



February 18, 2014

## Summary of Monetary Committee discussion on February 4, 2014 on the management of the foreign exchange reserves

### Asset allocation in the Monetary Committee's benchmark—recommendation for 2014

The Monetary Committee approved the Market Operations Department's recommendation for 2014 regarding the asset allocation in the Committee's benchmark. The approved allocation includes:

- a. 89 percent in government bonds, with an average duration of 1.3 years: 1.5 years in dollars, 1.0 year in euros, and 1.5 years in pound sterling.
- b. 3 percent in currency positions in Norway, Singapore, and Korea. These are already-existing positions in the benchmark and were left unchanged.
- c. 8 percent in equities—according to the following market distribution: 5.3 percent in the US, 1.3 percent in Germany, 1.1 percent in the UK, and 0.3 percent in France.

The changes in the Committee's benchmark, and the resulting changes in foreign exchange reserves investment, will be carried out gradually, in accordance with market conditions and according to the judgment of the Market Operations Department.

### Background:

#### The foreign exchange reserves risk management framework is based on:

1. **The basic portfolio** represents an asset composition which is conservative, investable, and which has minimal risk. It meets the first two goals of the foreign exchange reserves investment policy—maintaining the purchasing power of the reserves and managing the reserves with a high level of liquidity.
2. **The Monetary Committee's benchmark** represents the strategic allocation chosen by the Committee. This allocation is set with the goal of achieving an adequate return, subject to the risk profile established by the Committee and which appears in the guidelines, while meeting the first two goals of the reserves investment policy. In addition, the strategic allocation outlines the framework of the management of the reserves portfolio.

The basic portfolio provides a yardstick for the returns derived from the Committee decisions and for an assessment of the strategic allocation that it chose. The Committee's benchmark provides a yardstick for the performance analysis of the reserves portfolio managers' actual investment returns.

The strategic allocation is a complex process: It is based on a wide range of data and statistical models, and thus inherently contains some uncertainty. Within the framework of this process, the Market Operations Department took into account the forecasts of various entities regarding the returns on numerous assets, including the forecast of the Market Operations Department itself, and estimated—using various sets of constraints—the returns of a number of possible portfolio

allocations. Afterwards, the Department chose the portfolio allocations in which the expected rate of return was the highest relative to the desired level of risk.

At the end of the optimization process—after assessing the outcomes using stress test analysis and judgment—the Market Operations Department recommended the allocation for the Monetary Committee’s benchmark. This allocation meets the investment policy goals and is subject to the risk profile that the Committee set.

The Monetary Committee will examine the allocation at least once per year, and whenever it deems it appropriate, in accordance with market developments.

### **Quarterly report to the Minister of Finance on the management of the reserves (fourth quarter of 2013)**

#### **Background:**

In accordance with Section 40(c) of the Bank of Israel Law, 5770-2010, and the Memorandum of Understanding between the Bank of Israel and the Minister of Finance, Market Operations Department representatives presented the Committee with the quarterly report on the management of the reserves which is to be submitted to the Minister of Finance.

#### **Monetary Committee Decision:**

The Committee approved the recommendation.

#### **Participants in the discussion:**

##### **Members of the Monetary Committee**

Dr. Karnit Flug, Governor of the Bank of Israel, Chairperson

Prof. Alex Cukierman

Prof. Rafi Melnick

Prof. Nathan Sussman, Director of the Research Department

##### **Other participants in the discussion:**

Andrew Abir, Director of Market Operations Department

Eddy Azoulay, Chief of Staff to the Governor

Tal Biber, Head of Markets Division in the Market Operations Department

Mickey Blank, Deputy Head of Dealing Unit in Market Operations Department

Dr. Golan Benita, Head of Strategic Management Unit in Market Operations Department

Francoise Ben-Zur, Head of Finance Division in Market Operations Department

Guenia De Mayo, Head of Risk Management Unit in Market Operations Department

David Hoffman, Economist in Strategic Management Unit in Market Operations Department

Mark Yohai, Economist in Strategic Management Unit in Market Operations Department

Roe Levy, Economist in Risk Management Unit in Market Operations Department

Avi Meshayev, Economist in Dealing Unit in Market Operations Department

Ilan Socianu, Assistant to Secretary of the Monetary Committee and the Supervisory Council

Esti Schwartz, Secretary of the Monetary Committee and the Supervisory Council