



April 1, 2014

Summary of the Monetary Committee discussion on March 18, 2014 regarding the management of the foreign exchange reserves

The Monetary Committee was presented with a Market Operations Department recommendation to approve a pilot investment of up to 1 percent of the reserves in corporate debt securities issued in the US, rated BBB– and above.

Background:

The desired strategic asset allocation for 2014 includes a corporate bond component, totaling 2–6 percent of the portfolio. According to the guidelines, up to 6 percent of the portfolio may be invested in corporate bonds. As corporate bonds are a new asset class in the reserves portfolio, the Market Operations Department examined the various aspects of investment in this asset class, and recommended that the Monetary Committee approve a pilot: to invest up to 1 percent of the reserves in corporate debt securities issued in the US, rated BBB– and above.

Although corporate bond spreads in the US narrowed in recent years, and reduced the attractiveness of this investment channel relative to the past, it is still desirable, in the opinion of the Market Operations Department, to include this component in the reserves portfolio, for several reasons:

- Corporate bonds are still expected to outperform Treasury bonds.
- The recovery in the US economy and the improvement in companies' balance sheets in the US are expected to support bankruptcy rates remaining at their low levels in the medium term.
- This allocation will increase the portfolio's diversification. In the past, a negative correlation has been observed between increased government bond yields and corporate bond spreads.

The pilot is intended to enable the Market Operations Department to set up the required infrastructure for investment in the instrument being discussed, to become familiar with it, and to acquire hands-on experience in managing it.

During the course of the discussion, various issues were raised related to the investment process, including: dealing with credit risk inherent in corporate bond investment, the timing of the current investment, choosing an investment benchmark, the preferred extent of active

management relative to the benchmark, and the possibility of investing through internal management besides external management.

Monetary Committee's Decision:

The Committee approved, by a majority of 4 out of 5 Committee members participating in the discussion, a pilot investment of up to 1 percent of the total reserves in corporate bonds issued in the US, rated investment grade BBB– and higher, following the necessary preparations. One Committee member supported the decision in principle but had reservations over the timing: He claimed that the appropriate timing for an investment in the instrument being discussed was with the end of the tapering process in the US.

Participants:

Members of the Monetary Committee

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

Dr. Nadine Baudot-Trajtenberg, Deputy Governor

Prof. Alex Cukierman

Prof. Reuben Gronau

Prof. Rafi Melnick

Other participants

Andrew Abir, Director of Market Operations Department

Tal Biber, Head of Markets Division in Market Operations Department

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

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

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

Amir Veler, Economist in Bank of Israel Representative Office in New York

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

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

Marc Nulman, Economist in Strategic Management Unit

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

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