

CHAPTER XXI

THE ACTIVITIES OF THE BANK OF ISRAEL

1. SUMMARY OF THE BALANCE SHEET AT THE END OF 1977

The assets of the Bank of Israel and its liabilities at the end of 1977 totalled IL 73,000 million, as opposed to IL 36,391 million in 1976, an increase of 101 percent (as against 50 percent in 1976). This steep increase is derived mostly from a revaluation, totalling IL 21,457 million, of the balance sheet assets in foreign currency and those linked to foreign currency, following the devaluation of the IL; if we exclude revaluation of these items, the balance sheet increased by IL 15,152 million; i.e. 42 percent, a rate surpassing last year's (about 30 percent). The Israeli currency items increased in the course of the year by 107 percent¹, as against an increase of 43 percent in the price index during that period. The rapid growth rate this year expresses the changes that took place in the main items of the balance sheet of the Bank: a very rapid growth of government indebtedness to the Bank of Israel and credit granted by the Bank of Israel to finance export funds, as compared with a relatively moderate increase in the foreign currency assets of the Bank of Israel as expressed in dollars.

The growth of assets in the balance sheet of the Bank of Israel this year created conditions conducive to a rapid monetary expansion, which was expressed on the liabilities side: the most prominent among these were an accelerated increase in the item cash in circulation and deposits of banking institutions in Israeli currency, and particularly in the part dealing with the liquidity requirement of banks affiliated with the Bank of Israel. There was also a considerable increase in the banks foreign currency deposits, mostly stemming from the evaluation of these items following the devaluations of the IL and the increase in the value of strong European currencies particularly the German mark in relation to the dollar.

A. FOREIGN CURRENCY ACCOUNTS

The increased amount of foreign currency assets maintained by the Bank of Israel con-

¹ Not including linkage differentials to the dollar of the long term debt, credited to the temporary advanced payments item (see below, the item on government debt).

TABLE XXI-1

**CLAIMS ON AND LIABILITIES TO FOREIGNERS IN GOLD AND
FOREIGN EXCHANGE, 1976-1977**
(\$ million)

End of year	1976	1977	Annual change
ASSETS			
Gold, Special Drawing Rights and foreign currency assets	1,373.2	1,570.9	197.7
Other foreign currency assets	223.4	212.0	-11.4
Total claims on the rest of the world	1,596.6	1,782.9	186.3
LIABILITIES			
Allocation of Special Drawing Rights	49.7	52.0	2.3
Foreign currency deposits of foreign banks	10.1	9.8	-0.3
Liabilities to IMF	89.4	93.6	4.2
Other liabilities	1.8	1.1	-0.7
Nonresidents' deposits (Patach)	206.8	202.0	-4.8
Total liabilities to the rest of the world	357.8	358.5	0.7
Net claims on the rest of the world (foreign currency assets)	1,238.8	1,424.4	185.6
Net foreign currency reserves held with the Bank of Israel ^a	1,156.3	1,359.1	202.8

^a Defined as gold, Special Drawing Rights, and foreign currency assets, less foreign residents' deposits and foreign currency deposits of banks abroad.

tinued in 1977. Balances of foreign currency kept at the Bank of Israel² amounted this year to \$1,359 million, as opposed to \$1,156 million in 1976, an increase of \$203 million (\$117 million last year).

² Balances of foreign currency kept at the Bank of Israel are defined as gold, Special Drawing Rights and assets in foreign currency, after deduction of deposits of foreign residents and foreign currency deposits of banks abroad (see Table XXI-1).

The increase that took place this year in foreign currency balances in dollar terms includes the influence of a one-time factor which led this year to a decrease of balances increased value of European currencies vis-à-vis the dollar. Excluding these revaluation differentials, net balances increased by \$91 million. The net increase in this amount includes the influence of a one-time factor which led this year to a decrease of balances of about \$ 180 million (as a result of the change in the financing arrangements of the Export Shipments Fund in foreign currency)³. After deducting this factor, the increase of net foreign currency balances in 1977 amounts to about \$270 million.

The increase in net foreign currency balances reflects the two contradictory influences exerted by the private and the public sector on foreign currency balances: the influence of the private sector served to lower balances, while that of the public sector increased them. The private sector brought about a decrease of balances through its net acquisition of foreign currency in the amount of \$305 million, as opposed to \$450 million last year. The relative decrease in acquisitions this year marks an additional improvement in the current deficit of the private sector in the balance of payments. In the course of the year, there were zig zags in the capital movements of this sector in the balance of payments: from the beginning of the year and until the introduction of the reform on the foreign currency market, the foreign currency acquisitions of the private sector increased and amounted to about \$435 million (including speculative purchases prior to the reform). In the second period the private sector changed its behavior, and from an acquirer of foreign currency, became a supplier of foreign currency to the country, in the net amount of about \$130 million. This trend continued at the beginning of 1978. The public sector, as mentioned, brought about the increase of balances, through the transfer of foreign currency which it has mobilized abroad in the amount of \$575 million (of which \$94 million is income from the investment of assets of the Bank of Israel in foreign currency), as opposed to \$555 million last year.

The total gross assets of the Bank of Israel amounted at the end of 1977 to \$1,783 million as compared with \$1,597 million at the end of 1976, an increase of \$186 million.

B. GOVERNMENT DEBT

The government's indebtedness to the Bank of Israel this year totalled IL 22,807 million, an increase of IL 11,728 million, contrasting with an increase of IL 3,482 million last

³ According to the new arrangements, the banks were again enabled to finance credit to the Shipments Fund from resources of the Bank of Israel, instead of financing via credit funds in foreign currency from foreign sources.

year. The great increase this year reflects the deficit financing of the government budget. But it provides no direct expression of liquidity injections by the government to the economy in 1977. It includes on the one hand interest and linkage payments by the government to the Bank of Israel, which do not constitute injections to the economy, while on the other hand it does not include transfers of foreign currency mobilized abroad by the government to finance its expenses in local currency. After adjustments for the government debt are made the estimated liquidity injection by the government in 1977 amounts to about IL 8.6 billion as against IL 6.2 billion in 1976 (in the fiscal year 1977/78, the injection amounted to IL 9.6 billion).

The increase of long-term government debt amounting to IL 2,700 million derives from the receipt of a long-term advance payment in March 1977, intended to close the budgetary deficit at the end of the previous fiscal year (1976/77). The steep increase in temporary advance payments (amounting to IL 9,551 million) stems mostly from the government's obligation to pay linkage differentials amounting to IL 4,730 million on the last day of the year on its long term debts, which are half-linked to the rate of the dollar*. These were primarily affected by the devaluation at the end of October (these linkage payments are not included in the calculation of injection).

The credit balance of the government in foreign currency amounted to about IL 2,233 million. This balance derives from foreign currency deposits of governmental business concerns, and is unrelated to the budgetary activity of the government.

C. LOANS AND NOTES

This item includes credit granted to banking institutions as loans and against notes, and is mainly destined for financing the share of the Bank of Israel in export funds⁴. This credit increased in 1977 by a very large amount -- IL 10,149 million. Part of this steep increase (IL 3,173 million) stemmed from a change in the foreign currency financing arrangements of the Shipments Fund, and it therefore does not express the actual expansion of the volume of credit. (see below for details on credit in foreign currency). The increase of credit after deducting this change amounts to IL 6,976 million, or 92 percent. This

As from April, 1978, the advance payment was linked in its entirety to the currency basket.

⁴ It should be noted that changes in credit in the balance sheet of the Bank reflect only that part of the directed credit in the funds which is financed by the Bank of Israel. (On the development of the volume of total free and directed credit to the public, see Chapter XVIII).

increase stems mostly from the revaluation of the balance of foreign currency credit (IL 3,976 million) following devaluations of the IL. After deducting devaluation differentials, the increase of credit amounts to IL 3 billion (which is 39 percent), of which IL 2,014 million represents increased foreign currency credit and IL 986 million increased credit in Israeli currency.

The steep increase in the credit component in foreign currency stemmed partially as mentioned, from the changed role of the Bank of Israel in the Export Shipments Fund. This change, together with the increased volume of credit utilized to finance shipments following the reduction of its interest rate, prompted an increased participation of about \$ 180 million by the Bank of Israel in this fund. The balance of the rapid increase of credit in foreign currency stems principally from the increased participation of the Bank of Israel in the fund for financing exports (in the amount of \$ 172 million).

This increase surpasses the rate of expansion for diamond exports this year. The degree of participation by the Bank of Israel in the Import for Export Production Fund also the Export Production Fund, which is the major and largest in Israeli currency national institutions for early repayment of their foreign debts decreased (by \$16 million). (The total amount of this balance at the end of 1977 stood only at about \$6 million.)

The increase of the credit component in Israeli currency, amounting, as mentioned, to IL 986 million, reflects chiefly the rapidly growing role of the Bank of Israel in financing the Export Production Fund, which is the major and largest fund in Israeli currency. Credit granted by the Bank of Israel to this fund increased by about IL 877 million, or 62 percent. This increase stems mainly from adjustments in the rate of financing to the increase in the exchange rate of the IL vis-à-vis the dollar, as well as from a real growth in export volume.

The component of Israeli currency loans from the Bank of Israel to the banks decreased this year, with the repayment of the special loan, amounting to IL 400 million, that had been granted to banking institutions at the end of 1976 for the purpose of reducing liquidity deficits.

D. SECURITIES

The securities portfolio held by the Bank of Israel includes mostly government bonds linked to the index, purchased by the Bank in its capacity as government agent for the issuance of these bonds, and as regulator of current trade in bonds on the secondary market. The portfolio also includes Treasury notes of the Short-Term Loan held by the Bank of Israel, which are not linked.

The revalued worth of the securities portfolio held by the Bank of Israel increased in 1977 by IL 993 million and amounted at the end of the year to IL 2,770 million. This rapid growth includes mostly linkage differentials and cumulative interest on government bonds (in the amount of IL 508 million), which were accumulated but not yet actually redeemed or paid out this year (see footnote 7 below). Without these accumulation differentials, the value of the portfolio increased by IL 485 million, an increase which reflects mainly the Bank of Israel's net acquisition of surplus government bonds on the secondary market. These acquisitions were made mainly in November, in order to halt the steep decline in prices following the movement to cash in bonds. In this month alone, the Bank of Israel purchased government bonds in the amount of about IL 270 million on the secondary market. In the other months of the year, the net acquisitions of the Bank of Israel on the secondary market were relatively low.

F. BANKNOTES AND COINS IN CIRCULATION

The balance of banknotes and coins in circulation increased in 1977 by IL 1,787 million and amounted to IL 6,860 million, an increase of 35 percent, which contrasted with an increase of 22 percent in 1976. The more rapid growth rate of cash increase this year dovetails with rapid tempo of growth that took place in money supply, but falls somewhat below the pace of price increases. The share of cash in total money supply did not alter significantly, about 35 percent.

In May 1977, a new banknote, valued at IL 500 was put into circulation. At the end of the year this banknote constituted 28 percent of the total value of banknotes in circulation. It displaced mainly IL 100 banknotes, and to a smaller extent IL 50 banknotes. The total amount of IL 500 and IL 100 banknotes taken together constituted at the end of 1977 about 87 percent of the banknotes in circulation. This phenomenon expresses the decreasing value of the currency, in the wake of the price increases which befell the economy in the last years.

At the end of 1977, the amount of banknotes in circulation reached 89 million, as opposed to 82.1 million at the end of 1976. This small increase in the number of banknotes, despite the rapid growth in the amount of money in circulation, is due to the introduction of the IL 500 banknote.

F. DEPOSITS IN IL OF BANKING INSTITUTIONS

Deposits of banking institutions in IL at the Bank of Israel amounted in 1977 to IL 9,150 million, an increase of IL 3,361 million, constituting a growth of 58 percent. This rapid increase reflects mainly a growth in the liquid assets of the banks affiliated with the Bank

TABLE XXI-2

BANKNOTES AND COIN IN CIRCULATION, BY DENOMINATION, 1976-1977

End of period	1976		1977	
	(IL thousand)	(percent)	(IL thousand)	(percent)
Banknotes				
IL 5	51,239	1.1	63,744	1.0
IL 10	205,901	4.2	237,195	3.6
IL 50	508,409	10.4	394,647	5.9
IL 100	4,109,710	84.3	4,094,418	61.4
IL 500	—	—	1,871,347	28.1
Total	4,875,259	100.0	6,661,351	100.0
Coins				
1-500 prutot ^a	1,953	1.6	1,953	1.3
1 agora ^b	2,905	2.3	2,998	2.0
5 agorot ^b	6,675	5.3	8,096	5.3
10 agorot ^b	20,066	16.2	24,254	16.0
25 agorot ^b	6,395	5.2	7,924	5.2
IL 1/2 ^c	19,479	15.7	24,850	16.4
IL 1 ^c	66,704	53.7	81,602	53.8
Total	124,177	100.0	151,677	100.0
Total banknotes and coins	4,999,436		6,813,028	
Commemorative coins	87,443		90,775	
Total coins	5,086,879		6,903,803	
Less: Gold commemorative coins with gold content equal to or exceeding their nominal value	(-) 13,662		(-) 43,586	
Total currency in circulation	5,073,217		6,860,217	

a Including paper tokens worth 250 prutot.

b The agorot series includes mintmarked coins.

c The series of IL 1/2 and IL 1 also include paper and mintmarked coins.

of Israel. The increase also expresses the considerable liquidity injection by the government and the expansion of credit granted by the Bank of Israel, which were only partially offset through acquisitions of foreign currency by the private sector. Although the increase of IL deposits in 1976 was more rapid and amounted to about 75 percent, it should be noted that only about half this rate reflected actual monetary expansion, while the other half was used to reduce the liquidity deficits of banks during the year.

The Bank of Israel pays interest at various rates on deposits of banking institutions required to maintain liquidity, at a rate contingent upon the respective balance of the account and its state of liquidity. The balance in the account is divided into four categories. The category is determined by the nature of the deposits of the public in the banking institution, and every category bears interest at a different rate⁵. In addition to the liquidity obligation imposed by deposits of the public at the banking institution, there is also a liquidity obligation of 5 percent on total free credit in IL, on which the Bank pays interest at the rate of 18 percent. On liquidity deficits, penalties are paid by the banks at the rate of 10 to 22 percent; these are not considered recognized expenditures for tax purposes. As a result of this, their maximum effective rate amounts to more than 60 percent (in addition to loss of alternative interest, which stems from not depositing the money at the Bank of Israel).

G. FOREIGN CURRENCY DEPOSITS OF BANKING INSTITUTIONS

Foreign currency deposits of banking institutions at the Bank of Israel amounted in 1977 to IL 48,908 million (\$3,178 million), an increase of IL 26,792 million, or 121 percent. The main increase in terms of IL stems this year from the revaluation of deposits, amounting to about IL 19,263 million, following devaluations of the IL in relation to the dollar (the cumulative rate reached in 1977 about 75 percent). The increase in the banks foreign currency deposits in dollar terms amounted to about \$654 million, or 26 percent which is similar to the rate of growth for last year. Part of this increase stemmed this year as well from revaluations following the increase in the value of the strong European currencies in relation to the dollar. Most of these deposits originate from reparations from Germany held in German marks (during 1977, the value of the German mark in relation to the dollar increased by about 12 percent, and in relation to the IL – by about 98 percent). Without this revaluation, deposits increased by about \$460 million, which are 18 percent, as opposed to an increase of 15 percent in 1976.

⁵ These categories have deletions or expansions following published instructions from the Controller of Banks at the Bank of Israel. The assessments are made according to the volume of directed credit granted by the banking institution, the quantity of cash it holds and the amount of Treasury notes in its possession as well as the amount of liquidity exemptions to which it is entitled.

TABLE XXI-3

**INTEREST RATE PAID BY THE BANK OF ISRAEL ON IL DEPOSITS
OF BANKING AND FINANCIAL INSTITUTIONS, END OF 1977**
(percent)

The public's deposit in banking institutions	Total liquidity requirement	Share of the public's deposits and interest paid thereon			
		Interest grade 0%	Interest grade 8%	Interest grade 1.5%	Interest grade 1.8%
(percent of total deposits in banking institutions)					
Ordinary demand deposits	70	15	47.5	7.5	Balance
Time deposits:					
3-4 months	23	8	10	5	Balance
4-5 months	21	7	9	5	Balance
5-6 months	19	6	8	5	Balance
6+ months	17	5	8.5	3.5	Balance

The conversion of certain deposits immediately after the reform on the foreign currency market (mainly "deposits of local residents" not receiving reparations) continued only for two weeks and amounted to only about IL 1 billion. Contrary to the relatively prolonged conversion of deposits after previous devaluations, this time a counter movement of accumulation in foreign currency deposits occurred which after two weeks surpassed the conversion movement. This development was made possible by the reform in foreign currency, which permitted every Israeli citizen to open a foreign currency deposit. Total net accumulation in foreign currency increased faster towards the end of the year following expectations that a more rapid adjustment of the floating exchange rate to the pace of price increases would occur. Net accumulation in foreign currency deposits from the introduction of the reform until the end of the year amounted to more than \$150 million, and took place mainly in local residents' deposits (Patam). This accumulation does not comprise the increase of these deposits in dollar terms resulting from revaluations following the increase in the value of the strong European currencies vis-à-vis the dollar.

2. PROFIT AND LOSS ACCOUNT FOR 1977

A. PROFIT AND ITS DISTRIBUTION

The profit of the Bank of Israel from its regular operations amounted this year to IL 2,475 million, as opposed to IL 1,714 million in 1976 (including income from the investment of foreign currency balances). Total net profit of the Bank of Israel, including revaluation differentials on items of the balance sheet following the devaluation of the IL in relation to the various currencies in the world, decreased in 1977 to IL 221 million, as against IL 1,329 million in 1976. This decline in the net profit of the Bank of Israel in 1977 originated from revaluation differentials, amounting to IL 2,254 million, stemming in turn from the linkage balance of the Bank of Israel.

There is a clear distinction to be made between an evaluation of the activity of the Bank of Israel as the central bank, including the efficiency of its investment of foreign currency reserves maintained abroad (in various currencies and at various interest rates) and the amount of net profit in IL, which is influenced by the problem of the linkage balance in the profit and loss account of the Bank of Israel in terms of IL (income in foreign currency received by the Bank of Israel in 1977 on an investment of \$1.7 billion – the total of gross foreign currency reserves – amounted to \$206 million, representing a return of about 12 percent in dollar terms).

The obligations of the Bank of Israel in foreign currency derives mostly from deposits of receivers of reparations from Germany, who are entitled to hold their deposits in foreign currency – mostly in German marks (the value of the mark in relation to the IL increased in 1977 by 98 percent). These and other obligations of the Bank of Israel in foreign currency to local residents exceed the total foreign currency assets of the Bank of Israel, since part of the assets of the Bank of Israel are in the form of credit to the government and to exporters, granted in Israeli currency and without linkage. The revaluation of foreign currency deposits at the Bank of Israel – affected by the creeping devaluations, the change of the exchange rate policy in October, and changes in the value of various currencies in the world – is recorded as an expenditure, according to accepted rules of accounting. The volume of this expenditure exceeded the revaluation of foreign currency assets, whose amount as mentioned, is lower. This revaluation differential amounted in 1977 to IL 2,254 million, and the net profit of the Bank of Israel amounted this year to IL 221 million. The expenditure on the revaluation of local residents' deposits expressed in foreign currency increased their balances in IL, but it is not expressed in the volume of foreign currency balances of the Bank of Israel.

The net profit of the Bank of Israel for 1977 was transferred in its entirety, as in every year, to the Treasury in accordance with the Law of the Bank of Israel.

B. INCOME

Income of the Bank of Israel from its regular operations amounted in 1977 to IL 4,101 million, as opposed to IL 2,655 million in 1976, an increase of IL 1,446 million. The income from interest on foreign currency assets increased considerably this year: IL 1,243 million, as against IL 776 million in 1976, but in dollar terms there was no change and it amounted, in each of the two years, to about \$94 million. The stability in the amount of income from foreign currency assets despite the increase of their annual balance in 1977 stems from the continued decrease of interest rates in the world on the money markets.

The income of the Bank of Israel from loans and credit against notes, which since 1976 has been the greatest item in the income account, amounted this year to IL 1,360 million⁶, as opposed IL 936 million in 1976. This increased income stemmed this year mainly from an increase in the average annual balance of this credit. Income from interest on the government debt amounted to IL 1,034 million (as opposed to IL 638 million in 1976), of which IL 790 million represents income from interest on long-term advances to the government and IL 244 million represents income from interest on temporary advances to the government. Income originating from the government securities portfolio held by the Bank of Israel amounted in 1977 to IL 795 million, as opposed to IL 485 million in 1976. According to the principle of identical timing, the revaluation differentials (linkage and interest) on accumulated government bonds, not yet paid or budgeted in effect for each of these years, were deducted from these sums⁷.

Net income in the securities item after this deduction amounted to IL 332 million, as opposed to IL 118 million in 1976.

C. EXPENDITURE

Expenditures by the Bank of Israel in the framework of its regular operations increased in 1977 to IL 1,626 million, as opposed to IL 942 million in 1976. This rapid increase took place in the main expenditure items of the Bank, which are interest payments on deposits

⁶ This income includes the amount of IL 431 million, accumulated as differentials of linkage differentials to the Employers' Loan Fund (as against IL 286 million in 1976).

⁷ The deduction of these revaluation differentials was done according to recommendations of the Public Committee for the Examination of the Bank of Israel Balance Sheet. According to these recommendations, the profits of the Bank of Israel actually transferred to the government in any given year should not include income from the government which has not in effect been paid or budgeted in that year.

in IL and in foreign currency of the banks affiliated with the Bank of Israel. The rapid growth of these interest payments reflects mainly the steep increase in deposit balances of the banks at the Bank of Israel this year. Interest payments on IL deposits of banking institutions affiliated with the Bank of Israel increased from IL 332 million in 1976 to IL 634 million in 1977. This increase reflects primarily the rapid growth in the average balance of liquid assets of the banks affiliated with the Bank of Israel, which took place this year.

Interest payments on foreign currency deposits of the banks, originating mainly from the depositions of recipients of personal reparations from Germany, also increased considerably following the devaluations of the IL and the increase in the value of the German mark vis-à-vis the dollar. The government covered the bulk of interest payments on these deposits this year as well. The share of the Bank of Israel in these interest payments amounted to IL 567 million, as against IL 330 million in 1976.

3. CREDIT DIRECTED BY THE BANK OF ISRAEL⁸

The system of directed credit is operated through the Credit Department of the Bank of Israel, and it is assisted by committees, in which the representatives of various government departments participate. This credit is granted for the short term, and is financed mainly through funds common to the Bank of Israel and the commercial banks. The types of funds through which credit is granted have been established according to the various destinations and financing needs⁹. The bulk of directed credit is destined for the export sectors, and is partly granted in Israeli currency at an interest rate of about 12 percent, and partly in foreign currency. The balance of credit in working capital funds is granted in Israeli currency at an interest of about 24 percent, and it is destined mainly for the industrial and agricultural sectors (this is distinct from the Employers' Loan Fund, where credit is linked to the price index). In 1977 steps were taken to expand directed credit for financing export branches, at the expense of reducing credit for financing domestic economic activity (see below). The low rate of interest to the client in most funds is made possible by the low interest collected by the Bank of Israel on its shares in financing direct credit. (For details on the composition of resources for the financing of the funds, as well as their interest rates, see Table XXI-4).

⁸ Data on directed credit in this item are somewhat different from these appearing in Chapter XVIII of this Report, because these data are based on weekly liquidity reports as of the last Wednesday of each month, as submitted to the Credit Department, while data in Chapter XVIII are based on monthly reports as of the last day of the month.

⁹ An extensive and more detailed survey on the subject of directed credit in 1977 can be found in the Annual Survey of the Controller of Banks on the banking system in Israel for 1977.

TABLE XXI-4

STRUCTURE AND TERMS OF DIRECTED CREDIT FUNDS, 1976-1977
(percent)

Fund	Sources of funds 1976				Sources of funds 1977			
	Commercial banks	Bank of Israel		Interest rate in 1976	Commercial banks	Bank of Israel		Interest rate in 1977
		Liquidity exemptions	Rediscount			Liquidity exemptions	Rediscount	
Export funds in foreign currency								
Imports for export production	12.5	22.5	65	6	15	-	85	4
Regular export shipments	12.5	22.5	65	6	15	-	85	4
Special export shipment	12.5	22.5	65	9	15	-	85	9
Diamonds	-	-	100	6	-	-	100	6
Export funds in IL								
Export production	12.5	22.5	65	10	15	20	65	12
Citrus	12.5	22.5	65	10	15	20	65	12
Indirect exports	12.5	22.5	65	17	15	20	65	20
Working capital fund in IL								
Agricultural credit	40	20	40	17	40	10	50	24
Supervised farm credit	40	60	-	17	40	60	-	25
Industrial credit ^a	40	-	40	20	40	10	50	24
Crafts fund	40	20	40	20	40	10	50	24
General fund	40	20	40	20	40	10	50	24
Employers' Loan Fund								

^a As of December 31, 1976, government redemption was 20 percent.

In 1977 a most rapid increase of directed credit took place. Total directed credit in Israeli and foreign currency in export funds, for working capital and other purposes, amounted at the end of 1977 to IL 20,774 million, as against IL 9,492 million at the end of 1976, an increase of IL 11,282 million. Part of this steep increase (about IL 3 billion) stems from changes in the foreign currency financing arrangements of the Shipments Fund, and it therefore does not express an effective expansion of the credit volume¹⁰.

The increase in credit, after deducting this change, amounts to IL 8,282 million, or 87 percent. This increase partly reflects the revaluation of foreign currency credit balances following devaluations of the IL.

The growth rate of directed credit for exports in Israeli currency increased in 1977 by about 50 percent, while the credit component in foreign currency export funds increased, in dollar terms, by 55 percent (without the increase stemming from the change of financing arrangements in the Shipments Fund). On the other hand, the direct credit component in Israeli currency to the domestic market increased at a smaller rate, about 25 percent, due to the influence of the decision to reduce directed credit to the domestic market beginning November 1977.

A. EXPORT FUNDS

The export funds finance all stages of the export process: the production stage is financed through the Production for Export Fund (in Israeli currency); the import components are financed through the Import for Export Production Fund (in foreign currency); and the shipment stage is financed through the Shipments Fund (in foreign currency). In addition to these funds, two sectoral funds operate as well: the Diamond Fund (in foreign currency) and the Citrus Fund (in Israeli currency). There is also an Indirect Export Fund, assisting enterprises supplying products to direct exporters. Outside the framework of these funds, there are special arrangements for granting credit to exporters for long term export assisting transactions, and for exporters whose goods have been delayed inside the country for various reasons.

The considerable growth rate this year in export funds in Israeli currency stemmed from the rapid growth of the Production for Export Fund (about 61 percent). This Fund receives about three quarters of the total credit allotted the export funds in Israeli

¹⁰ According to the new financing arrangements, the banks were enabled to reinforce the credit in the Shipments Fund from the resources of the Bank of Israel at a rate of interest lower than that prevalent on the market (4 percent), instead of financing via foreign currency credit funds from foreign resources.

TABLE XXI-5

DIRECTED EXPORT CREDIT, 1976-1977

	1976		1977		Increase or (-) decrease	
	End-year balance	Average balance	End-year balance	Average balance	End-year balance	Average balance
	(IL million)				(percent)	
1. Credit from export funds						
In Israeli currency						
Export production	2,150.9	1,788.0	3,470.8	2,706.2	61.4	51.4
Citrus	615.1	429.6	714.8	495.1	16.2	15.2
Indirect exports	293.2	235.3	395.7	308.6	35.0	31.2
Total	3,059.2	2,452.9	4,581.3	3,509.9	49.8	43.1
In foreign currency						
Import for export product	644.8	444.0	2,010.6	1,078.4	211.8	142.9
Export shipments	332.2	718.9	3,348.6	722.9	908.0	0.6
Diamonds	2,871.4	2,215.3	7,634.2	4,301.1	165.9	94.2
Total	3,848.4	3,378.2	12,993.4	6,102.4	237.6	80.6
Thereof: in dollars	(439.7)	(425.5)	(845.1)	(580.1)	92.2	36.3
Total credit from export funds	6,907.6	5,831.1	17,574.7	9,612.3	154.4	64.8
2. Credit from export funds						
In Israeli currency	33.4	40.3	16.6	25.0	-50.3	-38.0
In foreign currency	40.8	28.4	33.6	42.5	-17.6	49.6
In dollars	(4.7)	(3.6)	(2.2)	(4.0)	-53.2	11.1
Total credit from outside the funds	74.2	68.7	50.2	67.5	-32.3	-1.7
3. Total directed export credit (1+2)						
	6,981.8	5,899.8	17,624.9	9,679.8	152.4	64.1

currency. Its rapid growth resulted from an about 30 percent increase in the financing rate for the Fund per annum, and from the real growth of exports this year. The more moderate increase in other export funds in Israeli currency (Citrus and Indirect Exports) derives from the transfer of part of the credit, granted via them in the past to foreign currency funds. Interest rates in export funds in Israeli currency were raised at the beginning of the year from 10 to 12 percent, and interest in the Indirect Fund was raised from 17 to 20 percent.

As mentioned, part of the rapid growth in the volume of foreign currency credit in dollar terms is inherent in the changed financing arrangements of the Shipments Fund, and after allowing for this credit in foreign currency, export funds increased (in dollar terms) by 55 percent. This increase reflects mainly the 51 percent rise in the Diamond Fund in dollar terms resulting from the accumulation of polished stock due to subsequently justified expectations of rapid price increases in this sector. The Import for Export Production Fund increased by 75 percent (in dollar terms), partly as a result of the transfer of a portion of Israeli currency credit (Citrus and Cotton) to this fund. Interest rates in the Shipments Fund and the Import for Export Production Fund were lowered from 6 to 4 percent, but in the Diamond Fund the interest rate remained at 6 percent.

In June 1977 it was decided to increase the participation of banks in all export funds from 12.5 to 15 percent, a step that brought with it the absorption of about IL 110 million from the banks (see chapter XVIII). The rates of financing in foreign currency funds are fully adjusted to the exchange rate, and consequently they were increased in the course of 1977 to accord with the rates of creeping devaluations and the great devaluation in October. The rate of financing in the Shipment Fund constituted until October 1977 about 75 percent of the revenue from export specified in the customs item, and following the introduction of the new economic policy, which included the abolition of export incentives, it was decided to up this rate to 85 percent (as from December 1977). The rates of financing in the Production for Export Fund were adjusted to price increases and raised to IL 8.90 per dollar at the beginning of August 1977, and to IL 10.40 per export dollar at the beginning of December 1977 (as from April 1978 the rate of financing increased to IL 12 per export dollar).

F. WORKING CAPITAL FUNDS FOR DOMESTIC PRODUCTION

The balances of credit in working capital funds for domestic production totalled at the end of 1977 IL 2,763 million, an increase of 25 percent, as opposed to 21 percent in 1976. Changes in the funds during the course of 1977 were not uniform, and the more important among them were increases in the funds of working capital to industry and

trade, supervised farms, transport enterprises, and the general fund. The main increase in these funds was concentrated in the first three quarters of the year, since towards the end of the year the introduction of measures for a gradual abolition of directed credit for domestic production began (see below). On the other hand, the balance in the Trucking Fund and the Vehicle and Equipment Import Fund, established following the Yom Kippur war, decreased (in 1977 only credit from these funds was repaid). At the beginning of the year a new fund was established – the Assistance to Industrial Enterprises Fund, granting special loans for shifting production to exports, and assisting in case of temporary liquidity difficulties, etc. The quota of the fund, fixed at IL 250 million, was fully exploited by the end of the year.

In the course of the year, interest on loans from domestic production funds was increased by 4.7 percent, and in most funds it reached 24 percent at the end of the year.

According to the decisions of the government, and within the framework of the policy of directing credit to finance the export branches, at the expense of reducing the credit available to finance domestic economic activity, it was decided to gradually abolish the directed credit for domestic production as of November 1977. Within these parameters it was decided to permit industrial, agricultural and trade enterprises entitled to directed credit to sell to the Bank of Israel the Employer' Loans bonds in their possession (or final rights, whose date of repayment had not yet arrived). Through this arrangement, enterprises were able to improve their liquidity without damaging their level of working capital and to rid themselves of non-negotiable linked loans, while directed credit for domestic production, was abolished.

4. THE ADMINISTRATION OF STATE LOANS¹¹

A. THE ISSUE AND REDEMPTION OF INTERNAL VOLUNTARY MEDIUM- AND LONG-TERM LOANS

In 1977, the Bank of Israel issued government bonds linked to the price index in the amount of IL 2,048 million, as opposed to IL 1,927 million in 1976. In addition, the other financial institutions issued index-linked bonds in 1977 in the amount of IL 15,171

¹¹ Data appearing in this item reflect the activity of the State Loans Administration at the Bank of Israel, but do not include all the data appearing in the economic analysis of the bond market in Chapter XX.

TABLE XXI-6

DIRECTED CREDIT FOR DOMESTIC PRODUCTION, 1976-1977

	1976		1977		Increase or (-) decrease	
	End-year balance	Average balance	End-year balance	Average balance	End-year balance	Average balance
	(IL million)				(percent)	
1. Credit from working capital funds						
Industry and crafts	510.2	435.7	727.4	595.2	42.6	36.6
Agriculture	499.0	413.3	435.5	501.0	-12.7	21.2
Supervised farms	177.7	176.7	245.5	219.9	38.2	24.4
General Fund	57.1	67.5	76.9	65.4	34.7	-3.1
2. Other funds						
Employers' Loan Fund ^a	531.8	498.2	727.5	618.2	36.8	24.1
Trucks	227.0	262.4	157.8	194.1	-30.5	-26.0
Vehicle and equipment imports	121.8	137.8	104.2	111.7	-14.4	-18.9
Transports companies	15.3	7.5	41.4	35.6	170.6	
3. Total (1)+(2)	2,139.9	1,999.1	2,764.5	2,454.6	29.2	22.8
4. Credit from outside the funds						
Liquidity exemptions	9.3		5.0		-46.2	
Rediscounts in IL	112.2		113.3		1.0	
Rediscounts in foreign currency	248.5		266.4		7.2	
Total	370.0		384.7		4.0	
5. Total directed credit for domestic production (3)+(4)	2,509.9		3,149.2		25.5	

^a The data do not include linkage differentials.

million, as against IL 7,736 million in 1976¹⁹. The increase in the total issue of linked bonds in 1977 reflects a considerable real increase in the acquisitions of institutional investors (savings schemes of the banks, social insurance funds and insurance), while direct acquisitions by the public dropped sharply this year. (For a detailed description of developments on the capital market in 1977 – see Chapter XX.

Net mobilization of capital through voluntary government bonds issued by the Bank of Israel (gross sales at source, after deduction of redemptions at market value and interest payments) was negative for 1977, and amounted to IL 1,947 million, as compared with IL 595 million in 1976, and with a positive mobilization of capital in the amount of IL 1,013 million in 1975¹³.

The relative weight of government bonds issued by the Bank of Israel in total gross issues of linked bonds continued to decline this year, as well and amounted to 12 percent, as against 20 percent in 1976 and 26 percent in 1975. This development reflects the continued sharp drop in direct acquisition of linked bonds by the public, which purchases mainly government issued bonds. On the other hand, the acquisition of linked bonds by institutional investors who purchase mainly bonds issued by the other financial institutions to which they are connected, increased considerably.

The decrease of direct public demand for linked bonds in contrast to the acquisitions of institutional investors was also expressed by the distribution of government bonds issued by the Bank of Israel. The component of issues to the public decrease in 1977 to 38 percent, as opposed to 63 percent in 1976 and 76 percent in 1975.

The direct issue of government bonds to the public by the Bank of Israel amounted in 1977 to only IL 750 million (IL 1,250 million in 1976), of these, IL 700 million were bonds linked to the index at the rate of 80 percent, and IL 50 million were bonds linked to the dollar at the rate of 70 percent. The public purchased significant quantities of bonds linked to the index only from the October 31st issue i.e., immediately after the introduction of the new economic policy. In the other months of the year no bonds of this type were purchased in significant quantities and the public even declined to reinvest its bonds due for redemption, despite the improvement of their terms. Interest on bonds linked to the index at the rate of 80 percent was raised as from October 1977 from 4 to

¹² According to agreements with the Treasury, part of these amounts issued by other financial institutions are also deposited with the Accountant General.

¹³ Data include redemptions of Absorption Loans, issued in the past as compulsory loans which became negotiable. The significance of a negative net capital mobilization is that the amounts redeemed were greater than the total gross acquisition of bonds.

TABLE XXI-7

STATE LOAN ISSUES AND SALES (INCLUDING REDEMPTION OF COMPULSORY LOANS), 1976-1977^a
(IL million)

	Gross issues	Redemption of principal	Interest and linkage increments thereon	Net issue (1-2-3) =	Gross issues	Redemption of principal	Interest and linkage increments thereon	Net issue (1-2-3) =
	(1)	(2)	(3)	(4)	(1)	(2)	(3)	(4)
A. Long and medium-term loans								
Five-year option-type	—	257	1,143	-1,400	—	504	2,143	-2,647
Option-type for savings schemes	28	—	—	28	299	—	—	299
Six-year bonds fully index-linked	—	—	2	-2	—	—	2	-2
Seven-year bonds fully index-linked	—	—	31	-31	—	—	184	-184
Ten-year bonds, 100% index-linked	1	—	247	-246	—	—	196	-196
Ten-year bonds, 90% index-linked	1,221	—	1	1,220	12	—	63	-51
Ten-year bonds, 80% index-linked	29	—	—	29	701	—	1	700
Eight-year bonds, 70% linked to dollar	—	—	—	—	50	—	—	50
Long-term loans for pension and social insurance funds (17, 20 years)	123	7	88	28	235	10	129	96

For insurance companies	515	8	154	353	737	19	264	454
Bank Defense Loan	—	49	137	-186	—	48	189	-237
Total	1,917	321	1,803	-207	2,034	581	3,171	-1,718
Absorption loans	—	76	317	-393	—	38	195	-233
Others ^b	10	2	3	5	14	5	5	4
Total voluntary state loans	1,927	399	2,123	-595	2,048	624	3,371	-1,947
B. Short-term loan ^c	674	690	21	-37	710	696	35	-21
C. Compulsory loans (redemption only)								
Defense Loan 1970-73	—	21	39	-60	—	36	169	-205
Savings loans 1970-72	—	425	959	-1,384	—	522	1,477	-1,999
War Loan 1973-74	—	1	2	-3	—	32	55	-87
Total redemption of compulsory loans	—	447	1,000	-1,447	—	590	1,701	-2,291

^a The data in this table were provided by State Loans Administration; they do not include the figures appearing in the economic analysis of the bond market in Chapter XX.

^b Included here are the voluntary War Loan, loans on the Law of Absentee's Properties, unlinked loans and others.

^c Including also issues and redemptions to Bank of Israel.

6 percent gross (an improvement of about 1.25 percent in net real returns), and an option to redeem them after 5 years was provided; commencing with the middle of the year new bonds, linked to the dollar at a rate of 70 percent and bearing interest at the rate of 6 percent were issued.

The need to improve and increasingly diversify the terms of linked bonds for the public increased with the introduction of the reform on the foreign currency market, which opened new saving possibilities in foreign currency to the public. Pursuantly the redemption level of linked bonds increased considerably in 1978. The issuance of bonds with new and improved terms was hence started in February 1978, of which the bond attracting the most demand was a new type, bearing an interest of 5 percent, and permitting the holder to choose upon redemption between full linkage to the dollar or linkage at the rate of 80 percent to the index (after 6 or 10 years, as wished).

The volume in issues to institutional investors amounted in 1977 to IL 1,270 million (IL 715 million in 1976) of which IL 737 million represented deposits of insurance companies for acquisitions of loans, about IL 300 million were issued to cover the savings schemes of the banks, and IL 235 million were purchased by social insurance funds.

The bulk of redemption of internal voluntary loans also occurred in 1977, in the option type development loans, and these continued to grow at a considerable rate: IL 504 million at nominal value, which represent IL 2,143 million at redemption value (including linkage differentials, interest, and linkage on accumulated interest). In 1976, these redemptions amounted to only IL 275 million and IL 1,143 million respectively.

B. DISTRIBUTION AND REDEMPTION OF COMPULSORY LOANS

The total distribution of Certificates of Compulsory loans – the Savings, Security, War (compulsory) and Cost of Living Allowance Loans, amounted in 1977 to IL 2,426 million (nominal value), as against IL 1,180 million in 1976, to 1,607 thousand beneficiaries as against 1,035 thousand in 1976. The certificates, issued in the names of their owners, were sent to the beneficiaries by mail or through banking institutions. During the year the distribution of the certificates of the Security and Savings Loans for the years 1970–1973, started in previous years, was continued and the distribution of certificates of the War Loan 1974 and the Cost of Living Allowance Loan was started.

The Bank of Israel continued taking various measures to trace the addresses of those entitled to loan certificates, whose certificates were returned because they were not handed to their owners. In the course of 1977, 143 thousand certificates were sent to owners whose addresses had been traced (as against 135 thousand sent in 1976), but from this total about 65 thousand certificates were returned for a second time.

In October 1977, the redemption of the last third (group 3) of the 1971 Savings Loan was commenced, the two other groups having already been redeemed in the previous two years. In August 1977, the bloc of the second third of the Employers' Savings Loan for 1972 (group 3) came up for redemption, as did the first third of the Employers' Savings Loan for 1973 (group 3). Total redemption of the fund in Savings Loans 1970-1973 amounted in 1977 to IL 522 million, at nominal value, which represents IL 1,999 million at redemption value, including accumulated interest and linkage. In 1976 redemptions of these loans amounted to IL 425 million at nominal value, representing IL 1,384 million at redemption value.

This year, too, improved terms were offered to the public to dissuade it from redeeming the Savings Loans and instead extend their holding period by two to four additional years. The terms included interest rates that would escalate the longer the bonds were retained and provided linkage to the June 1977 index (instead of the month of redemption in October 1977). It seems that this year, too, such an attempt to reduce the amounts of Savings Loans redemptions failed.

In October 1977 the first interest coupon from the 1970 Security Loan certificates came up for payment. By the end of the year 542 thousand coupons had been submitted for payment, and a total of IL 78.5 million was paid for them.

The provisions of the Security and War Loans permit early redemption of the loan certificates upon the death of the owner or due to age. These redemptions of the Security Loan for 1970-1973 and the War Loan for 1973-1974 amounted in 1977 to about IL 68 million at nominal value, being about IL 292 million at redemption value, including accumulated interest and linkage, as opposed to IL 23 million at nominal value, which represent IL 63 million at redemption value, in 1976.

In the last two months of 1977, the Department of Government Loans prepared to implement the new arrangement decided upon by the government. Under this arrangement various enterprises which had been entitled to direct credit for domestic production would be permitted to sell to the Bank of Israel the Employers' Loan and Security Loan bonds in their possession (or the final rights of these loans if they are not yet redeemable). At the end of December 1977, the Bank of Israel actually started receiving these loans.

C. SHORT-TERM LOAN

The balance of the Short-Term Loan in the possession of the public at the end of 1977 amounted to IL 82 million, an increase of IL 14 million, as opposed to a decrease of IL 16 million in 1976.

In May 1977, the Bank of Israel decided to improve the terms of the Short-Term Loan in order to increase balances held by the public. The improvement in terms was expressed by a considerable increase of gross interest on the Loan to a level of 21 to 22 percent – with the cancellation of the disagio (this cancellation was required by the income tax reform laws). The net improvement on returns from the loan to the public as a result of these changes amounted to 1.3.1.48 percent.

The increase in return led to a rise in the balance held by the public, from IL 74 million at the end of April to IL 120 million at the end of July, but from August onwards the balance of the Loan declined and continued to decline until the end of 1977. The decrease in the balance of Loan held by the public was accelerated considerably with the introduction of the reform on the foreign currency market, since it provided a wide variety of investment options based on foreign currency (Patam) or linked to the index.

In 1977, preference for the series issued for 3 months continued and its relative share in total sales was 82 percent, as in 1976. At the same time, the average life span of the loan certificates decreased to 67 days by the end of 1977, as opposed to 69 days at the end of 1976, and 78 days at the end of 1975.

D. OPEN MARKET (SECONDARY) OPERATIONS OF THE BANK OF ISRAEL

The Bank of Israel acts on the bond market as an agent for the government. It regulates trade in government bonds and in the Short-Term Loan, in order to promote sales at source, while taking the monetary situation prevailing in the economy during that period, into account. Most of the activity of the Bank of Israel was directed at preventing sharp fluctuations in the price of bonds during slack periods on the secondary market, and to the extent possible, at reducing the gap between returns on the market and returns at source as well. It attempts this without eliminating trends dictated by the market.

The need to regulate the rates of linked bonds arose from the void created in such activity by the departure of investors, who were detached from the market at the end of 1975 when the issue of special, non tradeable, bonds to covering their savings plans, was initiated.

The volume of transactions (acquisitions and sales) by the Bank of Israel, at market prices, amounted in 1977 to IL 1,260 million, of which IL 1,123 million in government bonds linked to the index and IL 137 million in Short Term Loan. In 1976, the Bank effected transactions amounting to IL 1,214 million, of which IL 1,104 million were in government bonds and IL 110 million in Short Term Loan. Most of the activity of the Bank on the market of index linked government bonds was concentrated in Loans with a distant redemption date. Most of the trade was transacted in the second half of 1977, and amounted during this period to about IL 840 million. This period was affected by the

unprecedented boom on the stock market, as well as by the results of the reform on the foreign currency market. These led to an increase need to absorb offers of linked bonds on the secondary market until bonds with improved terms could be issued at the beginning of 1978.

In addition to its activity on the Stock Exchange, the Bank of Israel sold in 1977 outside the Stock Exchange bank Security Loan bonds, which are not registered for trade, in the amount of about IL 150 million. Considerations prompting these sales were primarily monetary, off and partially offset the injection resulting from surplus acquisitions by the Bank on the secondary market.

Total net acquisitions of bonds in 1977 by the Bank of Israel amounted to IL 275 million, of which IL 425 million worth was acquired on the Stock Exchange. Accumulation of the latter took place in the second half of the year (IL 270 million of which were purchased in November alone). The Bank of Israel's share in trade on the bond market, within the framework of the Stock Exchange, decreased from 10.3 percent in 1975 and 11.7 percent in 1976 to 8.9 percent in 1977.

E. ADMINISTRATION OF DEPOSITS OF INTERNAL LOANS AND SERVICE TO THE PUBLIC

The Bank of Israel administers the securities deposits of insurance companies, banking institutions, the Accountant General of the Treasury, the Tel-Aviv Stock Exchange Clearing House, as well as those of various companies and individuals, that the bank holds the voluntary loan certificates they have purchased in their names. The administration of these deposits includes book-keeping, deposits and withdrawal of bonds, the calculation of interest payments and principal and linkage redemptions. The deposit account of the Stock Exchange is the largest and most active of these deposits. The daily movement in this account, in withdrawals and deposits, amounts to hundreds and even thousands of certificates. In 1977, about 180 thousand bonds were withdrawn from the deposits of the Clearing House of the Stock Exchange and the banking institutions. According to legal requirements, insurance companies deposit bonds or cash with the Accountant General; and about 100 such deposits are being administered by the Bank of Israel.

The Bank of Israel also administers various loans issued by financial institutions and other non-governmental public bodies. The balance of these loans, the bulk of which are loans issued by Bank "Tfahot" Ltd., includes 47 series at a nominal value amounting to IL 488 million at the end of 1977. The balance of the other loans is very low and no considerable changes took place in it.

The Bank of Israel allows the public to redeem bonds and interest Coupons of the State Loans which it administers, via the offices of the Administration of State Loans, in

each of the three major towns: Jerusalem, Tel-Aviv and Haifa, as well as in the bank's branches. During 1977 about 250 thousand bonds of Compulsory Loan certificates belonging to 85 thousand citizens were redeemed via the offices of the State Loans, as opposed to 213 thousand bonds belonging to 66 thousand citizens in 1976. In addition, about 87 thousand citizens applied in the course of the year to the Compulsory Loan unit for various clarifications regarding the loan certificates issued to them. Thirty thousand of these applications were in writing.

F. FOREIGN LOANS ADMINISTERED BY THE BANK OF ISRAEL

The Bank of Israel handles the conversion and redemption of the State of Israel Development Loans ("Israel Bonds"). These Loans can be converted and redeemed in advance at the Bank of Israel by institutions, tourists, investors, immigrants and returning residents, according to terms determined by the regulations of the Foreign Exchange Division of the Ministry of Finance.

The volume of advance conversions and redemptions of foreign loans in Israel grew in 1977, and amounted to \$110 million (\$100 million funds and \$10 million interest), as opposed to \$99 million in 1976 (\$91 million fund and \$8 million interest). The volume of conversions, at current IL rates, amounted to IL 1,193 million, an increase of 5 percent as opposed to 1976.

Despite the devaluation effected in October, there was no significant change in the breakdown of conversions during 1977; 31 percent of total conversions in dollars occurred in the last quarter of the year, as compared with 32 percent in the last quarter of 1976. At the same time, the increase in conversions by institutions was particularly prominent, in November and December 1977, averaging nearly \$10 million per month, as against \$12 million per month in September and October 1977, and about \$5 million a month during the first 8 months of the year.

The 1977 breakdown of conversions according to beneficiaries was similar to that of 1976: \$66 million (60 percent) was converted by institutions, \$25 million (23 percent) by tourists, \$13 million (12 percent) by investors and \$6 million (5 percent) by immigrants and returning residents.

5. SUPERVISION OF BANKING AND FINANCIAL INSTITUTIONS

A. INSTITUTIONS SUBJECT TO SUPERVISION

The number of banking and financial institutions subject to supervision increased during 1977 from 62 to 64. The most prominent change in activity in 1977 was the opening of

TABLE XXI-8

**BANKING AND FINANCIAL INSTITUTIONS UNDER BANK OF ISRAEL
SUPERVISION, 1976-1977**

End of Year	1976	1977
Commercial banks ^a	21	22
Cooperative credit societies	6	5
Mortgage banks	16	16
Investment banks	6	9
Financial institutions	13	12
Total	62	64

^a Excludes 4 inactive banks.

2 investment banks by the banking concerns which did not have a bank allocated for this purpose. The Bank for the Financing of Industry, was founded by the Discount Bank, and the Bank for the Advancement of Industry was founded by the Bank Hamizrachi Hameuhad' Ltd.. An additional institution, the Otsar le-Taasiah, which was previously a financial institution with no liquidity obligations, changed its status to an investment bank. The process of dismantling cooperative credit societies continued: the cooperative society "Massad" received the status of a commercial bank and was integrated into a banking concern. At the beginning of 1978 two additional cooperative societies ceased to exist as independent units, and a new commercial bank which was integrated in a banking concern, was established in their stead.

B. BRANCHES OF BANKING INSTITUTIONS

At the end of 1977, 968 branches of commercial banks and cooperative credit societies (including head offices) operated in Israel, as well as 24 banking services counters. In the course of the year 17 new branches were opened, 4 branches in the arab sector, 4 counters in hotels and a "drive-in" branch. In 1977 criteria for the approval of mobile branches serving villages situated far from urban centers were determined. Approvals in principle were granted for the establishment of 5 sub-branches. The number of branches on the other side of the green line, operating in addition to the Israeli branches, rose this year to 26, an increase of 4 branches, 2 of these branches were opened in Jewish settlements.

C. ACTIVITIES OF ISRAELI BANKING ABROAD

The Israeli banking system has been developing for a number of years a network of branches abroad. The year 1977 was characterized by a considerable expansion of the international activity of the banking system. Among other developments an additional banking company affiliate was established in South America, 4 new main branches and a number of additional representations were opened. A significant increase in the consolidated balance sheets of banking concerns, stemming from activities abroad, had been noted.

D. BANK AUDITS

The "field audit" of commercial banks by specialized professional teams (credit, foreign currency, liabilities, administration, securities and saving plans), continued in 1977. The increased professional specialization procedures led to more thorough auditing and to initiatives for expediting various subjects. Expressions of this were the publication of circulars on standard banking procedures and resolutions of the relevant institutions on following subjects: a prohibition on granting credit for the purchase of securities from issues, changes in liquidity regulations concerning fixed-term deposits etc.

The audit of commercial banks produced in 1977 about 22 external audit reports and another 30 audit letters.

The audit of mortgage banks, investment banks, cooperative credit societies and financial institutions was implemented by units specializing in these fields. These audit units handle both "field audit" conduct follow-up operations in institutions and evaluate their status. This year the mortgage banks unit up-dated rules and regulations governing the relations between the customer and the bank. In 1977 regulations concerning the preparation of annual financial reports by these banks were published, in which the transfer to the method of account report based on full accumulation was determined.

The investment banks unit prepared a new system of reporting, adjusted to the specific needs of this banking branch. This reporting system will be enforced as from June 1978.

E. INSTITUTIONAL COORDINATION

Three joint institutional teams operate in bank auditing, and carry out a current monitoring of the development of banking institutions, based on reports from the banks, audit reports, information issued to the public and direct contact with the institutions. The joint institutional teams also analyse the situation in banking concerns, since companies of the concerns are interconnected in business. In 1977, these teams presented about 60 periodic special reports, and follow-up reports on the main banks of the system.

A system of basic data on each bank and the various groups of banks is in preparation. The financial reports published by banks to the public have also been audited.

F. ADJUSTMENTS NECESSITATED BY THE REFORM ON THE FOREIGN CURRENCY MARKET

The reform on the foreign currency market necessitated the formulation and publication of new liquidity regulations in the field of foreign currency, since new types of deposits were added and new possibilities for receiving credit in foreign currency were opened to Israeli residents. The liberalization of foreign currency control and the expanded activities of Israeli banks abroad, necessitated the concentration of more extensive information by the Bank of Israel. To meet this need, the reporting system on foreign currency dealing transacted via the commercial banks was reorganized.

In addition, it became necessary to adjust the order on guarantees and other liabilities in customers' accounts to the new conditions, and impose volume restrictions on guarantees for ensuring currency credit.

In order to prevent the exertion of an untoward influence by the liberalization upon the banking system, evaluations concerning possible influences and alternatives were prepared on the following subjects: possible transition from deposits in Israeli currency to deposits in foreign currency, the repercussions of the floating rate on the banking system, risks inherent in foreign currency transactions, cost of foreign currency transactions.

G. RESEARCH, STATISTICS AND INFORMATION

As in previous years, in 1977, too, the annual survey of the Bank Comptroller on the banking system in Israel, and abstracts of the survey, in Hebrew and English, were published. The survey was made more vigorous and was expanded by additional chapters on investment banking and on bank auditing.

This year for the first time, the Bank Comptroller published a brochure of research articles, "Problems in Banking", containing 4 articles on various subjects dealing with bank stability. Among other publications were a brochure on internal auditing in commercial banks and its relation to the supervision of banks, a catalogue of Israel publications on banking subjects, a list of banking institutions and their branches, etc. The internal research works included surveys on the possible influences of the economic turnabout on the banking system, the influence of inflation on the profitability of banks, etc. The periodicals "Statistics of Banking Institutions" (a monthly brochure), "Promissory Notes not Duly Paid" (a monthly brochure), "Deposits in Banking Institutions" (an annual publication) were also published.

Activity in absorbing and adapting statistical reports grew. The absorption of the new monthly report, which went into operation at the beginning of 1977, and the absorption of modifications in it following the reform, as well as changes of reporting requirements in the report on large scale borrowers (the division of the report into Israeli and foreign currency) should be noted in particular.

H. CLEARING HOUSE

In 1977 total items (checks, notes, debit advices, excluding credit advices) which passed through the clearing houses amounted to IL 402,870 million, as opposed to IL 235,162 million in 1976. This represented an increase of 71.3 percent, as against an increase of 47.7 percent in 1976.

Given the expanded use of checks encoded in magnetic ink, and in view of the fact that these checks can be cleared only in Tel-Aviv, the Haifa clearing house ceased operations last year, there remained of 21.8.77 a single clearing house which operates in Tel-Aviv, and serves as clearing house for items from all parts of the country.

The Clearing House Council has begun deliberations on planning the transition to the exclusive use of checks with magnetic coding.

I. APPLICATIONS OF THE PUBLIC

The Bank Comptroller handles applications from the public which are related to the banking system. In 1977, 887 applications were received, as against 697 last year. 22 percent of these applications contained justified complaints. Similar to last year, the number of applications related to the implementation of regulations referring to the purchase and sale of securities increased, this year as well. After October 1977, the number of applications concerning foreign currency transactions doubled.

J. ADVISORY COMMITTEE ON MATTERS RELATING TO BANKING BUSINESS

The Committee held discussions on the following subjects: the survey of the Bank Comptroller on the banking system in 1976, rectifications of the order concerning guarantees and other liabilities in customers' accounts, the item of "remaining alive" in agreements between banks and their customers having common accounts, report on the trial operation of a mobile branch, the distribution of dividends from certain surpluses of mortgage banks, regulations concerning annual financial reporting of the mortgage bank, short-term credit for non-designated purposes granted by mortgage and investment banks, dismissed or suspected employees, divulging information to the client concerning orders for the presentation of documents or police investigation of his accounts, the publication, of a table of exchange rates at bank branches.

6. THE ISSUE OF BANKNOTES, COINS AND MEDALS

A. THE ISSUE OF BANKNOTES AND COINS IN CIRCULATION

On 26.5.77 the fourth banknote of the series d', at a nominal value of IL 500, was put into circulation. Its colours are ivory-gray-brown, and it bears the image of David Ben Gurion. On 26.1.78, a fifth and last banknote of this series was put into circulation, at a nominal value of IL 50. Its colour is green, and it bears the image of Haim Weizman. In the 1977 calendar year, the Israel Mints in Jerusalem minted, upon the commission of the Bank of Israel, 72.3 million coins, bearing the Hebrew date (5737). In addition to the minting in Israel, 15 million coins of 5 Agorot and 30 million coins of 10 Agorot were minted at the Royal Canadian Mint, bearing the Hebrew date of 5737.

In 1977, the Bank of Israel issued a commemorative medal for Independence Day 5737, its subject being "The brotherhood of peoples in Jerusalem", to mark 30 years of existence of the State of Israel. The medal was issued in two editions: plain silver and ornamental. Its nominal value is IL 25, and its composition 500 thousandth silver and 500 thousandth copper. Its weight is 20 gr., its diameter 34 mm.

This year, too, the Bank of Israel issued the commemorative medal of the series "redemption of the first born", at a nominal value of IL 25; its composition is 900 thousandth copper, its weight 26 gr. and its diameter 37 mm. The plain medal has a smooth periphery, while that of the ornamental one is indented.

A Hanukkah medal was issued for Hanukkah 5738: its nominal value is IL 10, its composition was raised this year to 75 percent copper and 25 percent nickel (as against a composition of 50 percent of each of these metals in previous years). Its weight is 15 gr., its diameter 34 mm; its subject: "Hanukkah lamp from Jerusalem". The medal was issued in two editions: plain, with a smooth periphery, and ornamental, with an indented periphery.

As in the past, this year, too, a series of special coins was issued, identical in its mould to the usual coins in circulation. It bears the date 5737, but possesses an additional identification mark in the form of a small Shield of David. This series includes the six existing denomination of 1, 5, 10, 25 agoroth, IL 1/2, and IL 1, and was issued in quantities of 37,376 units per denomination.

C. THE COMMITTEE FOR THE PLANNING OF BANKNOTES, COINS AND COMMEMORATIVE MEDALS

This Committee, headed by the Supreme Court Justice, Dr. A. Vitkin, deals with the planning of banknotes, coins and commemorative medals, issued by the Bank of Israel. It

TABLE XXI-9

COMMEMORATIVE COINS ISSUED BY THE BANK OF ISRAEL, 1977-1978^a

Coin	Place minted	Brilliant uncirculated	Proof	Total
Independence Day coins – IL 25				
1977 "Brotherhood of nations" in Jerusalem	Jerusalem	37,300	27,200	64,500
Pidyon Haben (Redemption of the First-born) – IL 25, 1977	Jerusalem	32,100	19,296	51,396
Hanukkah lamp from Jerusalem IL 10, 1978	Jerusalem	46,302	29,689	75,991

^a For details of coins issued by the Bank of Israel between 1957/58 and 1974/75, see Table XX-7 in Bank of Israel Annual Report 1975.

submits its recommendations to the governor of the Bank, on medal proposals, which it has selected in a bank sponsored competition for artists. The Committee's activities found expression in plans for the 1971 issues of both banknotes and coins.

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

In the course of 1977, two IMF missions visited Israel. The first mission arrived in March, to conduct the usual annual consultations within the framework of the covenant of the Fund, and to pursue discussions on additional credit under the interim arrangement for increased quotas that was reached. It should be recalled that in 1975 the Fund had decided to increase the credit quotas of member states by 32.5 on average¹⁴. As an interim stage, until the enforcement of the new quotas, existing credit tranches were increased by 45 percent. This decision made possible the granting of additional credit to

¹⁴ This credit bears an interest of 4.375 percent in the first year, with the addition of 0.5 percent for every additional year, up to a maximum of 6.375 percent. According to the Articles of the Monetary Fund, this credit must be repaid beginning from the end of the third year and not later than at the end of five years.

Israel in the amount of 29.25 million special drawing rights (hereinafter SDR)¹⁵ based on two credit tranches which Israel has already received. An agreement to this effect was signed in October 1976, and within its framework Israel received in November 1976 12 million SDR (about \$14 million). During 1977, the balance of credit at our disposal as per this agreement was not exploited.

A second visit of the mission of the Monetary Fund took place in December 1977, following the reform introduced on the foreign currency market in October 1977. The purpose of the discussions, which continued during an additional visit in January 1978, was to evaluate the significance of the reform and the complementary economic policy steps, and to prepare the ground for the receipt of additional assistance in the form of credit from the Monetary Fund.

According to the decision of the "Interim Committee of the Board of Governors" to gradually remove gold from the international reserve structure, the International Monetary Fund started in June 1976 to sell 25 million ounces of gold on the free market (in small batches). During 1977, the Fund sold about 6.0 million ounces of gold, and part of the profits from these sales (amounting to about \$640 million) was transferred to the trust fund established for granting credit at low interest (only about 0.5 percent) to very poor countries. In this decision it was also determined that developing countries should be reimbursed their share of profits deriving from the sales of gold, while developed countries will contribute their share in the profits to the trust fund. After extensive discussions in the management of the Monetary Fund, and following the decision of the Organization of Oil Producing Countries to recommend to its members that these contribute their profits to the trust fund, a decision was reached at the beginning of 1978. For this purpose a small number of developing countries, comprising Israel, characterized by a high per capita income would not be included in the list of developing countries and their share of gold profits would be transferred to the trust fund.

In tandem with the decision to sell 25 million ounces of gold on the free market, the Fund also decided to return to member countries 25 million additional ounces of gold against a payment of 35 SDR per ounce. These operations are effected once a year, and in December 1977, the Fund returned the "second portion", in which Israel's share was about 27,840 ounces of gold at the price of about 975,000 SDR.

Following the decision of the "Interim Committee of the Board of Governors", the "Withwain Plan" formulated by the Fund, which permitted the expansion of credit beyond the usual credit frameworks of which do not satisfy balance of payments requirements. The additional amounts (about 8.7 billion SDR) will be drawn simultaneously

¹⁵ The values of a special drawing right unit, calculated on the basis of a "basket" consisting of 16 currencies, ranged in 1977 between 1.165 and 1.215 dollars.

from the developed countries and the oil producing countries. It is not yet clear whether and when this plan will be implemented:

During 1977, the government of Israel approved the second rectification to the covenant of the Fund, and the participation of Israel in the sixth increase of quotas. This rectification of the covenant and the increase of quotas came into force on 1st April 1978. The total amount of quotas of member countries of the Fund increased from 29 to 39 SDR, while the quota of Israel increased from 130 million to 205 million SDR. This addition of 75 million SDR can be paid, with the agreement of the Fund, in Israel Pounds. As a result of this, the voting power of Israel increased from 0.48 percent to 0.55 percent.

1. The World Bank (I.B.R.D.):

In 1977, Israel continued to exploit loans approved by the World Bank in previous years. Total loans received in 1977 amounted to about \$10 million, and total loans repaid amounted to about \$13 million. Total loans approved for Israel in the course of the year amounted to about \$284 million, of which about \$217 million were utilized. The balance of loans not yet exploited at the end of 1977 amounted to about \$67 million, and included road development plans (about \$18 million), sewerage (about \$20 million) and the Bank for the Development of Industry (about \$29 million).

In May 1977, the World Bank decided to expand its equity capital by about \$8.5 billion. Israel was allocated additional shares amounting to about \$68 million.

2. The International Development Association

This Association is affiliated with the World Bank, and it provides loans on preferential terms to underdeveloped countries. The Association mobilizes most of its funds from contributions of member states in the World Bank.

It should be recalled, that already in 1973, the government of Israel had decided to contribute, within the framework of the "fourth round" of subscription by States, which came into force at the beginning of 1975, a total amount of IL 4.2 million in local currency (the value of which, at the time, was about one million dollars), payable in 5 equal annual installments. Thus, Israel transferred to the Association in November 1977 the fourth installment, amounting to IL 840,000.

3. The Inter-American Development Bank (I.D.B.)

The Inter-American Development Bank centers its activity around the development of the socio-economic infrastructure of the Latin-American countries. Total loans and grants to members in 1977 amounted to \$1.9 billion. This amount constituted the share of the

Bank in the financing of projects, with an overall value exceeding \$3.2 billion.

In July 1976, Israel was accepted as a member of the Inter-American Development Bank, within the framework for absorbing States from outside the area, who today number 15. Israel undertook to purchase shares from the Bank in a quantity of \$5 million, of which about \$820 thousand was payable in effect, and to contribute \$5 million to the Special Activities Fund. According to the agreement reached with the Bank Israel began in 1976 to pay its share of the Bank's capital in 5 equal annual installments. The membership of Israel in the Inter-American Development Bank entitles Israeli companies to participate in tenders for carrying out projects on the American continent financed with loans granted by the Bank.

8. ECONOMIC RESEARCH

As in every year, the Report of the Bank of Israel and its Appendix include this year, as well a great part of current research on the Israeli economy, conducted in the Research Department. In addition to current research, economists of the department also prepared economic forecasts, policy memoranda on monetary subjects, including various examinations connected with the reform on the foreign currency market. Comprehensive research was also conducted on specific subjects.

In 1977, the following research papers and surveys were published :

- a. Internal and current surveys on monetary developments.
- b. Economic indicators, a weekly publication, with restricted distribution.
- c. Surveys on "Recent Economic Developments", No. 24 and 25.
- d. The National Budget for 1978, prepared in collaboration with the Economic Advisory Bureau of the Ministry of Finance and presented to the Knesseth together with the State Budget.
- e. The Influence of Increased Support to large Families on the Labor Supply.
- f. The Estimate of Damage Caused by Road Accidents and their incidence among Various Types of Vehicles.

In addition, the following research works were concluded and disseminated :

1. The optimal investment file for Israeli's foreign currency reserves.
2. Policy measures and their influence on exports and on the real exchange rate in the Israeli economy – draft of a research submitted to the 1977 meeting of the Israeli Economic Association.
3. The function of aggregate consumption of the Israeli Economy and a study of the influence of changes in incoming distribution on consumption in the period 1960 to

1975 – draft of a research paper submitted to the 1977 meeting of the Israeli Economic Association.

4. The banking system as a monetary model – draft of research submitted to the 1977 meeting of the Israeli Economic Association.

9. ADVISORY COMMITTEE AND ADVISORY COUNCIL

This year as in every year, a majority of the meetings of the Bank's Advisory Committee and Advisory Council were devoted to economic and monetary developments in general, and to the policy of the Bank of Israel in particular.

Within the framework of measures taken to reduce the monetary expansion that had become evident at the beginning of the year, the Advisory Committee recommended that the banks repay the loan, in the amount of IL 400 million, granted to them by the Bank of Israel in 1976 for the reduction of their liquidity deficits. This suggestion ran parallel to the decrease which had indeed taken place in deficits by the end of 1976. The share of the banks in financing export funds from their free resources was also increased. As part and parcel to all this, fines on liquidity deficits, as well as interest on liquid deposits of banks, were increased.

Within the framework of the policy of adjusting bank interest rates in the economy to the rapid pace of inflation, a 2 percent increase on interest to borrowers from export funds a median 6 percent increase on borrowers from working capital funds and a 1.5 increase on net returns to the public on Short Term Loans were approved.

With the introduction of the reform on the foreign currency market, the operations indispensable for preventing an expansion of free credit to finance short term speculative activities, were discussed. The freezing of balances of free credit, both Israeli and foreign currency, for a restricted period of three months was also discussed.

In addition to the surveyed monetary policy, it was decided that measures to direct credit into the financing of export branches, at the expense of reducing available credit for financing domestic economic activities, be taken. Within this framework it was decided to gradually abolish directed credit to the domestic market, and to permit businesses which were entitled to this credit, to redeem the employers' loans and security loans in their possession.

In addition to discussions on economic and monetary developments in the Israeli economy, the Advisory Committee also dealt with general subjects connected with the activities of the Central Bank, these included: rectifications of liquidity regulations of the banks, changes in directed credit; the issue of negotiable deposit certificates, and the

lowering of interest on credit from foreign currency export funds. The Advisory Committee also discussed the Proposed Law of State Corporations and its application to the Bank of Israel.

The Advisory Council reviewed at its meetings during 1977 the Balance Sheet and Profit and Loss Account of the Bank of Israel for 1976, the Report of the Bank of Israel for 1976, the Survey of the Bank Comptroller for 1976, and the administrative budget for 1976. The Council also appointed Sub-Committees to examine the Balance Sheet of the Bank of Israel and the administrative budget of the Bank. The Council also recommended the issue of banknotes and coins, part of which have been issued in 1977, according to details appearing above in this Chapter.

In March 1977, the Sub-Committee of the Advisory Council recommended the election of an external accountant for the Bank of Israel and the determination of his mode of operation. In May 1977, the governor appointed Mr. J. Shemer to this post, and it was determined that his duty would be as follows: audit the financial reports of the Bank of Israel, to advise the governor and the senior staff of the Bank on all matters concerning the keeping of accounts and financial reports of the Bank, and to assist the Management of the Bank in the outlining of methods and guiding principles in the said spheres. Part of the recommendations of the external accountant were expressed already at the end of 1977 in methods utilized in the reporting and publication of the Bank's Balance Sheet.

STATEMENT OF ASSETS AND LIABILITIES AS AT DECEMBER 31, 1977

and

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING DECEMBER 31, 1977

STATEMENT OF ASSETS AND LIABILITIES

(IL

ASSETS

	December 31, December 31	
	1977	1976 ^a
Foreign assets		
Gold foreign currency and foreign currency securities ^b	24,173,228	12,031,410
Other foreign currency assets	3,261,656	1,957,721
	27,434,884	13,989,131
Credit to the government^c		
Long-term liabilities	13,255,782	10,555,782
Provisional advances	9,551,239	522,989
	22,807,021	11,078,771
Loans and bills^d		
in foreign currency	13,519,745	4,356,931
in Israeli currency	4,569,096	3,582,682
	18,088,841	7,939,613
Securities^e		
Other accounts ^f	2,770,415	1,777,933
Guarantees and documentary credits (see contra)	1,384,327	1,092,729
	514,626	512,605
	73,000,114	36,390,782

^a Classified anew.

ISRAEL

AS OF DECEMBER 31, 1977

(thousand)

LIABILITIES

	December 31 1977	December 31 1976 ^a
Banknotes and coin in circulation ^g	6,860,217	5,073,217
Allocations of Special Drawing Rights	800,766	435,348
Foreign liabilities		
Foreign currency deposits of banks abroad	150,805	88,069
Liability to IMF ^h	1,440,159	783,005
Other liabilities ⁱ	192,606	119,440
	1,783,570	990,514
Government and National Institution deposits in foreign currency	2,232,552	460,163
Banking institution deposits in foreign currency ^j		
Against non-resident deposits	3,108,354	1,811,825
Against resident deposits-indemnities	32,763,333	15,157,246
Against resident deposits – others	13,036,089	5,146,706
	48,907,776	22,115,777
Deposits of banking and financial institutions in Israel		
Banking institution deposits ^d	9,020,703	5,741,913
Financial institution deposits	128,883	46,848
	9,149,586	5,788,761
Other deposits ^k	1,051,664	268,226
Other accounts ^l	1,679,357	726,171
Capital and reserves	20,000	20,000
Liabilities on account of guarantees and documentary credits (see contra)	514,626	512,605
	73,000,114	36,390,782

^b The attached explanations constitute an inseparable part of the financial reports.

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDING
DECEMBER 31, 1977
(IL thousand)

REVENUES	1977	1976
Revenues from foreign currency investments	1,242,884	775,593
Interest from government	1,033,964	637,740
Interest from loans and bills	1,359,860	935,877
Revenues from securities	794,598	485,382
Less: revenues not yet realized	462,172	332,426
Other revenues	132,129	(367,001)
Total	4,101,263	2,655,484
EXPENDITURES		
Interest on deposits of banking and financial institutions in Israel ^a	1,203,245	665,316
Expenditures on printing and issue of money and coins, investment in equipment and construction and administrative expenses	270,207	171,056
Other expenses	152,410	105,405
Total	1,625,862	941,777
Operating profit	2,475,401	1,713,707
Less net loss from foreign exchange rate differentials and from devaluation	2,254,361	385,054
Net profit	221,404	1,328,653
DISTRIBUTION OF PROFIT		
To the government – for lowering of the long-term debt		1,312,032
To the government – as transfer	221,040	16,621

^a Not including interest amounting to IL 941,901 thousand on Pazak and Tamam deposits, covered by the government (in 1976: IL 795,898 thousand).

MAIN ACCOUNTING POLICY

Income and expenditure are based on accumulation.

Income from the government is based on accumulation, but is included in the net profits of the Bank on the principle of simultaneous registration. Therefore Bank does not include in its net profits for the business year amounts accruing to it from debiting the government, unless they were actually budgeted by the government or will be disbursed by it in the course of the fiscal year ending on 31 March following the close of the business year. The difference between income based on accumulation and income included in the net profit can be found in the Balance Sheet under "other accounts" on liabilities side.

Investment by the Bank in buildings and in equipment is charged to expenditure.

Expenditure with respect to pension and retirement compensation to employees is charged to the profit and loss account at the time of actual payment.

Accumulated income is included in the Balance Sheet under "other accounts" on assets side; accumulated expenditure under "other accounts" is on the liabilities side. The exception is income accumulated from securities in Israeli pounds, which can be found in the "securities" item.

1. FOREIGN CURRENCY ACCOUNTS

Assets and liabilities in foreign currency are converted to IL as follows:

As of 31 December 1977 – at representative rates published by the Bank of Israel for 30 December 1977 (U.S. dollars at the rate of IL 15.3883).

As of 31 December 1976 – at the purchasing rates published by the Bank of Israel on 29 December 1976 (U.S. dollars at the rate of IL 8.717).

Special Drawing Rights (SDR) are converted to IL at the rate of the SDR vis a vis the U.S. dollar. Gold is converted to IL at the official price of the International Monetary Fund – 35 Special Drawing Rights per ounce.

Income and expenditure in foreign currency is converted to IL according to the exchange rates at the close of each month and on the day preceding the devaluation of the IL.

Exchange rate and devaluation differentials deriving from the conversion of the assets and liabilities are charged to the profit and loss account.

SECURITIES:

Securities in foreign currency are included in the Balance Sheet at cost (average weighted purchase price) or at market value, whichever is lower.

Securities in IL are included in the Balance Sheet as follows:

Negotiable loans – at adjusted prices (cost plus interest and linkage based on the Consumer Price Index published on December 1977) or at market value, whichever is lower.

Treasury notes – at cost plus accumulated interest.

Non-negotiable Compulsory Loans – at cost plus interest and accumulated linkage differentials.

PARTICIPATION IN INTERNATIONAL FINANCIAL INSTITUTIONS:

The investment is included in the Balance Sheet at cost: the amounts paid are included according to exchange rates in force at the time of payment, the other amounts at their value in foreign currency on the date of the Balance Sheet.

In previous years, the investment was recorded in the Balance Sheet at cost in foreign currency, converted according to the exchange rate on the date of the Balance Sheet. As a result of the change in recording methods, the amount invested decreased, and with it the net profit for 1977, to the amount of IL 114,240 thousand (of which IL 49,861 thousand refers to previous years).

2. GOLD, FOREIGN CURRENCY AND SECURITIES IN FOREIGN CURRENCY

This item includes Special Drawing Rights (SDR) in the International Monetary Fund amounting to IL 415,450 thousand (on 31 December 1976, IL 87, 939 thousand).

3. CREDIT TO THE GOVERNMENT

"Long-term liabilities" include the amount of IL 13,003,782 thousand linked to 50 percent of the increase in the exchange rate of the U.S. dollar (on 31 December 1976: IL 10,303,782 thousand), and "temporary advances" include the amount of IL 508,102 thousand in U.S. dollars.

4. LOANS AND NOTES, AND DEPOSITS OF BANKING INSTITUTIONS

Balances in deposits for financing the export of banking institutions, which reflect obligatory deposits against foreign currency credit, are included in deposits of the banking institutions. On 31 December 1976 these balances were presented as deductions from credit. Data in this report have been reclassified.

5. SECURITIES

This item includes government bonds, which are mostly linked to the Consumer Price Index. The amount presented in the Balance Sheet includes Treasury notes amounting to IL 206,570 thousand (in 31 December 1976: IL 210,433 thousand), and non-negotiable compulsory loans amounting to IL 29,405 thousand (on 31 December, 1976, IL 15,717 thousand).

6. OTHER ACCOUNTS (ASSETS):

This item includes, inter alia:

Investments in international financial institutions amounting to IL 214,629 thousand. In previous years, the part paid was included in the item "other assets in foreign currency", and the balance of the amount in the item "guarantees given and documentary credit".

Income accumulated but not yet received, to the amount of IL 1,001,380 thousand (on 31 December 1976: IL 627,804 thousand).

7. BANKNOTES AND COINS IN CIRCULATION

The amount presented in the Balance Sheet includes commemorative medals and special medals at a nominal value of IL 48,558 thousand (on 31 December 1976: IL 13,662 thousand), where the value of the metal is higher than the nominal value. The amount represented by the nominal value of gold commemorative medals is recorded as mentioned, as income.

8. LIABILITY TO THE INTERNATIONAL MONETARY FUND

This item reflects total liabilities to the International Monetary Fund amounting to IL 3,871,821 (on 31 December 1976: IL 2,105,011), after deducting the amount of the quota in the Fund amounting to IL 2,431,662 (on 31 December, 1976: IL 1,322,006).

Total liability, to the Fund is broken down as follows:

	31 December 1977 (IL thousand)	31 December 1976 (IL thousand)
Drawings of credit tranches	1,440,159	783,005
Drawing of gold tranche	607,916	330,502
Liabilities in respect of the balance of the quota	1,823,746	991,504
TOTAL	3,871,821	2,105,011

Corresponding figures which have been presented otherwise in the Balance Sheet, of 31 December 1976 have been re-classified.

9. OTHER LIABILITIES

This item reflects the liability, to international financial institutions, which amounts to IL 192,606 thousand. On 31 December 1976, the portion deposited in their current account was included in this item, and the balance of the amount in the item "liabilities for guarantees given and documentary credit".

10. FOREIGN CURRENCY DEPOSITS OF ISRAELI BANKING INSTITUTIONS

Items in this group are presented after reclassification; on 31 December 1976 they were presented as foreign currency deposits and deposits expressed as foreign currency of banking institutions. The item "non-resident deposits" in this group reflects most of the "deposits" against free deposits" as defined in No. 10 to the Balance Sheet of 31 December 1976.

11 OTHER DEPOSITS

Includes the deposit of "the Binational U.S. - Israeli Science Fund, to the amount of IL 252,000 thousand (on 31 December 1976: IL 252,000 thousand) and deposits of the Binational U.S. - Israeli Fund for Industrial Research and Development - a deposit amounting to IL 253,541 thousand and a deposit in U.S. dollars equal to IL 518,224 thousand. In previous years the deposit of the Binational Science Fund was included in the item "Other accounts". Data for 1976 have been re-classified.

12. OTHER ACCOUNTS (LIABILITIES)

Includes expenditure accumulated and not yet paid, to the amount of IL 810,504 thousand (on 31 December 1976: IL 352,195 thousand) and income as yet unrealized to which the principle of simultaneous registration applies (see Main Accounting Policy), to the amount of IL 829,174 thousand (the corresponding amount on 31 December 1976: IL 367,001 thousand).

MEMBERS OF THE ADVISORY COMMITTEE ON MATTERS
RELATING TO BANKING BUSINESS
31 MAY 1978

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

BANK OF ISRAEL

THE GOVERNOR AND MEMBERS OF THE ADVISORY
COMMITTEE AND ADVISORY COUNCIL

31 MAY 1978

Governor

A. GAFNI

Advisory Committee

D. HOROWITZ, *Chairman*

CH. M. BASOK

A. EFRAT

E. I. JAPHET

J. LEVINSON

D. RECANATI (*observer*)

E. REINER

Z. SUSAYEFF

Advisory Council

D. HOROWITZ, *Chairman*

Y. BADER

H. BARKAI

CH. M. BASOK

A. BECKER

A. EFRAT

N. FEINGOLD

E. I. JAPHET

E. LEHMAN (*observer*)

J. LEVINSON

M. OLENIK

Z. ONN

E. OSTASHINSKY

D. RECANATI

E. REINER

Z. SUSAYEFF

MEMBERS OF THE COMMITTEE FOR THE PLANNING
OF BANKNOTES AND COINS

31 MAY 1978

A. WITKON, *Chairman*
M. ARAD
A. BIRAN
R. DAYAN
D. GAD
D. GANHOVSKY
G. KEICK
A. KINDLER
G. LEHRMAN
F. NAKHLA
Z. NARKISS
E. NAVI
D. REISINGER
S. ROSENFELD
Z. VILNAY
G. ZIFRONI