

## ***NOTES TO THE 2007 FINANCIAL STATEMENTS***

### **1. Accounting policies**

#### **a. General**

The financial statements are presented in accordance with generally accepted accounting principles adapted for the special activity of a central bank, and consistent with the practice of other central banks.

The main items presented in accordance with generally accepted accounting principles of central banks are:

1. Revaluation accounts, as detailed in Section 1.l below.
2. Local currency securities, as detailed in Section 1.f below.
3. Cash flow statements, as detailed in Section 1.r below.

#### **b. Definitions**

In these financial statements:

1. "The Bank" - The Bank of Israel
2. "CPI" - The Consumer Price Index as published by the Central Bureau of Statistics.
3. "Adjusted amount" - The nominal historical amount adjusted to the CPI in respect of December 2003, in accordance with the provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.
4. "Reported amount" - The adjusted amount as at the transition date (December 31, 2003), with the addition of amounts in nominal values that were added after the transition date, less amounts eliminated after the transition date.
5. "Nominal financial reporting" - Financial reporting based on reported amounts.

#### **c. Financial statements in reported amounts**

1. In October 2001 the Israel Accounting Standards Board published Accounting Standard No. 12, "Discontinuance of Adjustment of Financial Statements." Pursuant to this standard and in accordance with Accounting Standard No. 17 that was published in December 2002, the adjustment of financial statements for the effect of inflation was discontinued as of January 1, 2004.
2. In the past the Bank prepared its financial statements on the basis of historical cost, with no adjustment for changes in purchasing power of the Israeli currency. In the financial statements for 2005, comparable figures for the year ending December 31, 2003 were recalculated on a historical cost basis, adjusted for the changes in the CPI, as required by Accounting Standard No. 12, in order to prepare for the transition to nominal financial reporting.

The adjusted amounts included in the financial statements as at December 31, 2003 constituted the starting point for the nominal financial report as of January 1, 2004. Any additions and disposals made during the period were included in their nominal values.

3. Amounts of non-monetary assets do not necessarily reflect their realizable value or current economic value, but only the reported amounts of such assets.
4. The term “cost” in these financial statements means the reported amount of cost.

**d. Reporting principles**

1. Balance sheet:

- a. Non-monetary items (mainly fixed assets, investments presented at cost) are stated in reported amounts.
- b. Monetary items are stated in the balance sheet at their nominal historical values as of balance sheet date.

2. Statement of Operations:

- a. Income and expenses deriving from non-monetary items (such as: depreciation, prepaid expenses and deferred income) or from provisions included in the balance sheet are derived from the difference between the reported amount of the opening balance and the reported amount of the closing balance.
- b. All other operating items (such as: interest income and expenses) are stated at their nominal values.

3. Statement of changes in equity:

In accordance with the Bank of Israel Law, 5714-1954, the Bank must transfer its net profits to the government within 60 days from the end of its business year. As the Bank of Israel had an accumulated loss as of December 31, 2006 and December 31, 2007, profits are set off against the accumulated loss and no transfers are made to the government.

**e. Use of estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires the Bank’s management to make estimates and assumptions regarding transactions or matters the final effect of which on the financial statements cannot be accurately determined at the time of their preparation. Even though the estimates and assumptions are based on management’s best judgment, the final effect of such transactions or matters may be different from the estimates and assumptions made in their respect.

**f. Securities***Foreign currency securities*

Tradable foreign currency securities are stated at their market value as of the balance sheet date.

Interest and indexation income on foreign currency securities are recorded in the Statement of Operations on an accrual basis and presented in the “Interest income from foreign currency financial assets abroad” item.

Unrealized profits arising from the difference between the adjusted cost of securities and their market value are included in the “Revaluation accounts” item in the balance sheet.

Unrealized losses at the end of the year due to a fall in the market price of securities to below their adjusted cost are transferred to the Statement of Operations and are shown under “Other financial income from (expenses on) securities and derivatives.” The adjusted cost of securities is their nominal value plus interest, indexation differentials and the balance of the premium or discount not yet amortized. The premium or discount is amortized over the period from the date of purchase until the date of redemption.

Income from the realization of securities is shown under “Other financial income (expense) from securities and derivatives.”

*Local currency securities*

Tradable local currency government securities are stated in the balance sheet at their market value as of balance sheet date.

The difference between the market value of securities and their original cost is recorded in the “Revaluation accounts” item in the balance sheet.

Income from tradable government securities is included in the Statement of Operations on a cash basis in accordance with the matched timing principle according to which accrued profits from government securities not yet received in cash from the government are not included in the Bank’s income.

Interest and indexation income on local currency securities are shown under “Interest income from the government.”

**g. International financial institutions***The International Monetary Fund (IMF)*

The Bank of Israel’s participation in the IMF less its liability for participation is shown under assets in the item “International financial institutions.”

Special drawing rights (SDR) allocated by the IMF are shown under liabilities in the item “International financial institutions.”

*Balances related to other international financial institutions and investment in shares of the Bank for International Settlements (BIS)*

The Bank of Israel's participation in other international financial institutions includes initial participation in their capital and additional participation payments for increases in the capital of those institutions. The Bank of Israel's participation in other international financial institutions is shown under "International financial institutions" as an asset according to the cost in the currency in which the participation was paid, translated at the exchange rate on the date the transaction took place. Liabilities to international financial institutions are shown under liabilities in the item "International financial institutions."

**h. Fixed assets**

1. Fixed assets are stated at cost.
2. Improvements and enhancements are added to the cost of the assets whereas maintenance and repairs are charged to expense as incurred.
3. Depreciation is calculated by the straight-line method on the basis of the estimated useful lives of the assets:
 

Buildings	—	fifty to sixty-seven years;
Vehicles	—	six and a half years;
Computers	—	four years;
Equipment	—	ten years.
4. Purchases of certain items of fixed assets for non-significant amounts are recorded in the Statement of Operations.

**i. Banknotes and coins in circulation**

Banknotes and coins issued by the Bank reflect the Bank's liabilities towards holders of the banknotes and coins. The liabilities are shown in the Bank's balance sheet according to their denominated values.

**j. *Makam* (short-term bills issued by the Bank of Israel)**

The balance of *makam* in the balance sheet reflects the par value (the redemption price) of *makam* held by the public less the balance of the discount that has not yet been amortized. *Makam* sold by the government to the Bank of Israel but not yet sold to the public are not included in this balance.

The discount is the difference between the par value of the *makam* and the proceeds of their sale to the public. The discount is amortized by the straight-line method.

Expenses of amortizing the discount on the balance of *makam* held by the public are presented in the Statement of Operations in the item "Interest paid to the banks and the public."

**k. Liabilities in respect of employees' rights**

The liability for employee pensions and severance pay is actuarially computed, and reflects the liability for pensions and severance payments to employees accrued as of the balance sheet date.

Provision for vacation pay is computed on the basis of vacation days due, accrued as of the balance sheet date. (See Note 14).

**l. Revaluation accounts**

The revaluation accounts include unrealized profits from exchange-rate differentials on balances denominated in foreign currency and unrealized profits from the revaluation of tradable securities in local currency and foreign currency to market value.

There are separate revaluation accounts for each item (currency, security), which are transferred to the Statement of Operations when the item is realized in whole or in part.

The balance of the loss in the revaluation accounts arising from price differentials in foreign currency securities and from exchange-rate differentials on balances in foreign currency is transferred to the Statement of Operations at the end of the year.

**m. Foreign currency**

The assets and liabilities denominated in foreign currency, or indexed to foreign currency, are presented in New Israeli Shekels according to the representative rate of exchange published by the Bank of Israel on the balance sheet date.

Differences in rate arising from the adjustment of assets and liabilities due to changes in the exchange rate include realized and unrealized exchange-rate differentials.

Unrealized exchange-rate differentials are charged separately for each currency in the "Revaluation accounts" item. Realized exchange-rate differentials are transferred to the Statement of Operations, and are calculated on the basis of the average cost of the balances of that currency. Realization is calculated separately for each calendar month for all foreign currency assets and liabilities and for each currency. A balance of loss in the revaluation accounts at the end of the year is transferred to the Statement of Operations, and is not offset in the future against unrealized profits. Unrealized losses in one currency are not offset against unrealized profits in other currencies.

Income and expenses in foreign currency are included in the Statement of Operations according to the representative exchange rates prevailing on the days that the transaction occurred.

Details of the exchange rates are as follows:

	December 31			Change	
	2007	2006	2005	2007	2006
		(NIS)		(percent)	
US\$	<b>3.8460</b>	4.2250	4.6030	-9.0	-8.2
Euro	<b>5.6592</b>	5.5643	5.4465	1.7	2.2
Special drawing rights (SDR) <sup>a</sup>	<b>6.0705</b>	6.3510	6.5781	-4.4	-3.5
First currency basket <sup>b</sup>	<b>4.9857</b>	5.1489	5.1812	-3.2	-0.6
Currency basket <sup>c</sup>	-	4.8253	5.0891	-	-5.2

<sup>a</sup> SDR rate is based on a weighted 4-currency basket consisting of US\$, €, ¥, and £.

<sup>b</sup> First currency basket was in effect until July 31, 1986, and consisted of: US\$ 0.3500; £ 0.1295; and € 0.4667.

<sup>c</sup> Currency basket in effect since May 2, 2000, and consists of: US\$ 0.6698; £ 0.0453; € 0.2493; and ¥ 7.2411. The publication of the currency basket exchange rate was discontinued on May 1, 2007, because the exchange rate band (which related to the currency basket exchange rate) was abolished on June 9, 2005, and that exchange rate is no longer used for monitoring or analysis.

## n. Indexation

Assets and liabilities indexed to the Consumer Price Index (CPI) are shown according to the indexation terms determined for each balance.

	December 31			Change	
	2007	2006	2005	2007	2006
		(points) <sup>a</sup>		(percent)	
CPI <sup>a</sup> November	<b>105.8</b>	102.9	103.2	2.8	-0.3
December	<b>106.4</b>	102.9	103.0	3.4	-0.1

<sup>a</sup> CPI is presented in points based on the 2002 average.

## o. Derivative financial instruments

The Bank of Israel uses financial instruments in its monetary and foreign exchange activities.

### 1. Activity in derivative financial instruments in Israel:

#### a) Purchase and sale options on the NIS/US\$ exchange rate

The Bank of Israel sells NIS/US\$ exchange rate options to the banks. Expenses arising from the exercise of options during the period of the statement, and expenses expected from their exercise in accordance with the representative exchange rate of the dollar on the balance sheet date, less income from the premium on the options, are shown in the item "Other financial income (expense) from securities and derivatives." The

income from the premium on options is spread evenly over the duration of the options using the straight-line method. Prepaid income on the premium plus expenses accrued in respect of the difference between the exercise rate and the representative dollar exchange rate on the balance sheet date is included in the "Other liabilities" item. In August 2006 the Bank of Israel ceased these transactions, although there are still some options whose expiry dates had not yet been reached by December 31, 2006. The balance of options as of December 31, 2007 was zero.

*b) Future remittances of makam*

The balance of the liability for future remittance of *makam* through the date of the financial statement is presented at par (redemption price) in Note 18, "Contingent liabilities and special commitments."

Receipts on account of future issues of *makam* are included in the balance sheet under "Other liabilities."

*(c) Reverse repurchase agreements (RRepo) for makam and government bonds*

In October 2007, the Bank of Israel started engaging in RRepo of *makam* and government debentures.

These transactions are presented in the balance sheet within "Other Assets." Income from interest accrued due to these transactions is presented under "Other Income." The balance of RRepo as of December 31, 2007 was zero.

*2. Financial instruments in activities abroad:*

*a) Repurchase agreements (Repo), and Reverse Repurchase agreements (Reverse Repo)*

The Bank executes repurchase agreements (Repo). The securities sold in the repurchase agreements are presented in Note 2, "Foreign currency financial assets abroad," under "Tradable securities." The liability for buying the securities is included in the item "Foreign currency financial liabilities abroad." In the Statement of Operations the results of the transactions are presented as "Interest expense for foreign currency financial liabilities abroad."

The Bank also executes reverse repurchase agreements (RRepo). These balances are shown in Note 2, "Foreign currency financial assets abroad," under "Securities bought in reverse repurchase agreements." In the Statement of Operations, the results of these transactions are presented as "Interest income from foreign currency financial assets abroad."

*b) Foreign currency swaps*

The transactions are presented in the balance sheet at net value in the "Foreign currency financial assets abroad" item: the balance of future foreign currency receipts

less future foreign currency remittances.

In the Statement of Operations the results of these transactions are included in the item, "Interest income from foreign currency financial assets abroad."

*c) Futures*

The balance of futures contracts at market prices on the date of the financial statement is given in Note 18, "Contingent liabilities and special commitments."

In the Statement of Operations the change in the value of the contracts is recorded under "Other financial income (expense) from securities and derivatives."

*(d) Options (foreign exchange options/currency options)*

As part of its management of the foreign exchange reserves, the Bank of Israel purchases options which give their holder the right, but not the obligation, to buy a specified quantity of a currency with another currency at a pre-determined price, on or by a given date, against payment of a premium. The results of these transactions are shown in the Statement of Operations under "Other financial income (expense) from securities and derivatives." On December 31, 2007 the Bank of Israel did not hold such options.

**p. Offsetting financial balances**

Assets and financial liabilities are presented in the balance sheet net only when the Bank has a legal and enforceable offsetting right, and when it intends to pay the asset or liability off on a net basis or to realize the asset and settle the liability simultaneously.

**q. Impairment of assets**

The Bank applies Accounting Standard No. 15 - Impairment of assets (hereafter: the Standard), which defines procedures that the Bank must apply in order to ensure that its assets in the balance sheet are not stated in an amount greater than the recoverable amount, which is the higher of the net sale price and usage value (the present value of an estimated future cash flow expected to derive from the use and disposal of the asset). The Standard applies to all balance sheet assets, except for financial assets. The Standard also sets the rules of presentation and disclosure regarding assets which have been impaired. Where the value of an asset exceeds its recoverable amount, the Bank recognizes a loss from impairment in the amount of the difference between the book value of the asset and its recoverable amount. The loss so recognized will be cancelled only if changes occur in the estimates that were used to determine the recoverable amount of the asset from the date on which the last loss from impairment was recognized.

**r. Cash flow statements**

These financial statements do not include a cash flow statement, as it does not contain significant information beyond that which appears in the financial statements. This is also in accordance with the general practice among central banks worldwide.

**s. Taxes**

According to the Bank of Israel Law, 5714-1954, concerning the payment of taxes the Bank's laws follow that of the State of Israel and therefore the Bank is exempt from paying certain taxes such as income tax and capital gains tax.

**t. First time implementation of accounting standards**

(a) Since 1 January 2007 the Bank of Israel has applied Accounting Standard 27 with regard to fixed assets ("the Standard") of the Israel Accounting Standards Board. The Standard sets rules for the recognition, measurement and depreciation of items of fixed assets and the required disclosure thereof.

The main changes in the Standard from the previous practice are:

- (i) With regard to a fixed asset, the inclusion of the estimated costs to be incurred due to an obligation to dismantle and move an asset and reconstruction of its location, at the time when the asset is first recognized.
- (ii) Providing an alternative for measuring groups of similar fixed assets by using a revalued amount less accumulated depreciation; an increase in the value of an asset as a result of the revaluation to a value higher than its initial cost will be recorded as equity in a "Revaluation Reserve" item.
- (iii) Separate depreciation of each part of a fixed asset item with a cost that is significant in comparison to the total cost of the asset, including significant costs of periodic examination;
- (iv) Determination that a fixed asset item, which has been purchased in consideration of another non-monetary item as part of a commercial transaction, shall be measured according to fair value;
- (v) The demand that the residual value be reviewed, along with the assets' useful lifespan and depreciation method at least at the end of each business year, and if expectations are different from previous estimates, the change(s) shall be treated as a change in accounting estimate.

The Bank has selected the cost method as its accounting policy concerning the measurement of fixed assets (see also Note 1h). The implementation for the first time of Standard 27 had no material effect on the results of the Bank's activities and financial position.

(b) Since January 1, 2007, the Bank has implemented Accounting Standard 30 of the Israeli Accounting Standards Board - Intangible Assets (hereinafter: "the Standard"). The Standard explains the accounting treatment of intangible assets and defines the

method of measuring the bookkeeping value of these assets, while detailing the required disclosures.

In accordance with the interim directives regarding the Standard, it will be implemented retroactively.

Programs that do not constitute an integral part of the relevant hardware are shown under fixed assets.

The implementation for the first time of Standard 30 had no material effect on the results of the Bank's activities and financial position.

## 2. Foreign currency financial assets abroad (see section a below)

	December 31		December 31	
	2007	2006	2007	2006
	(NIS million)		(\$ million)	
Tradable securities	<b>97,811</b>	111,773	<b>25,432</b>	26,455
Short-term deposits	<b>20,340</b>	24,160	<b>5,289</b>	5,718
Demand deposits	<b>1,074</b>	1,000	<b>279</b>	237
Reverse repurchase agreements	<b>1,210</b>	2,891	<b>315</b>	684
Derivative financial instruments <sup>a</sup>	<b>5</b>	36	<b>1</b>	9
<b>Total</b>	<b>120,440</b>	139,860	<b>31,316</b>	33,103

<sup>a</sup> Derivative financial instruments are shown net, i.e., future foreign currency liabilities minus future foreign currency assets (see note 1.o.2).

### a. Foreign exchange reserves

In economic terms, as mentioned in the Explanatory Remarks, the reference to foreign exchange reserves includes the net balance of Repo transactions. These balances consist of the balance of the "Foreign currency financial assets abroad" item less the balance of the "Foreign currency financial liabilities abroad" item.

The balance of the "Foreign currency financial liabilities abroad" item shows the balance of securities sold in the framework of the repurchase agreements.

The currency composition of these balances matches their possible uses. These uses, which also constitute a basis for the determination of the desired level of the reserves, consist of selling them (foreign currency) to the government to service its debts and to finance imports in an emergency; using them to implement the Bank of Israel's policy on the stability of the banking system and the foreign currency market; and using them as an instrument for implementing monetary policy. (The yields on the foreign exchange reserves are shown in Table 4 in the Explanatory Remarks to the Financial Statements.)

Details of the foreign exchange reserves are as follows:

	December 31		December 31	
	2007	2006	2007	2006
	(NIS million)		(\$ million)	
Foreign currency financial assets abroad	<b>120,440</b>	139,860	<b>31,316</b>	33,103
Foreign currency financial liabilities abroad	<b>(10,983)</b>	(17,103)	<b>(2,856)</b>	(4,048)
<b>Total foreign exchange reserves</b>	<b>109,457</b>	122,757	<b>28,460</b>	29,055

### 3. International financial institutions

	December 31	
	2007	2006
	(NIS million)	
The IMF (see section a below)	<b>369</b>	521
Investment in BIS shares	<b>282</b>	282
Balances related to other international financial institutions (see section b below)	<b>554</b>	554
<b>Total</b>	<b>1,205</b>	1,357

#### a. The International Monetary Fund (IMF)

The balance with the IMF (the reserve tranche) constitutes part of the quota allocated to Israel for which Israel paid the Fund in foreign currency.

##### *The quota in the IMF*

Each member country has a quota allowing it to participate in the capital of the Fund. The quota is determined according to the country's economic situation (national income, exports, balance of payments, level of the reserves) and it also determines the country's voting rights. Part of the quota paid in cash (called the reserve tranche) is transferred to the Fund in foreign currency, and can be withdrawn by the country, and the rest is deposited in the country's central bank in deposits and notes indexed to Special Drawing Rights.

Up to 1998 Israel drew down its reserve tranche, putting up against this withdrawal a non-interest-bearing deposit in favor of the Fund. In the latest increase in members' participation, in 1999, Israel's quota rose by SDR 262 million. The foreign currency payment for this increase, approximately SDR 66 million, was deposited in the Fund, and has not been withdrawn by Israel.

*The IMF Financial Transactions Plan*

Since 1999 Israel has been part of the IMF's financial transaction plan. The plan is a mechanism through which a member country can exchange SDR or foreign currency against its local currency, and another country is asked to execute a counter-exchange. The request to exchange foreign currency is passed on by the Fund at short notice. The IMF manages the sums transferred and received in these transactions in such a way that the share of the reserve tranche in the quota of each member country participating in the plan remains similar. Through 2004, Israel's reserve tranche balance grew gradually due to Israel's transfer of foreign currency to other countries. Since 2004, the Fund has transferred foreign currency to Israel. In 2007 Israel's reserve tranche was reduced by about SDR 21 million.

	December 31		December 31	
	2007	2006	2007	2006
	(NIS million)		(SDR million)	
International Monetary Fund (IMF) quota	<b>5,636</b>	5,897	<b>928</b>	928
Minus liability for the quota <sup>a</sup>	<b>5,267</b>	5,376	<b>867</b>	846
<b>Total<sup>b</sup></b>	<b>369</b>	521	<b>61</b>	82

<sup>a</sup> The balance of the liability to the IMF is in notes and deposits  
<sup>b</sup> The surplus of the reserve tranche over the "basic sum" of SDR 33 million bears interest at a rate set by IMF from time to time. The annual rate of interest on December 31, 2007, was 3.42 percent (on December 31, 2006 – 4.1 percent).

**b. Balances related to other international financial institutions**

The balances relate to the following institutions:

IBRD	–	The International Bank for Reconstruction and Development
IDA	–	The International Development Association
IFC	–	The International Finance Corporation
EBRD	–	The European Bank for Reconstruction and Development
MIGA	–	The Multilateral Investment Guarantee Agency
IDB	–	The Inter-American Development Bank
IIC	–	The Inter-American Investment Corporation

#### **4. Government balances**

Government balances consist of the balances of local currency for the financing of the government's budgetary activities.

Budget financing balances are defined as balances that the government may use to finance its budgetary and extra-budgetary activities, and are therefore covered by Section 45(b) of the Bank of Israel Law, 5714-1954. These accounts list financial transactions deriving from budgetary and extra-budgetary activities by the government in Israel and financial transactions with the Bank of Israel.

All government balances in local currency in the Bank of Israel (with the exception of a number of extraordinary balances) may be offset against each other. The government has no intention of offsetting its local currency balances against its foreign currency balances, and these balances are therefore presented separately (Note 11).

Interest on government local currency balances is charged (on debit balances) or paid (on credit balances) at prime. The average prime interest rate for 2007 was 5.4 percent (in 2006—6.6 percent).

Interest expenses on government balances in local currency are shown net in the Statement of Operations (Note 25).

## 5. Credit to the government

Credit to the government consists mainly of long-term advances, that were provided through 1988.

	December 31	
	2007	2006
	(NIS million)	
Long-term advances <sup>a,c</sup>		
Indexed <sup>b</sup>	1,597	2,168
Unindexed <sup>c</sup>	415	498
Credit for binational funds <sup>d</sup>	127	139
<b>Total</b>	<b>2,139</b>	<b>2,805</b>

<sup>a</sup> The interest and indexation differentials for each year are due for payment on December 31 of that year. The principal is due to be paid in annual payments, the last of which will be in the year 2012.

<sup>b</sup> This credit is indexed to the first currency basket, and bears interest at a rate of 8 percent, also indexed to the same basket.

<sup>c</sup> This credit bears interest at prime rate plus 2 percent. The average rate of interest during 2007 was 7.6 percent (2006 – 8.9 percent).

<sup>d</sup> This credit was given to the government for investment in the Binational (US–Israel) Industrial Research and Development Fund and the Binational (US–Israel) Science Fund, established in cooperation with the US government. The Funds deposited their money in deposits in the Bank of Israel, and it is presented in the balance sheet under “Other Liabilities” (see Note 14). The credit and the deposits bear interest.

<sup>e</sup> i. Correspondence in September 2003 between the Minister of Finance and the Governor of the Bank of Israel included several agreements regarding “Proposals in the Economic Program for 2004 Relating to the Bank of Israel.” One of the items in that correspondence was “the repayment of the government’s debt to the Bank of Israel due to be repaid on December 31, 2003,” and it was determined that “the Bank of Israel will grant a loan to the government to finance the balance of the debt, principal and interest due for repayment on December 31, 2003.” The same section also specified the repayment dates of the loan, the fact that the Bank and the Ministry of Finance should reach an agreement on the interest payable, and that “if the Attorney General is of the opinion that the debt can be cancelled, then it shall be cancelled.”

The amount of the debt, principal and interest, due for repayment on December 31, 2003 was NIS 1,070 million (the total balance of the government debt, principal plus interest, prior to the above repayment was NIS 5,460 million). The debt due to be repaid on December 31, 2003 was duly repaid, as at that time the views of the Attorney General regarding the debt had not been received. Furthermore, as the Bank and the Ministry of Finance had not reached an agreement with regard to the rate of interest on the loan to finance the repayment of that debt, no such loan was granted to the government. In 2004, as in later years, the advances and the interest on them, were repaid by the government as required.

ii. In February 2005 the opinion of the Deputy Attorney General, on behalf of the Attorney General, was received, according to which “there are no legal grounds preventing the Bank of Israel from cancelling the government’s debt to the Bank as agreed between the outgoing Governor and the Minister of Finance.” In the summary giving the basis for this opinion it was written that “it appears that from a legal standpoint the Bank of Israel has the authority to cancel a government debt to the Bank that dates back to a time prior to the prohibition on granting loans to the government under section 45 of the Bank of Israel Law.” With regard to the reasonableness of a Bank of Israel decision to cancel a government debt to the Bank, it noted that “if there are macroeconomic reasons supporting such a decision that are consistent with the Bank’s objectives and policies, such a decision would not be unreasonable.” Summarizing the position, it stated that “we stress that our conclusion that there are no legal grounds preventing the Bank of Israel from cancelling a government debt to the Bank applies in the light of the special circumstances in this case, which is about a debt created in essence prior to the amendment of section 45 of the Bank of Israel Law, and it does not create a precedent for other issues, including any other government debts to the Bank of Israel.”

iii. In effect, most of the government debt (about two-thirds of the principal) to the Bank of Israel was created after the passing of the amendment to section 45 of the Bank of Israel Law (the section relevant to the question of the possibility of cancelling such a debt).

iv. In light of the above, based on the opinion of the Bank’s legal department, and taking into account the fact that the government is making the scheduled repayments, the Bank is of the opinion that the debt will be repaid in full.

## 6. Loans

	December 31	
	2007	2006
	(NIS million)	
Monetary loans <sup>a</sup>	-	7,501
Other loans <sup>b</sup>	<b>481</b>	819
<b>Total</b>	<b>481</b>	8,320

<sup>a</sup> In 2006 and 2007, the Bank of Israel provided banking corporations with monetary loans via auction and overnight monetary loans. Overnight monetary loans to banking corporations were provided at an interest of 1 percent above Bank of Israel interest. The loans are not limited by quota, and are given in return for appropriate guarantees.

The balance as of December 31, 2006 consisted of auctioned monetary loans.

The average interest rate for these loans on December 31, 2006 stood at 4.6 percent.

The average interest rate for these loans in 2007 stood at 3.9 percent (2006—5.1 percent).

The average interest rate for overnight monetary loans in 2007 stood at 5.1 percent (2006—6.1 percent).

<sup>b</sup> The item “Other loans” includes credit to the Industrial Development Bank of NIS 476 million (December 31, 2006—NIS 751 million). In August 2002, the Industrial Development Bank encountered liquidity problems and could not meet its liabilities. The Bank of Israel responded to a request from the bank and made available to it a special credit line to enable it to continue operating regularly. The credit line was originally NIS 2,200 million; this was reduced from time to time, and was supposed to cease at the end of July 2006. On October 30, 2005, the Bank of Israel agreed to a request from the bank to extend the period of the loan by two years to July 31, 2008. The Industrial Development Bank pays interest on the utilized part of the credit at the Bank of Israel interest rate. In accordance with the decision of the economic-social cabinet, since July 1, 2005, responsibility for repayment of the credit lies with the government. If at the end of the period there remains a balance of credit to be repaid on this credit line, it will be repaid by the government. This credit is therefore not expected to result in a loss to the Bank of Israel.

## 7. Local currency securities

This item consists of tradable government securities indexed to the last CPI known on the balance sheet date. They are shown at market value.

The yield to maturity on the local currency securities portfolio on December 31, 2007 was 2.6 percent, and the portfolio’s average period to maturity was 2.8 years (on December 31, 2006 the yield to maturity was 3.8 percent, and the average period to maturity was 3.4 years).

	December 31	
	2007	2006
	(NIS million)	
<b>Time to redemption from balance sheet date</b>		
Less than one year	<b>519</b>	403
Between one and two years	<b>715</b>	501
Between two and three years	<b>925</b>	682
Between three and four years	<b>76</b>	880
Between four and five years	<b>306</b>	73
Between five and seven years	<b>206</b>	483
Seven years or longer	<b>116</b>	121
<b>Total</b>	<b>2,863</b>	3,143

## 8. Other assets

	December 31	
	2007	2006
	(NIS million)	
Fixed assets <sup>a</sup>	<b>220</b>	218
Loans to employees	<b>220</b>	224
Sundry receivables <sup>b</sup>	<b>2</b>	34
<b>Total</b>	<b>442</b>	476

<sup>a</sup> See 8a, "Fixed asset composition," below.

<sup>b</sup> Includes amounts receivable from the official receiver of Trade Bank (in Liquidation) Ltd., – reimbursement of payments made by the Bank of Israel based on the strength of guarantees provided, with government authorization, to depositors in the Trade Bank, following the discovery of embezzlement in the bank in April 2002. (Note 14).

**a. Fixed asset composition<sup>a</sup>**

	Land and buildings <sup>b</sup>	Equipment, furniture and vehicles	Total
<b>Cost</b>	(NIS million)		
Balance as of January 1, 2007	221	85	306
Additions	<b>1</b>	<b>13</b>	<b>14</b>
<b>Balance as of December 31, 2007</b>	<b>222</b>	<b>98</b>	<b>320</b>
<b>Accumulative depreciation</b>			
Balance as of January 1, 2007	25	63	88
Additions	<b>5</b>	<b>7</b>	<b>12</b>
<b>Balance as of December 31, 2007</b>	<b>30</b>	<b>70</b>	<b>100</b>
<b>Net book balance as of December 31, 2007</b>	<b>192</b>	<b>28</b>	<b>220</b>
<b>Net book balance as of December 31, 2006</b>	196	22	218

<sup>a</sup> A numismatic collection is kept at the Bank of Israel, which includes banknotes and coins issued in Israel from ancient times until today, along with various other items. According to expert assessments in November 2005, the value of the ancient coin collection is \$1.7 million (the remainder of the collection has yet to be assessed). In addition, the Bank of Israel operates a library containing professional (economic, financial etc.), legal and general literature. According to an assessor's appraisal in 2006, the replacement value for the library was determined at \$3 million. The item, fixed assets, does not include these items.

<sup>b</sup> The land of the Bank's premises in Jerusalem, with a depreciated cost of the structures thereon amounting to NIS 176 million as of December 31, 2007 (NIS 180 million as of December 31, 2006) is leased from the Israel Land Administration through June 30, 2016. The Bank holds an option to extend the lease for another 49 years.

**9. International financial institutions**

	December 31	
	2007	2006
	(NIS million)	
Special Drawing Rights allocated <sup>a</sup>	<b>649</b>	680
Liabilities to international financial institutions <sup>b</sup>	<b>50</b>	56
<b>Total</b>	<b>699</b>	736

<sup>a</sup> Special drawing rights (SDR) are money which member countries of the International Monetary Fund (IMF) have undertaken to buy from the Fund. The Fund allocates SDRs to member countries relative to the size of their quotas. To date, Israel has been allocated SDR 106.4 million.

<sup>b</sup> Liabilities in bills or deposits to the following institutions: IDB, MIGA, EBRD, IDA, IBRD (see Note 1.g).

## 10. Banknotes and coins in circulation

	December 31, 2007		December 31, 2006	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
<b>Banknotes in circulation</b>				
NIS 20	25	505	24	471
NIS 50	47	2,370	46	2,320
NIS 100	131	13,098	127	12,704
NIS 200	59	11,748	44	8,883
<b>Coins in circulation</b>		1,212		1,128
<b>Other<sup>a</sup></b>		33		33
<b>Total</b>		<b>28,966</b>		<b>25,539</b>

<sup>a</sup> Consisting mainly of old banknotes that can be exchanged in the Bank of Israel.

## 11. Government balances

Government balances comprise balances for financing its budgetary activity and other balances.

### Government balances for financing the budget

These are defined as balances that the government may use to finance its budgetary and extra-budgetary activity and which are therefore subject to section 45(b) of the Bank of Israel Law (the “Non-Printing Law”), 5714–1954. Financial movements arising from government budgetary and extra-budgetary activity in Israel and abroad and financial movements with the Bank of Israel are recorded in this item.

All government balances in local currency in Israel (with the exception of several extraordinary balances) may be offset against each other. The government has no intention of offsetting its local currency balances with foreign currency balances, and therefore these balances are presented separately. Some of the government’s balances for financing the budget in local currency are listed on the assets side of the “Government balances” item (Note 4).

### Other government balances

Other balances include a local currency deposit for stabilizing bond prices, and various foreign currency deposits. The bond-price stabilization deposit represents the proceeds from the purchase, at source, of government securities by the Bank of Israel in order to stabilize prices on the Tel Aviv Stock Exchange (TASE). In accordance with an agreement with the Ministry of Finance, the proceeds are placed in a special deposit

on behalf of the government, but may not be used to finance government expenses. At the request of the Ministry of Finance the bond-price stabilization arrangement was discontinued in January 1993, and the deposit is gradually being reduced against the redemption of such bonds purchased in the past. The redemption of these bonds will end in 2009.

	December 31			
	2007	2006	2007	2006
	(NIS million)		(\$ million)	
<b>Balance for financing the budget</b>				
<b>Local currency<sup>a</sup></b>	<b>2,055</b>	1,259*		
<b>Foreign currency</b>				
Borrowing under US government guarantee <sup>b</sup>	<b>6,011</b>	5,685	<b>1,563</b>	1,346
US government economic aid <sup>b</sup>	<b>303</b>	381	<b>79</b>	90
<b>Total foreign currency</b>	<b>6,314</b>	6,066	<b>1,642</b>	1,436
<b>Total balance for financing the budget</b>	<b>8,369</b>	7,325		
<b>Other deposits</b>				
Bond-price stabilization local currency deposit	<b>19</b>	38		
Other foreign currency deposits <sup>b</sup>	<b>238</b>	630	<b>62</b>	149
<b>Total other deposits</b>	<b>257</b>	668		
<b>Total</b>	<b>8,626</b>	7,993		

\* Reclassified.

<sup>a</sup> Most local currency government balances bear (when in debit) or pay (when in credit) interest at prime. The average prime rate in 2007 was 5.4 percent (2006 – 6.6 percent).

A portion of the government balances used for bond loan activity earns the Bank of Israel rate of interest. The average rate of interest on these balances in 2007 was 3.9 percent (2006 - 5.1 percent).

The balance in this item also includes the balance of the National Insurance Institute and that of the Postal Bank, which, since March 1, 2006, has operated through the Israel Postal Company Ltd., a wholly government-owned corporation.

<sup>b</sup> Government foreign currency deposits derived from borrowing under US government guarantee or from US government economic aid and a portion of the other foreign currency deposits earn interest at the rate paid on US Treasury bills with an average of 6 months to maturity. The rate of interest on December 31, 2007 was 3.4 percent (December 31, 2006 – 5.1 percent). The balance of U.S. economic aid deposits as of December 31, 2007 and December 31, 2006 was zero.

## 12. *Makam* deposits

The Short-Term Loan Law, 5744–1984, authorizes the government to issue short-term bills (called *makam*) to be sold only to the Bank of Israel, with the Bank selling them to, and buying them from, the public to regulate the money supply and to carry out its functions. The government must deposit the entire proceeds from sales of these bills in the Bank of Israel and may not use the proceeds except for repaying the loan in accordance with this Law or paying the yield on it. The purchase of bills from the government by the Bank of Israel and the deposit of the proceeds of this sale in the Bank of Israel are not reflected in the Bank's balance sheet.

The balance of *makam* shown in the balance sheet reflects the redemption value of bills held by the public less the balance of the discount not yet amortized.

The following is the composition of the balance of *makam*:

	December 31	
	2007	2006
	(NIS million)	
Redemption value of <i>makam</i> sold to the public	<b>77,561</b>	97,953
Less discount at time of sale to public	<b>3,277</b>	5,016
Proceeds of sale of <i>makam</i> to the public	<b>74,284</b>	92,937
Plus reduction in discount for period to balance sheet date	<b>1,702</b>	2,603
<b>Total balance of <i>makam</i></b>	<b>75,986</b>	95,540

## 13. Deposits of banking corporations

	December 31	
	2007	2006
	(NIS million)	
Demand and other deposits (see section a below)	<b>14,671</b>	14,096
Local currency time deposits (see section b below)	<b>300</b>	-
<b>Total</b>	<b>14,971</b>	14,096

### a. Demand and other deposits

The banking corporations' local currency demand deposits in the Bank of Israel serve as liquid assets against residents' local currency and foreign currency deposits.

Foreign currency demand deposits (Pamach) serve as a liquid asset against nonresidents' foreign currency deposits.

The reserve requirement ranges from 0 percent to 6 percent, according to the term of the deposit.

	December 31		December 31	
	2007	2006	2007	2006
	(NIS million)		(\$ million)	
<b>Local currency demand deposits</b>	<b>12,398</b>	11,846		
<b>Foreign currency deposits</b>				
Foreign currency demand deposits	771	820	200	194
Unrestricted deposits <sup>a</sup>	1,502	1,430	391	338
<b>Total foreign currency deposits</b>	<b>2,273</b>	2,250	<b>591</b>	532
<b>Total</b>	<b>14,671</b>	14,096		

<sup>a</sup> At the beginning of September 2007 the Bank started receiving foreign currency deposits from the banks as collateral for the banks' activities in the Zahav (RTGS) system. The deposits are for a period of 30 days. The balance of the deposits on December 31, 2007 was NIS 1,460 million.

#### b. Local currency time deposits

The Bank of Israel receives local currency time deposits from the banking corporations. The deposits are allocated by auction for periods of a day or a week. The deposits are not considered liquid assets for the purpose of fulfilling the banking corporations' reserve requirements.

In addition, overnight deposits are received at an interest rate of 1 percent under the Bank of Israel interest rate.

The balance as of December 31, 2007 consists of such overnight deposits.

The average interest rate for these deposits as of December 31, 2007 was 3.25 percent.

The average rate of interest on time deposits by auction in 2007 was 3.7 percent (2006—5 percent).

The average interest rate for overnight deposits in 2007 was 3 percent (2006—4.1 percent).

## 14. Other liabilities

	December 31	
	2007	2006
	(NIS million)	
Pension and severance pay liabilities <sup>a,c</sup>	<b>3,320</b>	3,175
Other liabilities on employees' rights <sup>b,c</sup>	<b>132</b>	149
Deposits of US-Israel binational funds <sup>d</sup>	<b>141</b>	162
Accounts payable <sup>e</sup>	<b>47</b>	60
<b>Total</b>	<b>3,640</b>	3,546

<sup>a</sup> The pension liability is calculated according to the pension agreements with the Bank employees and pensioners who commenced their employment before May 2002. (As of December 31, 2007 this included 462 staff and 631 retirees and surviving spouses and orphans; as of December 31, 2006, this included 517 staff and 603 retirees and surviving spouses and orphans.) The pension liability includes future payment allocations for bank employees, former employees whose pensions have been frozen, retirees and others. In addition, the liability includes payment of the cashing-in of sick days at the time of cessation of employment.

The Bank's liability is calculated based on salary and allocation data for the month of December 2007 and actuarial calculations. The method is based on assessing accrued benefits under certain parameters: rate of early retirement, pension rates for surviving spouses and orphans, employees' seniority and grade, relevant tax rates, etc.

The actuarial calculation is based on forecast changes in "white-collar" mortality rates, in accordance with the Pension Funds Directives published by the Ministry of Finance—Capital Market, Insurance and Savings Division on May 17, 2007.

The Bank's actuarial liability was calculated based on the discount rate of 4 percent, in accordance with the instructions of reporting to the public issued by the Supervisor of Banks. Reflecting prior experience, the calculation was carried out based on an assumption of real annual wage increases of up to 2 percent a year.

The difference in pension liability and retirement payments derives primarily from the use of the new mortality tables published by the Ministry of Finance (an increase of NIS 131 million), net of the effect of the Bank of Israel salary agreement (a reduction of NIS 42 million—footnote c below) and a current change (an increase of NIS 56 million). Regarding Bank employees who commenced their employment subsequent to September 2002, the Bank's liability for pension and compensation payments is covered by current deposits made in the name of the individual employee in a recognized pension and compensation fund. Such sums deposited are neither controlled nor managed by the Bank, and therefore neither they, nor the liabilities against which they have been deposited, are reflected in the balance sheet.

<sup>b</sup> Consisting mainly of a sum of about NIS 102 million in respect of employees' vacation entitlement (2006—NIS 123 million). Bank employees are entitled by law and labor agreements to annual vacation days and advanced training days. The provisions as of December 31, 2007 and December 31, 2006 were calculated based on the wage for determining redemption of vacation and vacation days accrued to the balance sheet date.

<sup>c</sup> On December 20, 2007, a Bank of Israel salary agreement was signed. In addition, in 2008 the Labor Court is supposed to present its arbitration decision concerning a very limited number of issues. The first two items in the table include the impact of the new agreement up to December 31, 2007, excluding the clauses presented to the Labor Court regarding which no decision had been reached by the publication date of these financial statements.

<sup>d</sup> Includes deposits of the US-Israel Binational Industrial Research and Development (BIRD) Foundation and a deposit of the US-Israel Binational Science Foundation.

<sup>e</sup> For 2007 this section includes sums payable to depositors in the Trade Bank (in Liquidation) Ltd., as a result of guarantees provided by the Bank of Israel with government approval to the depositors of said bank, in which embezzlement was discovered in April 2002 (See Note 8).

## 15. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see also Notes 1.f, 1.l, and 1.m):

	December 31	
	2007	2006
	(NIS million)	
Foreign currency balances	<b>3,321</b>	4,135
Tradable foreign currency securities	<b>1,591</b>	21
Tradable local currency securities	<b>755</b>	734
<b>Total</b>	<b>5,667</b>	4,890

## 16. Share capital and general reserves in historical nominal values

Data on the Bank's share capital and general reserves appear in the financial statements in reported values. (See Note 1.c). The following shows the data in historical nominal values:

	December 31	
	2007	2006
	(NIS million)	
Share capital	<b>60</b>	60
General reserve <sup>a</sup>	<b>260</b>	260
<b>Total Bank capital in historical nominal values</b>	<b>320</b>	320

<sup>a</sup> The general reserve is in accordance with Section 6 of the Bank of Israel Law, 5714-1954, and has been applied in the past to increase the Bank's capital.

## 17. Assets and liabilities by indexation bases

	December 31, 2007				December 31, 2006			
	In local currency	In foreign currency <sup>a</sup>	Non-financial items	Total	In local currency	In foreign currency <sup>a</sup>	Non-financial items	Total
(NIS million)								
<b>Assets</b>								
Foreign currency financial assets abroad <sup>b</sup>		120,440		120,440		139,860		139,860
International financial institutions		369	836	1,205		521	836	1,357
Government balances	5,132			5,132	1,911			1,911*
Credit to the government <sup>c</sup>	415	1,724		2,139	498	2,307		2,805
Loans	481			481	8,320			8,320
Local currency securities <sup>d</sup>	2,863			2,863	3,143			3,143
Other assets	222		220	442	258		218	476
<b>Total assets</b>	<b>9,113</b>	<b>122,533</b>	<b>1,056</b>	<b>132,702</b>	<b>14,130</b>	<b>142,688</b>	<b>1,054</b>	<b>157,872</b>
<b>Liabilities</b>								
Foreign currency financial liabilities abroad		10,983		10,983		17,103		17,103
International financial institutions		699		699		736		736
Banknotes and coins in circulation	28,966			28,966	25,539			25,539
Government balances	2,074	6,552		8,626	1,297	6,696		7,993*
<i>Makam</i> deposits	75,986			75,986	95,540			95,540
Deposits of banking corporations	12,698	2,273		14,971	11,846	2,250		14,096
Other liabilities	3,499	141		3,640	3,365	181		3,546
Revaluation accounts	4,076	1,591		5,667	4,869	21		4,890
Bank of Israel capital			(16,836)	(16,836)			(11,571)	(11,571)
<b>Total liabilities</b>	<b>127,299</b>	<b>22,239</b>	<b>(16,836)</b>	<b>132,702</b>	<b>142,456</b>	<b>26,987</b>	<b>(11,571)</b>	<b>157,872</b>
<b>Surplus assets (liabilities)</b>	<b>(118,186)</b>	<b>100,294</b>	<b>17,892</b>	<b>-</b>	<b>(128,326)</b>	<b>115,701</b>	<b>12,625</b>	<b>-</b>

\* Reclassified.

<sup>a</sup> Including those indexed to foreign currency.

<sup>b</sup> In 2007 the balance of this item includes NIS 2,366 million indexed to the US and Japan Consumer Price Index (2006 – NIS 1,513 million).

<sup>c</sup> Foreign currency credit to the government includes long-term advances totalling NIS 1,597 million denominated in shekels and indexed to the exchange rate against the first currency basket (December 31, 2006 – NIS 2,168 million).

<sup>d</sup> Local currency securities indexed to the Consumer Price Index.

**18. Contingent liabilities<sup>a</sup> and commitments**

	31 December	
	2007	2006
	(NIS million)	
<b>1. Off-balance-sheet financial instruments</b>		
Documentary credits and guarantees for government imports and exports		
Documentary credits	<b>46</b>	25
Guarantees	<b>195</b>	198
Liabilities to pay international financial institutions on demand	<b>3,192</b>	3,488
<b>2 Commitments</b>		
Derivative financial instruments in activity in Israel		
Future remittances of <i>makam</i> (at par)	<b>640</b>	640
Derivative financial instruments in activity abroad		
Currency swaps and forward transactions		
Future receipts of foreign currency	<b>2,964</b>	3,802
Future payments of foreign currency	<b>2,960</b>	3,763
Repurchase Agreements (Rep) and Reverse Repurchase Agreements (RRepo)		
Repo	<b>10,956</b>	17,049
Reverse Repo	<b>1,209</b>	2,887
Futures		
Sales commitments	<b>3,192</b>	6,246
Purchase commitments	<b>17,185</b>	4,700

<sup>a</sup> Several claims are pending against the Bank of Israel. However it is the Bank's opinion based on the opinion of Bank's Legal Department that the probability of these claims being successful is low, and therefore no provisions have been recorded in respect thereof.

**19. Interest income from financial assets in foreign currency abroad** (see section a below)

	For the year ended December 31	
	2007	2006
	(NIS million)	
Tradable securities	<b>4,446</b>	3,735
Short-term deposits	<b>1,310</b>	938
Demand deposits	<b>48</b>	46
Securities purchased as part of the RRepo Agreements	<b>122</b>	98
Derivative financial instruments <sup>a</sup>	<b>(6)</b>	66
<b>Total</b>	<b>5,920</b>	4,883

<sup>a</sup> Interest expense on derivatives is shown net.

**a. Interest income from foreign exchange reserves**

The following shows the composition of interest income from the foreign exchange reserves (See Notes 2 and 23):

	For the year ended December 31	
	2007	2006
	(NIS million)	
Interest income from foreign currency financial assets abroad	<b>5,920</b>	4,883
Interest paid on foreign currency financial liabilities abroad <sup>a</sup>	<b>(1,090)</b>	(871)
<b>Total income from foreign exchange reserves</b>	<b>4,830</b>	4,012

<sup>a</sup> See Note 23.

**20. Interest income from loans**

	For the year ended December 31	
	2007	2006
	(NIS million)	
From monetary loans	<b>355</b>	167
From other loans <sup>a</sup>	<b>24</b>	46
<b>Total</b>	<b>379</b>	213

<sup>a</sup> Mostly deriving from interest on credit advanced to the Industrial Development Bank (see Note 6).

**21. Interest income from the government**

	For the year ended December 31	
	2007	2006
	(NIS million)	
Long-term advances		
Indexed	<b>174</b>	216
Unindexed	<b>38</b>	52
From binational funds	<b>69</b>	69
From local currency securities	<b>226</b>	201
<b>Total</b>	<b>507</b>	538

**22. Other interest income**

This item contains interest income from the International Monetary Fund and interest on reverse repurchase agreements of *makam* and government bonds.

**23. Interest expense on financial assets in foreign currency abroad**

This item consists of interest expense in respect of securities sold in the framework of the repurchase agreements (see Note 19).

**24. Interest expense to banks and the public**

	For the year ended December 31	
	2007	2006
	(NIS million)	
<b>In local currency</b>		
On <i>makam</i> deposits	<b>4,184</b>	4,449
On local currency time deposits	<b>25</b>	132
Other	<b>1</b>	-
<b>Total in local currency</b>	<b>4,210</b>	4,581
<b>In foreign currency</b>		
On banks' deposits	<b>150</b>	9
<b>Total</b>	<b>4,360</b>	4,590

**25. Interest expense to the government**

	For the year ended December 31	
	2007	2006
	(NIS million)	
On local currency deposits <sup>a</sup>	<b>220</b>	57
On foreign currency deposits	<b>290</b>	318
<b>Total</b>	<b>510</b>	375

<sup>a</sup> Government local currency interest expense includes—in addition to interest expense on balances for financing the budget—interest expense on the bond price stabilization deposit, interest expense to the National Insurance Institute, and interest expense to the Israel Postal Company Ltd (see Notes 4 and 11).

**26. Other interest expense**

This item consists mainly of interest expense:

- a. To international financial institutions;
- b. On deposits of the US–Israel Binational Industrial Research and Development (BIRD) Foundation and a deposit of the US–Israel Binational Science Foundation.

**27. Other financial income (expense) from securities and derivatives**

	For the year ended December 31	
	2007	2006
	(NIS million)	
<b>Foreign currency securities<sup>a</sup></b>	<b>1,057</b>	611
<b>Derivative financial instruments<sup>b</sup></b>		
In foreign currency	<b>137</b>	10
In local currency	<b>3</b>	(50)
<b>Total derivative financial instruments</b>	<b>140</b>	(40)
<b>Total</b>	<b>1,197</b>	571

<sup>a</sup> Including gain from the realization of securities and loss from reduction in their value at the end of the year.

<sup>b</sup> Consisting mainly of financial income (expense) from the realization of derivative financial instruments.

**28. Other financial income (expense) from exchange rate differentials**

This item consists of realized exchange rate differentials in respect of balances denominated in foreign currency, principally in dollars (in 2006, principally in euro and pounds sterling) (see Notes 1.l and 1.m).

**29. Other financial income—miscellaneous<sup>a</sup>**

	For the year ended December 31	
	2007	2006
	(NIS million)	
In local currency	<b>5</b>	6
In foreign currency	<b>3</b>	5
<b>Total</b>	<b>8</b>	11

<sup>a</sup> Consisting mainly of income from fees and fines deriving from the Bank of Israel's financial activities.

**30. Administrative and general expenses**

	For the year ended December 31	
	2007	2006
	(NIS million)	
Staff wages and employees' rights <sup>a</sup>	<b>548</b>	554
General expenses	<b>64</b>	59
<b>Total</b>	<b>612</b>	613

<sup>a</sup> This item consists mostly of employees' salaries (on December 31, 2007 there were 716 employee posts, and on December 31, 2006, 727), pension payments to retirees on unfunded (non-contributory) posts, and an update of the Bank's pension and vacation liabilities to employees. This item also includes the impact of the new mortality tables published by the Ministry of Finance and of the new collective wage agreement in the Bank (Note 14).

**31. Other income**

This item consists of dividend income from the BIS and updating the provision for the Trade Bank.