,249	59,421
385	14,516	27,166	42,066	28,794	43,586	66,659
406	15,074	31,073	46,552	30,095	46,228	73,310
423	15,054	32,656	48,133	31,011	48,667	76,075
431	14,709	32,907	48,047	31,174	49,649	76,580
390	15,267	33,457	49,115	31,402	50,885	79,174
401	16,659	34,007	51,066	31,980	51,917	81,584
395	16,804	35,444	52,643	33,214	54,667	84,924
436	19,590	35,266	55,291	37,585	60,610	89,435

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

Table

FINANCIAL OPERATIONS OF THE PUBLIC SECTOR

(IS million,

	1979
1. Bond issues and receipt of earmarked and other deposits	4,725
2. Redemption of bonds and earmarked and other deposits	2,399
3. Net govt. capital mobilization[a] (1-2)	2,326
4. Govt. credit to the private sector	2,259
5. Repayment of govt. credit to the private sector	495
6. Net govt. credit[b] (4-5)	1,764
7. Financial resources raised by the govt. (3-6)	562
8. Long-term resources raised by local authorities and National Institutions[c]	-36
9. Total net long-term resources raised by the public sector (7+8)	526
10. Public sector injection	1,480
11. Public sector injection generated other than through its demand surplus[d]	469
12. Injection generated by public sector demand surplus[e] (9+10-11)	1,537

[a] Capital raised through the sale of tradable bonds, deposits, and nontradable bonds held against long- and medium-term savings.

[b] Excludes credit to local authorities and repayments thereof.

[c] Includes long-term credit inflows and outflows of local authorities and the National Institutions with the private sector; excludes changes in their short-term credit balances.

[d] Early redemption of Israel Bonds, which is included in the public sector injection (line 10)

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AND ITS ESTIMATED DEMAND SURPLUS, 1979-81

at current prices)

		1980		1981	
1980	1981	1st half	2nd half	1st half	2nd half
10,809	28,903	3,694	7,115	10,858	18,045
4,831	10,559	2,065	2,766	5,113	5,446
5,978	18,344	1,629	4,349	5,745	12,599
5,726	11,522	2,048	3,678	4,947	11,522
1,207	2,843	545	662	1,122	1,721
4,519	8,679	1,503	3,016	3,825	4,854
1,459	9,665	126	1,333	1,920	7,745
-400	-138	-92	-308	189	-327
1,059	9,527	34	1,025	2,109	7,418
4,916	17,235	2,716	2,200	4,607	12,628
812	2.695	312	500	948	1,747
5,163	24,067	2,438	2,225	5,768	18,299

and does not finance the government's real activity.

[e] The difference between this estimate and the national accounts estimate in Chapter V is due to the inclusion of several financial items in the demand surplus as defined in the national accounts, as well as to advance payments for services.

SOURCE: Bank of Israel calculations.

Table

INDICATORS OF THE BANKING INSTITUTIONS'

(IS

	Required liquidity on ordinary deposits [a] (1)	Required liquidity on CDs [b] (2)	Required liquidity on other items [c] (3)	Total gross required liquidity (4)
1979	1,487	190	190	1,867
1980	2,866	406	494	3,766
1981	4,248	918	2,001	7,167
January	2,385	447	885	3,717
February	2,738	540	429	3,707
March	3,166	571	506	4,243
April	2,764	502	349	3,615
May	2,885	472	2,121	5,478
June	3,091	522	519	4,132
July	3,262	607	607	4,476
August	3,952	757	702	5,411
September	3,668	729	415	4,812
October	3,600	710	661	4,971
November	4,183	748	556	5,487
December	4,248	918	2,001	7,167

[a] Demand deposits and deposits against liabilities in Israeli currency.

[b] Includes time deposits and such deposits withdrawn before maturity.

[c] Nondirected credit, savings, directed credit, and unutilized balance of earmarked deposits.

[d] Liquidity deficits represent the balance between liquid assets and the required liquidity net of liquidity exemptions. The liquid assets on which this table is based are from liquidity

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LIQUIDITY IN ISRAELI CURRENCY, 1979-81

million)

Required liquidity less liquidity exemptions (5)	End-of-month liquidity surplus (+) or deficit (-)[d] (6)	Average daily liquidity deficit (7)	Deficit/gross required liquidity[e] (daily average, %) (8)	Deficit/net required liquidity (daily average, %). (9)
1,400	-459	-382	-22.1	-32.3
3,103	-1,153	-473	-14.1	-18.2
5,882	-1,501	310	5.4	7.0
2,738	213	163	4.8	6.0
3,012	-1,184	235	5.5	6.6
3,649	-1,319	44	1.1	1.3
2,823	-138	843	22.1	27.5
4,654	-3,245	467	12.6	16.0
3,270	-504	-582	-15.0	-19.1
3,365	-311	411	9.5	12.5
4,247	472	141	2.8	3.7
3,612	-1,654	335	5.9	7.5
3,690	-1,118	-702	-14.2	-19.0
4,171	380	-353	-6.6	-8.7
5,882	-1,501	310	5.4	7.0

reports, and include certain adjustments which do not appear in the liquid assets data from the banking institutions' monthly balance sheet, which are presented in Table VIII-A2.

[e] Gross required liquidity before deduction of liquidity exemptions and recognized liquidity deficiencies; the net required liquidity is after subtraction of these items.

SOURCE: Monthly liquidity report of the banking institutions and Department of the Examiner of Banks, *Banking Statistics*.

Table VIII-B2
OUTSTANDING ISRAELI CURRENCY CREDIT TO THE GOVERNMENT FROM THE BANKING SYSTEM, 1979-81
(IS million)

	From the Bank of Israel			From banking institutions				Total net Israeli currency credit to the govt. (3+7) (8)
	Credit to the govt. [a] (1)	Govt. and National Institution deposits [b] (2)	Net Bank of Israel credit (1-2) (3)	Credit to the govt. [c] (4)	Govt. securities [d] (5)	Less: Govt. deposits [e] (6)	Net credit from banking institutions (7)	
1979	5,367	3,576	1,791	1,109	1,198	38	2,269	4,060
1980	8,865	9,969	-1,104	2,264	3,142	133	5,273	4,169
1981	28,746	17,045	11,701	9,962	6,973	294	16,641	28,342
January	5,898	6,814	-916	1,957	3,273	144	5,086	4,170
February	4,682	6,754	-2,072	2,050	3,879	157	5,772	3,700
March	1,758	6,616	-4,858	2,184	4,582	169	6,597	1,739
April	1,889	6,986	-5,097	2,161	4,551	199	6,513	1,416
May	1,250	6,986	-5,736	3,188	4,724	165	7,747	2,011
June	5,414	6,805	-1,391	3,250	4,564	170	7,644	6,253
July	5,871	6,910	-1,039	3,338	4,671	191	7,818	6,779
August	8,686	7,230	1,456	4,065	4,601	216	8,450	9,906
September	12,108	6,994	5,114	4,333	4,895	194	9,034	14,148
October	14,984	6,389	8,595	4,784	4,889	218	9,455	18,050
November	15,506	6,357	9,149	6,994	4,950	244	11,700	20,849
December	28,746	17,045	11,701	9,962	6,973	294	16,641	28,342

[a] Includes the monthly debits to the government's account for Bank of Israel profits transferred to the Treasury.

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

[c] The big increase in such credit originated in indexed long-term deposits of banking institutions with the Accountant General, which constituted part of the freely usable funds deriving from savings schemes.

[d] Excludes treasury bills and Short-Term Loan certificates held by the banks.

[e] The government's Israeli currency deposits, its participation in the working capital funds, and the difference between its deposits for loan purposes and the loans actually granted.

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

Table VIII-B3

MARKET VALUE OF SECURITIES LISTED FOR TRADING ON THE TEL AVIV STOCK EXCHANGE, 1979-81[a]

(IS billion)

	Market value			Weight in total listed securities at market value			Percent real increase in market value		
	1979	1980	1981	1979	1980	1981	1979	1980	1981
A. Bonds									
1. Linked to and traded in foreign currency	1.19	2.37	5.36	5.7	3.4	3.1	-19.6	-14.5	12.2
2. Index-linked issued to the public[b]	10.7	29.61	55.01	51.2	41.9	31.9	16.4	18.8	-7.8
3. Option-type loans (linked and unlinked)	0.2	0.17	0.05	1.0	0.2	0.0	-84.5	-63.5	-85.4
4. Double-option (linked to the index or dollar)	0.7	1.9	3.3	3.3	2.7	1.9	18.3	16.5	-13.8
5. Estimated bonds not yet listed for trade[c]	0.02	0.44	0.03	0.1	0.6	0.0			
6. Total bonds	**12.81**	**34.49**	**63.75**	**61.3**	**48.8**	**36.9**	**-3.7**	**15.6**	**-8.3**
B. Shares and convertible securities[d]									
7. Traded in Israeli currency	7.9	35.85	108.26	37.7	50.7	62.8	-16.8	94.8	49.9
8. Traded in foreign currency	0.2	0.35	0.54	1.0	0.5	0.3	-47.4	-24.9	-23.4
9. Total shares and convertible securities	**8.1**	**36.2**	**108.80**	**38.7**	**51.2**	**63.1**	**-17.9**	**91.8**	49.2
C. Total bonds and shares (6+9)	**20.91**	**70.69**	**172.55**	**100.0**	**100.0**	**100.0**	**-9.7**	**45.1**	**21.1**

[a] Excludes securities not intended to be listed for trade, such as certain institutional bonds.
[b] Excludes bonds issued to institutional investors.
[c] The market value, calculated as the face value plus accrued linkage differentials and interest.
[d] Includes shares held by institutional investors.
SOURCE: Tel Aviv Stock Exchange and Bank of Israel.

Table VIII-B4

SECURITIES HELD BY THE PUBLIC, 1979-81[a]

	Market value (IS billion)			Percentage distribution			Percent annual real increase in market value		
	1979	1980	1981	1979	1980	1981	1979	1980	1981
Bonds									
1. Total tradable bonds	12.81	34.49	63.75	100.00	100.00	100.00	-3.7	15.6	-8.3
2. Bonds held by commercial banks	2.90	9.30	20.10	22.63	26.96	31.53	33.2	37.7	7.3
3. Bonds held by Bank of Israel	1.13	2.27	6.18	8.83	6.58	9.69	30.4	-13.8	35.1
4. Estimated holdings of the public[b](1-2-3)	**8.78**	**22.92**	**37.47**	**68.54**	**66.45**	**58.78**	**-14.4**	**12.1**	**-18.9**
Shares and convertible securities									
5. Total shares and convertible securities[c]	8.10	36.20	108.80	100.00	100.00	100.00	-17.9	91.8	49.2
6. Shares and convertible securities held by banks	0.42	1.30	2.98	5.19	3.59	2.74	-17.2	32.9	13.8
7. Estimated holdings of the public (5-6)	**7.68**	**34.90**	**105.82**	**94.81**	**96.41**	**97.26**	**-18.0**	**95.1**	**50.5**
Total securities held by the public (4+7)	**16.46**	**57.82**	**143.29**	**78.70**	**81.79**	**83.00**	**-16.1**	**50.8**	**23.0**

[a] Excludes securities not intended to be listed on the Stock Exchange, such as certain institutional bonds.

[b] This estimate is biased upward since some institutional investors hold bonds of the type issued to the public; includes investment through mutual funds.

[c] Includes shares held by institutional investors.

SOURCE: Tel Aviv Stock Exchange and Bank of Israel.

Table VIII-B5

SECURITY ISSUES AND ESTIMATED CAPITAL MOBILIZED FROM THE PUBLIC, 1978-81

(IS million, at current prices)

	Net capital mobilized through bonds								
	From the public [a]								
	Amount issued (1)	Amount redeemed (2)	Open-market operations [b] (3)	Net capital mobilized (1-2-3) (4)	Savings schemes (5)	Provident and pension funds and insurance companies (6)	Total net capital mobilized through bonds (4+5+6) (7)	Shares and convertible securities [c] (8)	Total net capital mobilized (9)
1978	1,067	1,523	-26	-430	430	677	677	555	1,232
1979	1,573	1,456	281	-164	290	1,624	1,750	204	2,017
1980	3,399	2,182	-264	1,481	323	4,161	5,965	1,432	7,397
1981	1,625	3,430	1,539	-3,344	7,186	8,348	18,878	5,884	18,074
January	280	641	-23	-338	-55	417	24	296	320
February	25	122	4	-101	1,487	433	1,819	489	2,308
March	90	168	45	-123	1,219	745	1,841	69	1,910
April	167	400	4	-237	342	672	777	31	808
May	43	151	40	-148	-142	575	285	188	473
June	98	220	108	-230	-137	55	-312	809	497
July	87	313	40	-266	222	1,001	957	345	1,302
August	35	215	39	-219	-87	316	10	406	416
September	237	154	-251	334	143	1,422	1,899	1,905	3,804
October	84	207	114	-237	-95	631	299	—	299
November	179	333	561	-715	2,071	600	1,956	635	2,591
December	300	506	858	-1,064	2,218	1,481	2,635	711	3,346

[a] Includes bonds purchased through mutual funds.

[b] Net purchases (+) by the Bank of Israel.

[c] Where shares were issued by both the parent company and its subsidiary, only the parent company's issue is included.

SOURCE: State Loans Administration.

Table

STOCK EXCHANGE

	Bonds				
		Linked to consumer price index		Linked to exchange rate or traded in foreign currency	
	Total	Short-term	Medium- and long-term		Double-option
					IS
1978	733	293	342	49	49
1979	1,867	270	1,450	49	98
1980	3,655	194	3,243	121	97
1981	10,619	49	10,157	267	146
					Percent annual
1979	154.7	-7.8	324.0	0	100.0
1980	95.8	-28.1	123.7	146.9	-1.0
1981	190.5	-74.7	213.2	120.7	50.5
					Weight in total Stock
1978	30.6	12.3	14.3	2.0	2.0
1979	43.6	6.3	33.8	1.2	2.3
1980	21.6	1.1	19.2	0.7	0.6
1981	18.1	0.0	17.3	0.5	0.3

[a] According to reports of Stock Exchange members; excludes convertible bonds.
SOURCE: Tel Aviv Stock Exchange.

VIII-B6

TURNOVER, 1978-81

Shares and convertible securities			Total shares and convertible securities traded on and off the floor[a]	
Total shares	Commercial banks	Total securities	Total	Commercial banks
million				
1,659	774	2,392	3,587	2,250
2,419	1,390	4,286	7,644	5,316
13,296	7,276	16,951	33,590	24,074
48,000	29,229	58,619	134,087	85,958
increase				
45.8	79.6	79.2	113.1	136.3
449.6	423.5	295.5	339.4	352.9
261.0	301.7	245.8	299.2	257.1
Exchange turnover (%)			**Stock Exchange trade as a percent of total trade**	
69.4	32.4	100.0	46.3	34.3
56.4	32.4	100.0	31.6	26.1
78.4	42.9	100.0	39.6	30.2
81.9	49.9	100.0	35.8	34.0

Table VIII-B7

MONTHLY REAL OVERALL RATE OF RETURN ON VARIOUS FINANCIAL ASSETS, 1978-81

(Index: December 1980=100)

	Linked bonds			Shares		Foreign currency deposits [b]		
	Total	Linked to consumer price index	Linked to exchange rate or traded in foreign currency	Total ordinary and preferred [a]	Commercial banks	German mark	Dollar	Mutual funds
1978	97.00	96.01	136.39	81.4	73.36	123.10	106.35	93.00
1979	92.69	90.59	112.49	61.3	71.03	117.14	100.37	85.94
1980	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1981								
January	96.3	96.0	99.9	110.8	111.6	92.7	100.5	97.8
February	94.3	94.0	101.3	93.1	101.3	93.9	103.1	92.5
March	93.8	93.3	101.3	93.0	104.0	93.7	101.7	93.5
April	94.3	94.5	95.3	99.3	104.8	86.5	99.0	95.0
May	93.1	92.4	104.6	96.7	108.3	91.2	109.9	91.6
June	94.5	93.3	112.4	102.8	118.4	94.3	116.7	95.8
July	93.6	92.4	110.1	115.8	123.9	90.0	115.5	98.0
August	95.1	94.1	109.2	117.4	128.3	91.4	117.4	100.0
September	96.1	95.3	109.2	113.4	126.2	92.9	115.9	100.8
October	91.3	90.4	105.7	117.4	128.8	94.1	111.0	95.9
November	92.6	91.5	168.9	120.6	130.4	96.7	113.7	99.5
December	93.2	92.0	111.0	125.8	133.2	94.4	113.4	103.9
Real overall rate of return—percent								
Jan.-June	-5.5	-6.7	12.4	2.8	18.4	-5.7	16.7	-4.2
July-Dec.	-1.4	-1.4	-1.2	22.4	12.5	0.1	-2.8	8.5
Jan.-Dec.	-6.8	-8.0	11.0	25.8	33.2	-5.6	13.4	3.9

[a] The weight of preferred shares in the total is very low.

[b] Residents' foreign currency deposits, including interest for a three-month period net of at-source tax deduction of 35 percent.

SOURCE: Central Bureau of Statistics; foreign currency and mutual funds—Bank of Israel.

Table VIII-B8

MARKET VALUE OF EXISTING SHARES BY ISSUING GROUP AND NEW ISSUES OF SHARES AND CONVERTIBLE SECURITIES, 1978-81 [a]

(IS million)

	Market value of listed shares and convertible securities			Weight of group in total new issues of shares and convertible securities against cash (%)					Weight of new issues in total market value of group's shares at end-1980 (%)
	Weight of group in total market value, end-1981		Percent real increase in market value of shares in 1981				1981		
	IS million	%		1978	1979	1980	%	IS million	
Commercial banks and bank holding companies	71,507	65.8	52.2	59.4	63.1	70.3	64.7	3,814	16.4
Mortgage banks	3,424	3.1	6.5	7.5	0.0	4.6	1.2	72	4.5
Specialized financial institutions	982	0.9	0.3	0.5	2.0	1.6	1.7	102	21.0
Insurance	1,710	1.6	6.2	5.1	5.6	5.7	1.7	102	12.8
Total financial sector	**77,623**	**71.4**	**47.0**	**72.5**	**70.7**	**82.2**	**69.3**	**4,090**	**15.6**
Commerce and services	2,255	2.1	63.9	0.3	2.3	2.6	0.5	28	4.1
Land, building, development, and citrus [b]	4,692	4.3	49.1	6.9	5.3	7.2	6.8	402	25.7
Industry	12,992	11.9	46.8	11.4	15.4	3.6	10.7	630	14.3
Investment and holding companies	11,200	10.3	65.1	8.9	6.3	4.4	12.7	748	22.2
Total	**108,762**	**100.0**	**49.1**	**100.0**	**100.0**	**100.0**	**100.0**	**5,898**	**16.3**

[a] Excludes stock dividends, conversion of convertible bonds, issues not against cash, and existing shares listed for trade on the Stock Exchange.

[b] Includes oil exploration companies.

SOURCE: Tel Aviv Stock Exchange and Bank of Israel.

Table VIII-B9

OVERALL RATE OF RETURN INDEX FOR LISTED ORDINARY AND PREFERRED SHARES, 1978-81

(December 1980=100)

End of period	General Stock Exchange index	Finance and insurance						Industry	Commerce and services	Land, building, development
		Total	Commercial banks	Insurance companies	Mortgage banks	Specialized financial institutions	Investment companies			
1978	16.4	15.8	14.9	26.9	21.0	29.2	18.6	14.7	14.6	19.2
1979	26.4	29.6	30.5	22.1	22.3	33.6	25.5	13.2	17.4	15.4
1980	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1981										
I	112.2	119.6	123.4	76.0	89.4	104.6	92.9	89.9	109.1	100.3
II	142.8	158.5	165.0	80.0	107.7	129.8	95.3	103.3	110.5	122.8
III	190.2	202.8	209.7	103.6	143.5	186.0	137.6	144.0	170.5	204.1
IV	253.8	262.0	268.4	181.6	203.7	209.6	198.4	226.5	285.3	258.8
Real change in 1981 (%)										
December levels	26.0	30.0	33.2	-9.9	1.1	4.0	-1.5	12.4	41.6	28.4
Annual average [a]	41.5	42.3	46.2	-6.5	6.8	10.4	5.8	53.7	41.9	99.2

[a] Deflated monthly by the consumer price index.

SOURCE: Central Bureau of Statistics.

Table VIII-B10

BANK OF ISRAEL OPERATIONS ON THE STOCK EXCHANGE, 1978-81

(IS million)

				1981			
					Monthly average		
	1978	1979	1980	Total	Jan.-June	July-Dec.	Dec.
Net purchases in the secondary market [a]	9.7	160.5	-231.7	1,145.4	22.7	213.2	868.9
Total trade in bonds	179.3	610.4	347.5	3,995.4	59.6	606.3	1,600.4
Weight in total trade (%) [b]	24.5	32.7	9.5	37.6	9.9	52.0	71.7

[a] Does not include off-the-floor transactions. Net purchases in Table VIII-B5 include redemptions and purchases of newly issued bonds for the Bank of Israel's portfolio, and so they differ from the data presented here.

[b] The Bank of Israel's weight in total trade indicates its intervention in the market. It is calculated by summing its purchases and sales and dividing by the total volume of Stock Exchange trade. The data are biased upward, since they do not include off-the-floor transactions.

SOURCE: State Loans Administration.

Table VIII-B11

AVERAGE REAL NET BOND YIELDS TO MATURITY, MONTHLY, 1981

(Percentages)

Years to maturity	100% indexed 3½-5½	90% indexed 4½-6½	80% indexed 8¼
1980			
1st half (monthly average)	2.5	2.8	2.8
2nd half (monthly average)	2.3	2.6	2.3
1981			
January	1.9	2.3	1.7
February	2.8	2.9	2.3
March	3.2	3.2	2.6
April	2.9	3.2	2.5
May	2.8	3.0	2.5
June	2.9	3.6	3.0
July	3.0	3.3	2.7
August	2.6	3.0	2.4
September	1.6	2.3	2.5
October	3.0	3.1	2.5
November	3.5	3.5	2.6
December	4.0	3.8	3.0

NOTES:

1. The yields shown in this table are averages of end-of-week data for government bonds.
2. The yields were calculated according to the actual price index, with no adjustment for the loss of one monthly indexation increment on redemption.
3. In 1981 there was a net negative return on original-issue bonds, which ranged from 1.9 to 2.5 percent, depending on the issue price and the timing of the purchase during the month.

SOURCE: Bank of Israel calculations.

Table VIII-B12

MUTUAL FUND OPERATIONS, 1979-81

	1979	1980	1981
Net issues [a] (IS million)	-189	1,438	-2,420
Ratio of net issues to total mutual fund assets at beginning of year (%)	-0.9	20.8	-10.7
Mutual fund assets as a percent of tradable assets held by the public [b]	15.6	15.7	11.0
Bonds denominated in Israeli currency	37.9	41.7	41.3
Foreign currency assets (incl. securities)	6.5	5.3	3.0
Shares denominated in Israeli currency	6.7	8.6	6.3
Composition of mutual funds' portfolio at end of year [c] (%)	100.0	100.0	100.0
Bonds denominated in Israeli currency	70.0	66.6	62.0
Foreign currency assets	18.4	11.7	9.1
Shares denominated in Israeli currency	11.6	21.7	28.9

[a] Mutual fund shares sold, less redemptions and dividends paid.

[b] Tradable assets held by the public consist of bonds, foreign currency deposits, and shares and convertible securities listed on the Tel Aviv Stock Exchange.

[c] Excludes cash.

SOURCE: Bank of Israel calculations.

Table VIII-B13

ASSETS PORTFOLIO OF MUTUAL FUNDS AND THEIR OVERALL RATES OF RETURN, 1981

Classification of funds by specialization[a]	Composition of assets portfolio,[b] 31.12.1981 (%)			Market value of assets, 31.12.1981 (IS million)		Real rate of return weighted by market value of funds, 1981 (%)			Standard deviation of real monthly rate of return, 1981 (%)[c]
	Indexed and option bonds	Foreign currency	Shares in Israeli currency	1980	1981	Jan.-June	July-Dec.	Jan.-Dec.	
Indexed securities	87.1	0.9	12.0	7,070	10,777	30.9	48.4	94.9	4.9
Foreign currency	10.4	74.8	14.7	236	792	57.4	51.4	138.5	6.3
Shares	6.6	0.2	93.2	742	1,569	24.3	107.6	159.8	17.2
Dual foreign currency-indexed	52.2	34.0	13.8	1,270	1,519	42.7	49.3	113.2	4.4
Dual shares-indexed	48.6	2.5	48.9	550	2,116	35.0	65.6	130.3	8.3
Mixed with guaranteed indexed	60.6	17.6	21.9	1,235	2,446	39.2	54.0	108.3	5.6
Mixed with guaranteed foreign currency	23.8	58.5	17.7	52	140	42.2	52.0	114.6	5.3
Mixed with guaranteed shares	13.5	0.9	85.6	409	858	26.9	95.9	157.3	14.0
Pure mix	44.0	22.3	33.7	491	1,193	36.6	61.3	120.3	7.2
Money market fund	43.4	2.2	54.4	1,587	1,408	30.1	63.8	122.7	8.3
Total funds	62.1	9.1	28.9	13,642	22,818	34.0	58.3	110.7	6.6

[a] A speciality fund is one which invests at least 75 percent of its assets in a particular category. A dual fund is one where the weight of the two asset categories comes to at least 80 percent. A mixed fund is one which invests at least 50 percent of its assets in a particular category. A money market fund is one with no spread between its bid and ask price. A pure mix refers to those funds not included in the above classification. The classification here is based on the average composition on the funds' portfolios in the last 18 months.

[b] Does not add up to 100 percent because of the omission of cash and the rounding of figures.

[c] The standard deviation measures the risk associated with quarterly changes in the real return on mutual fund shares in the last 18 months. The data here are not comparable with the standard deviations of the returns on other financial assets which appear in Table VIII-15, since they were calculated here as three-month moving averages and not on a monthly basis.

Table VIII-B14

SOURCES AND USES OF MEDIUM- AND LONG-TERM FUNDS OF THE CAPITAL MARKET INTERMEDIARIES, [a] 1979-81

(Gross flows in IS million)

	1979	1980	1981 Total	1981 1st half	1981 2nd half
Sources					
1. Savings of the public	2,203	4,913	17,814	9,265	8,549
2. Loan repayments	2,218	4,038	8,313	3,310	5,003
By households	471	883	1,708	851	857
By business	1,270	2,387	4,971	1,899	3,072
By local authorities	387	768	1,634	560	1,074
3. Other sources	110	137	2,233	-344	2,577
National Institutions (net)	52	271	55	30	25
Foreign sector (net)	-97	-399	1,833	-334	2,167
Bank of Israel (net)	90	76	-30	-161	131
Other	65	189	375	121	254
4. Total sources	**4,441**	**9,088**	**28,360**	**12,231**	**16,129**
Uses					
5. Total medium- and long-term credit	3,863	7,369	18,994	8,236	10,758
6. Net transfer of funds	-339	-521	6,678	2,924	3,754
To the government	-404	-1,354	6,796	1,022	5,774
To banking institutions	65	833	-118	1,902	-2,020
7. Net short-term uses (incl. currency and demand deposits)	392	1,261	1,114	329	785
8. Surplus of expenditure over income	646	1,161	2,473	888	1,585
9. Dividends and other net payments [b]	-121	-182	-899	-146	-753
10. Total uses	**4,441**	**9,088**	**28,360**	**12,231**	**16,129**

[a] Defined as the system of financial intermediaries engaged primarily in the mobilization of medium- and long-term funds for investment in financial assets, such as loans, deposits, and securities. For a detailed definition see the Annual Report for 1977, Ch. XIX. This year the mutual funds were transferred from the category of capital market intermediaries to the "public".

[b] Mainly in connection with general insurance transactions.

SOURCE: Bank of Israel estimates.

Table VIII-B15

FLOW OF FUNDS BETWEEN THE CAPITAL MARKET INTERMEDIARIES [a] AND THE GOVERNMENT AND BANKING INSTITUTIONS, 1979-81

(IS million)

		Long-term assets and liabilities [b]			Current long-term transactions [c]			
		Receipts o/a assets (1)	Payments o/a liabilities (2)	Surplus of receipts over payments (1-2) (3)	Receipts (4)	Payments (5)	Surplus of receipts over payments (4-5) (6)	Total surplus receipts (3+6) (7)
Government	1979	2,875	458	2,417	1,641	3,853	-2,212	205
	1980	6,691	880	5,811	3,840	8,915	-5,075	736
	1981	14,055	1,993	12,062	8,031	26,889	-18,858	-6,796
	First half	6,001	766	5,235	3,414	9,671	-6,257	1,022
	Second half	8,054	1,227	6,827	4,617	17,218	-12,601	-5,774
Banking institutions [d]	1979	67	93	-26	1,049	1,072	-23	-49
	1980	195	692	-497	1,266	1,586	-320	-817
	1981	2,508	1,132	1,376	4,177	5,435	-1,258	118
	First half	608	497	111	1,820	3,833	-2,013	-1,902
	Second half	1,900	635	1,265	2,357	1,602	755	2,020

[a] See note a to Table VIII-B14.

[b] Deposits, loans, and securities (including interest and linkage increments received and paid). In the case of the government col. 1 consists mainly of repayments of past deposits by the Accountant General, and col. 2 of repayments of deposits of the Accountant General with the capital market intermediaries and Finance Ministry participation in savings scheme grants.

[c] Deposits, loans, and sales and purchases of securities. Col. 4 consists mainly of sums redeposited by the government.

[d] The commercial banking system, less medium- and long-term transactions included in the data on the capital market intermediaries.

SOURCE: Bank of Israel estimates.

Table VIII-B16
FLOW OF SAVINGS IN SOCIAL INSURANCE FUNDS, 1979-81 [a]
(IS million)

				Percent annual real increase [b]		
	1979	1980	1981	1979	1980	1981
Deposits						
Pension funds	778	1,947	4,283	21.1	11.0	1.9
Provident funds	1,142	2,886	6,659	2.8	7.2	7.4
Financial sector	912	2,316	5,408	-0.4	9.2	7.3
Histadrut and companies	230	570	1,251	18.7	-0.1	8.1
Severance pay funds	281	678	1,707	42.9	0.0	18.7
Other funds	277	842	2,510	8.4	29.5	40.5
Total	**2,478**	**6,353**	**15,159**	**12.3**	**10.0**	**11.3**
Payments to members and withdrawals						
Pension funds	490	1,245	3,184	3.1	14.0	15.6
Provident funds	324	742	2,094	10.5	-0.1	29.8
Financial sector	269	585	1,761	19.8	-0.1	38.2
Histadrut and companies	55	157	333	-18.0	13.5	-2.1
Severance pay funds	145	349	566	27.3	1.7	-19.7
Other funds	108	342	731	0.5	35.7	5.8
Total	**1,067**	**2,678**	**6,575**	**7.8**	**9.8**	**13.8**
Net accumulation						
Pension funds	288	702	1,099	76.1	5.6	-24.5
Provident funds	818	2,144	4,565	0.2	10.4	-0.3
Financial sector	643	1,731	3,647	-6.7	14.5	-3.0
Histadrut and companies	175	413	918	40.7	-0.1	12.2
Severance pay funds	136	329	1,141	63.1	-0.1	59.1
Other funds	169	500	1,779	13.8	25.7	63.1
Total	**1,411**	**3,675**	**8,584**	**15.8**	**10.1**	**9.5**

[a] The social insurance funds are classified according to function and not the institutional division used previously.

[b] Deflated by the semiannual average change in the consumer price index.

SOURCE: 1980 and 1981—based on Central Bureau of Statistics data; 1979—Bank of Israel.

Table VIII-B17

SOURCES AND USES OF SOCIAL INSURANCE FUNDS, 1979-81

(IS million)

Sources	1979	1980	1981	Uses	1979	1980	1981
Net savings deposits [a]	1,411	3,675	8,584	Net transfers [b]	1,184	3,086	8,137
Repayment of medium- and long-term loans	112	177	505	Medium- and long-term credit	169	335	673
				Net short-term credit (up to two years)	40	-27	835
				Net change in other short-term uses [c]	31	309	-193
				Surplus of expenditure over income and net purchase of real assets	99	149	-364
Total sources	**1,523**	**3,852**	**9,088**	Total uses	**1,523**	**3,852**	**9,088**

[a] Net of payments to members; contributions to severance pay funds are treated as household savings.

[b] Net purchase of securities from original issues and in the secondary market.

[c] Includes the increase in outstanding short-term assets less the increase in short-term liabilities, as well as adjustment items.

SOURCE: 1978, 1980, and 1981—based on Central Bureau of Statistics data; 1979—Bank of Israel estimates.

Table VIII-B18

BALANCE SHEET OF SOCIAL INSURANCE FUNDS, 1979-81 [a]

(IS million)

				Percentage distribution		
	1979	1980	1981	1979	1980	1981
Assets						
Securities	23,025	65,618	149,693	96.2	95.2	94.9
Loans to members [b]	244	325	749	1.0	0.5	0.4
Deposits and loans to others	120	1,373	5,237	0.5	2.0	3.3
Fixed assets	160	737	504	0.7	1.1	0.4
Employers' debt	99	239	393	0.4	0.3	0.3
Accrued interest and indexation increments receivable and other current assets	290	639	1,128	1.2	0.9	0.7
Total assets	**23,938**	**68,931**	**157,704**	**100.0**	**100.0**	**100.0**
Liabilities						
Pension reserve	9,592	25,853	58,471	40.1	37.5	37.0
Provident and advanced study reserve	11,065	33,939	77,427	46.2	49.2	49.1
Severance pay, social benefit, and other reserves	2,407	5,945	14,629	10.0	8.6	9.3
General and other reserves	14	16	331	0.1	0.1	0.3
Auxiliary reserve and undistributed profits	764	2,142	6,261	3.2	3.1	3.9
Current liabilities	96	1,036	585	0.4	1.5	0.4
Total liabilities	**23,938**	**68,931**	**157,704**	**100.0**	**100.0**	**100.0**

[a] Linkage increments are included in the relevant balance sheet items.

[b] Directly and through banks and financial institutions.

SOURCE: 1980, 1981—Central Bureau of Statistics; 1979—Bank of Israel.

Table VIII-B19

DOMESTIC SOURCES AND USES OF FUNDS FOR THE GOVERNMENT'S MEDIUM- AND LONG-TERM FINANCIAL TRANSACTIONS, 1979-81[a]

(Gross flows in IS million)

	1979	1980	1981		
			Total	1st half	2nd half
Sources					
1. Sale of government bonds (voluntary)	2,278	5,220	4,246	1,852	2,394
2. Financial institution deposits of earmarked security issue proceeds	1,936	4,630	21,843	7,616	14,227
3. Nonearmarked deposits of commercial banks and financial institutions	511	959	2,814	1,390	1,424
4. Repayment of deposits with financial institutions	443	836	1,993	773	1,220
5. Direct repayment of credit	75	428	1,000	390	610
6. Receipts o/a of the government's securities portfolio (incl. sales of shares from the portfolio)	4	97	100	40	60
7. Surplus of domestic sources (-) or uses (+)—residual	588	1,910	-1,785	789	-2,574
Total domestic sources	**5,835**	**14,080**	**30,211**	**12,850**	**17,361**
Uses					
1. Redemption of government bonds	1,195	2,108	3,659	1,794	1,865
2. Repayment of financial institution deposits of earmarked security issue proceeds	990	2,094	5,378	2,180	3,198
3. Repayment of nonearmarked deposits of commercial banks and financial institutions	117	394	1,391	615	776
4. Savings scheme grants (in place of interest) and interest compensation to pension funds	97	235	131	124	7
5. Deposits in financial institutions for granting loans	1,641	3,852	8,031	3,377	4,654
6. Credit provided directly	748	2,071	3,989	1,820	2,169
7. Purchase of shares and bonds	21	69	140	60	80
8. Net payments o/a of exchange rate and linkage insurance	1,026	3,257	7,492	2,880	4,612
Total domestic uses	**5,835**	**14,080**	**30,211**	**12,850**	**17,361**

[a] This table is based on flows of funds between the government and the rest of the economy, including financial transactions between the government and the local authorities.

SOURCE: Bank of Israel estimates.