

Chapter 1

Developments in the Activity of Israel's Banking System in 2006

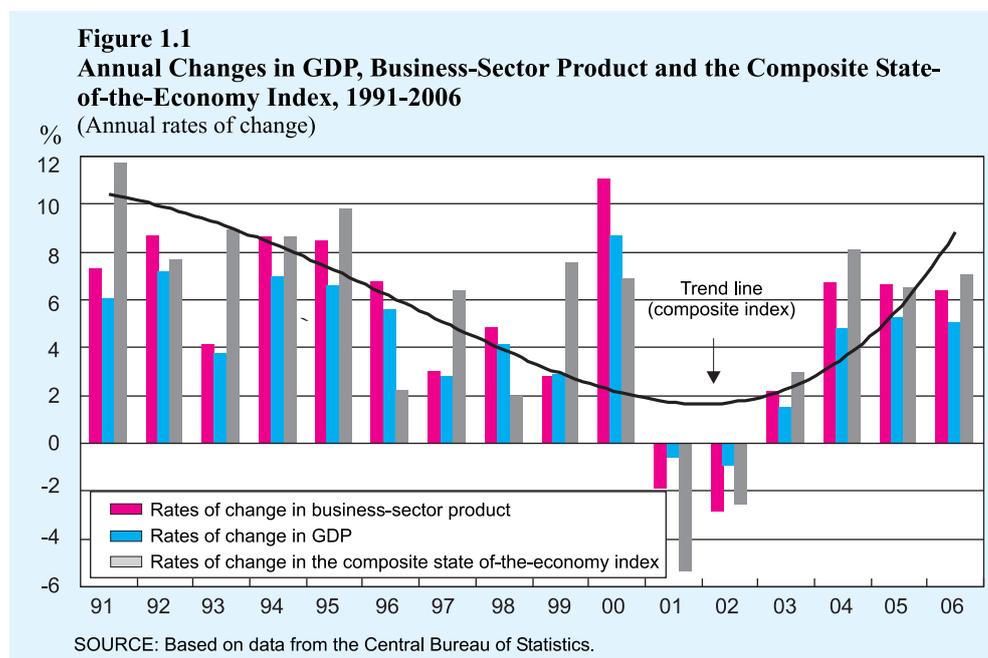
In 2006 Israel's domestic economic activity and the capital market continued to grow, against the background of the uninterrupted boom in the global economy.

The disintermediation in classic banking continued, as could be seen in two areas: (1) Bank credit to businesses fell, as a result of the expansion of nonbank alternative sources of credit to this sector—a change that increased the threat of competition to the banks. (On the other hand, retail bank credit to households increased.) (2) The share of the public's total financial assets handled by the banks fell, as the mix in the public's asset portfolio changed, expressed by the transfer of bank deposits to the capital market and to nonbank financial institutions. The banks, for their part, acted to expand their activity in Israel and abroad, so as to extend their sources of profit and to spread their risks. This was reflected in Israel in increased activity by their credit card companies, and in a rise in their investments in the capital market (in underwriting and management); abroad it was reflected by a widening of the extent of the banking groups' activities. Although there was a small reduction in Herfindahl-Hirschman (H) Index of concentration in the banking system in 2006, it remains higher than in most of the advanced countries.

1. MACROECONOMIC DEVELOPMENTS IN ISRAEL'S ECONOMY

Economic activity continued expanding throughout the year, extending the trend that started three years ago, following the deep recession of 2001 and 2002. The recovery persisted, even though the rate of growth slowed in the third quarter of 2006, due to the Second Lebanon War.¹ Domestic economic activity in 2006 benefited from the continued

¹ From 12 July 2006 to 14 August 2006.



improvement in the global economy,² reflected by the 4.9 percent increase in goods and services exports, and the 3.3 percent increase in their imports. Domestic demand also rose: on the retail side, private consumption increased by 4.8 percent, while on the business side gross domestic investment went up by some 4.2 percent. The outcome of the above was that GDP increased by 5.1 percent, and business sector product by 6.4 percent, and the composite state-of-the-economy index rose by 7.1 percent (Figure 1.1). The high rates of growth were reflected in the labor market too: the average rate of unemployment fell from 9.0 percent in December 2005 to 8.4 percent in December 2006;³ the average real wage per employee post rose by 3.4 percent, to settle at about NIS 7,500 a month (Figure 1.2). The sustained improvement in the macroeconomic environment in which Israel's banking system operates was accompanied by a boom in the capital market: in 2006 share prices rose for the fourth year in succession, and the leading share indices—the Tel Aviv 25 and the Tel Aviv 100—went up by 15 percent and 12 percent respectively (Figure 1.3). Average daily share trading volume in 2006 was about NIS 1.5 billion, its highest level in the last ten years, and 45 percent higher

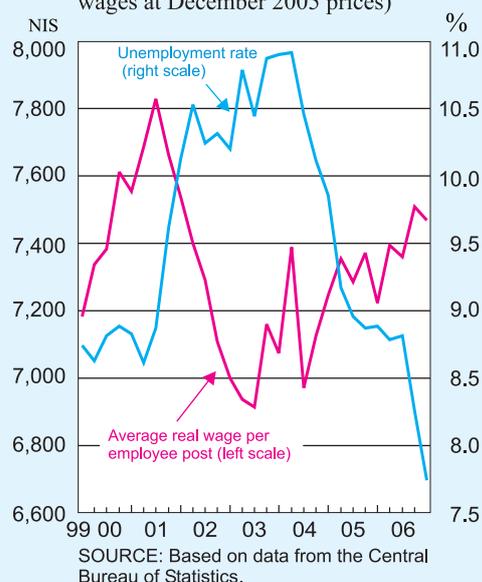
² The global growth rate in 2006 was about 5.4 percent; the US rate, about 3.3 percent; and the eurozone rate, about 2.6 percent.

³ This occurred at the same time as the participation rate in the labor force rose to a peak of 55.6 percent.

than in 2005. This reflects both the development of the capital market⁴ and its high level of liquidity, which derived from the greater involvement of foreign and institutional investors (pension funds, provident funds and insurance companies) in the capital market. The daily trading volume in government bonds (both CPI-indexed, of the Galil type, and unindexed, of the Shahar type), *makam* (short-term bills issued by the Bank of Israel) and corporate bonds of public corporations rose steeply (by 20 percent from 2005 to 2006), to a daily average of NIS 1.6 billion. Trade in corporate bonds average some NIS 217 million a day, 23 percent more than in 2005, a rise explained in part by the continued decline in the government's domestic borrowing,⁵ and an increase in issues and allocations by the business sector, which came to NIS 42 billion⁶ (Figure 1.4). The high degree of financial stability and low real interest rates enabled trade and companies' bond issues in the primary and secondary markets to expand—a process that reflected the rapid increase in nonbank alternative sources of credit. Capital market activity indirectly helped boost the banks' income, via operating profit (a rise of 2.5 percent in income from capital market activity) and by interest income derived from banks' direct investment in the capital market (mainly from holding bonds, see Table 1.1).

Figure 1.2
Major Developments in the Labor Market - Unemployment and Average Real Wage per Employee Post, December 1999 to December 2006

(Quarterly data, seasonally adjusted, wages at December 2005 prices)



⁴ The number of companies registered for trading on the Tel Aviv Stock Exchange (TASE) increased from 584 at the end of 2005 to 605 at the end of 2006. Forty-four new and dual-listed companies (whose shares are traded both on the TASE and in a stock exchange abroad) were registered, ten were delisted because of takeover offers, noncompliance with the maintenance rules or other reasons. Thirty-seven companies raised a total of NIS 3.4 billion by share issues. Source: TASE Annual Review, 2006.

⁵ Government net issues on the domestic capital market continued to fall for the year in succession. Gross government borrowing in 2006 totaled about NIS 29 billion, whereas its net borrowing was only NIS 2 billion, its lowest level since 2000.

⁶ Twenty-four companies raised a total of NIS 2.4 billion via bonds issues, more than twice the amount raised in 2005.

Table 1.1
The Securities Portfolios of the Major Banking Groups, 2005-06

	Hapoalim						Leumi						Discount			
	2005		2006		2005		2006		2005		2006		2005		2006	
	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)
Bonds held to maturity	56	0.17	111	0.25	3,577	0.07	2,441	5.26	5,761	13.67	4,750	12.22				
Government bonds	349	1.03	2,996	6.74	120	0.25	125	0.27	23	0.05	40	0.10				
Other bonds	405	1.20	3,107	6.99	3,697	7.72	2,566	5.53	5,784	13.73	4,790	12.32				
Total bonds held to maturity																
Securities available for sale	13,385	39.59	14,015	31.53	20,117	42.01	16,963	36.55	27,856	66.11	25,516	65.63				
Government bonds	15,265	45.15	22,559	50.74	15,308	31.97	15,688	33.80	4,761	11.30	4,316	11.10				
Other bonds	28,650	84.73	36,574	82.27	35,425	73.98	32,651	70.35	32,617	77.40	29,832	76.73				
Total shares available for sale	1,381	4.08	1,827	4.11	1,660	3.47	4,199	9.05	1,060	2.52	1,193	3.07				
Total securities available for sale																
Total securities available for sale	30,031	88.82	38,401	86.38	37,085	77.44	36,850	79.40	33,677	79.92	31,025	79.80				
Tradable securities	3,069	9.08	2,853	6.42	4,977	10.39	4,880	10.51	2,166	5.14	2,580	6.64				
Government bonds	221	0.65	59	0.13	1,828	3.82	2,084	4.49	509	1.21	471	1.21				
Other bonds	3,290	9.73	2,912	6.55	6,805	14.21	6,964	15.00	2,675	6.35	3,051	7.85				
Total tradable bonds	86	0.25	36	0.08	300	0.63	33	0.07	3	0.01	14	0.04				
Total tradable shares	3,376	9.98	2,948	6.63	7,105	14.84	6,997	15.08	2,678	6.36	3,065	7.88				
Total tradable securities	16,510	49	16,979	38	28,671	52	24,284	52	35,783	85	32,846	84				
Total government bonds	17,302	51	27,477	62	19,216	40	22,129	48	6,356	15	6,034	16				
Total other bonds	33,812	100	44,456	100	47,887	100	46,413	100	42,139	100	38,880	100				
Total securities																

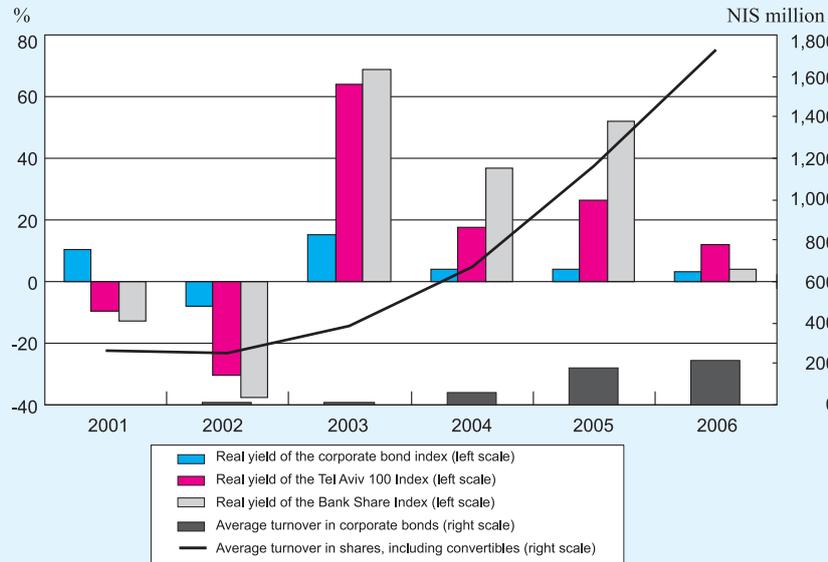
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Table 1.1 (Cont'd)
The Securities Portfolios of the Major Banking Groups, 2005-06

	Mizrahi-Tefahot				First International				Total of Five Banking Groups			
	2005		2006		2005		2006		2005		2006	
	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)	Fair value (NIS million)	Distribution (percent)
Bonds held to maturity	0	0.00	0	0.00	0	0.00	0	0.00	9,394	6.36	7,302	4.67
Government bonds	151	2.30	153	2.56	1,012	5.88	1,032	4.97	1,655	1.12	4,346	2.78
Total bonds held to maturity	151	2.30	153	2.56	1,012	5.88	1,032	4.97	11,049	7.48	11,648	7.44
Securities available for sale	4,560	69.40	3,074	51.41	7,809	45.36	7,844	37.81	73,727	49.94	67,412	43.08
Government bonds	1,492	22.71	2,318	38.77	5,462	31.73	8,538	41.16	42,288	28.65	53,419	34.14
Other bonds	6,052	92.10	5,392	90.18	13,271	77.09	16,382	78.97	116,015	78.59	120,831	77.22
Total bonds available for sale	367	5.59	404	6.76	636	3.69	920	4.44	5,104	3.46	8,543	5.46
Total shares available for sale												
Total securities available for sale	6,419	97.69	5,796	96.94	13,907	80.79	17,302	83.41	121,119	82.05	129,374	82.68
Tradable securities	0	0.00	29	0.49	2,216	12.87	2,067	9.96	12,428	8.42	12,409	7.93
Government bonds	1	0.02	1	0.02	58	0.34	325	1.57	2,617	1.77	2,940	1.88
Other bonds	1	0.02	30	0.50	2,274	13.21	2,392	11.53	15,045	10.19	15,349	9.81
Total tradable bonds	0	0.00	0	0.00	21	0.12	18	0.09	410	0.28	101	0.06
Total tradable securities	1	0.02	30	0.50	2,295	13.33	2,410	11.62	15,455	10.47	15,450	9.87
Total government bonds	4,560	69	3,103	52	10,025	58	9,911	48	95,549	65	87,123	56
Total other bonds	2,011	31	2,876	48	7,189	42	10,833	52	52,074	35	69,349	44
Total securities	6,571	100	5,979	100	17,214	100	20,744	100	147,623	100	156,472	100

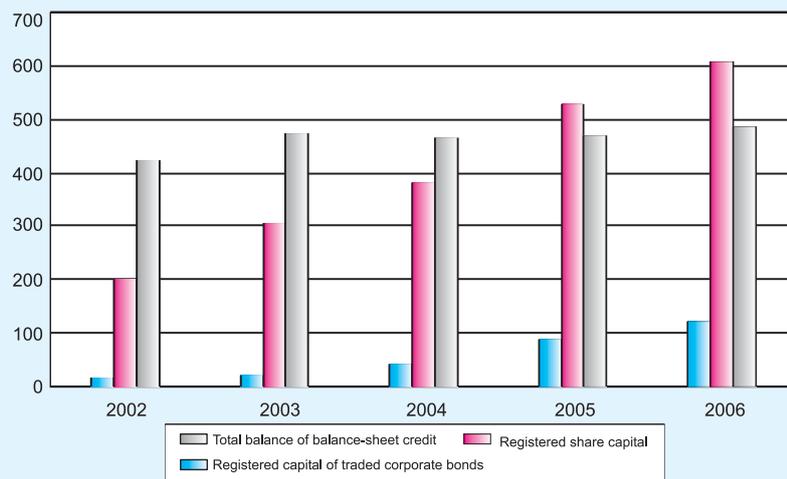
SOURCE: Published financial reports.

Figure 1.3
Real Annual Yield of the Tel Aviv 100 Index, the Bank Share Index,
the General Bond Price Index and Average Daily Turnover in Shares
and Corporate Bonds, 2001-06



SOURCE: Based on data from the Tel Aviv Stock Exchange.

Figure 1.4
Registered Capital for Trading of Bonds and Shares Traded on the Tel Aviv
Stock Exchange, and Balance of Bank Credit,^a 2002-06
 (NIS billion)



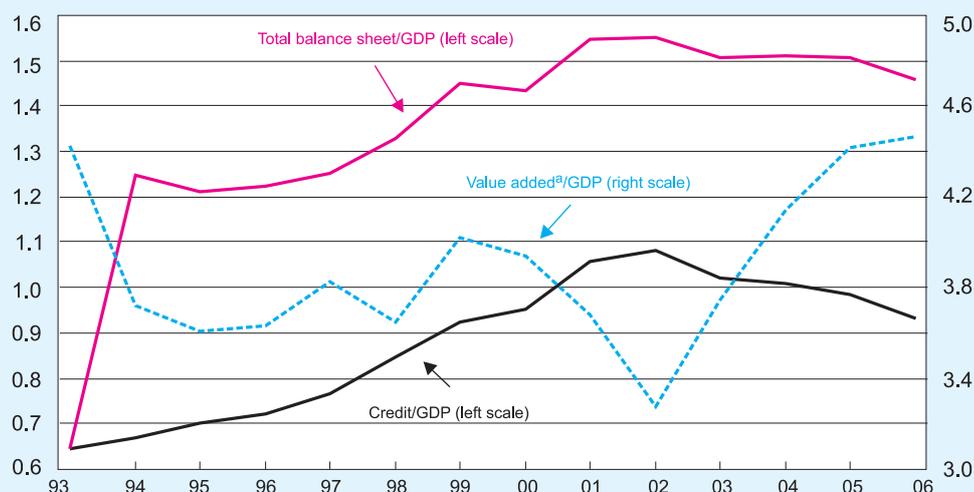
^a The balance of balance-sheet credit for 2003 and 2004 includes Mishkan and Tefahot banks.

SOURCE: Based on data of the Tel Aviv Stock Exchange and published financial statements.

2. MAIN DEVELOPMENTS IN THE INDICES OF BANKING ACTIVITY

The index of banking activity, that is the ratio of added value⁷ to GDP, continued along the upward trend that started in 2002 (Figure 1.5), and came close to the average ratio in the advanced economies (Figure 1.6). Ordinary income did not change to any significant extent, but the rise of some 16 percent in salaries and related expenses⁸ and of about 6 percent in maintenance and depreciation of buildings and equipment resulted in the improvement in the ratio of added value to GDP. Nevertheless, the ratio of bank credit to GDP has been falling since 2002, as a result of the evolution of a market offering alternatives to bank credit. The ratio of bank credit to GDP is an indicator of the quality of bank credit, as GDP is the major source of credit repayment.⁹ That ratio continued falling in 2006, indicating an improvement in customers' repayment ability (see Chapter 3, Risks and Capital Adequacy).

Figure 1.5
Indices of Banking Activity of the Five Major Banking Groups Relative to GDP, 1993-2006
(Percent)



^a Value added is the sum of net ordinary before-tax income, salaries and related expenses, general expenses, maintenance and depreciation on buildings and equipment.

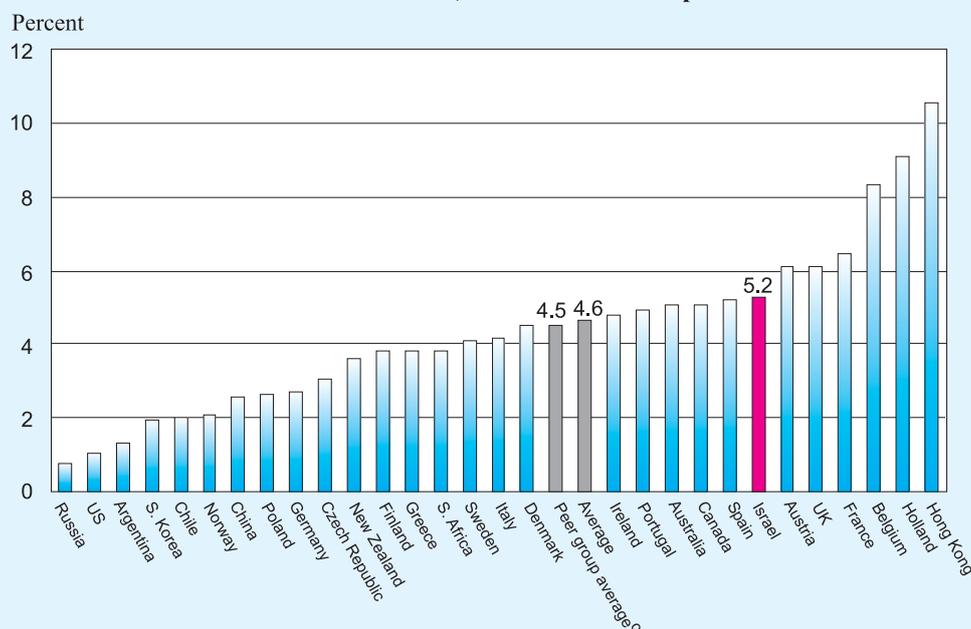
SOURCE: Based on published financial statements and data from the Central Bureau of Statistics.

⁷ Value added is calculated as total ordinary before-tax net income plus salaries and related expenses, general expenses, and expenses of maintenance and depreciation on buildings and equipment.

⁸ See Chapter 2.

⁹ See Chapter 3.

Figure 1.6
Value Added^a as Share of GDP 2006, International Comparison^b



^a Value added is the sum of net ordinary before-tax income, salaries and related expenses, general expenses, maintenance and depreciation on buildings and equipment.

^b In each country the optimal number of banking groups was chosen, as a function of the structure and size of the banking sector. In general, values were based on the 10 largest banking groups, except for: the US, which was based on the 50 largest banking groups; Chile, Portugal, and South Korea, on the seven largest banking groups; Israel, South Africa, Finland, Belgium and the Czech Republic, on the five largest banking groups; and New Zealand, on the four largest banking groups.

^c Israel's peer group consists of eight similar countries in terms of size of GDP and banking system: Belgium, Denmark, Ireland, Greece, Norway, Portugal, Finland and South Africa.

SOURCE: Based on data from Bankscope, and the IFS database of the International Monetary Fund.

3. THE STRUCTURE OF THE BANKING SYSTEM AND ACTIVITY OF THE BANKING GROUPS

Israel's banking system comprises five banking groups, two independent banks, and four branches of foreign banks¹⁰ (Figure 1.7 and Table 1.2). In addition to classic banking intermediation activity, which focuses on commercial banking in Israel and abroad (together with mortgage activity, most of which is currently handled by the commercial banks), the large banking corporations also operate, via subsidiaries, in areas that complement their commercial banking activities. This in effect enables them to engage in universal banking, with activities in credit cards, the capital market (brokerage services

¹⁰ At the end of 2006 a branch of BNP Paribas Bank opened, and in March 2007 a branch of the State Bank of India. These two joined the two branches of foreign banks already operating in Israel, those of Citibank and HSBC.

for customers in securities and financial assets), security custodian services, portfolio management for customers, underwriting and distribution, and issuing securities. The banks also have holdings in real companies (companies included on an equity basis) and in insurance companies via share holdings.¹¹ The enactment of the Law for Increasing Competition and Reducing Concentration and Conflicts of Interest in the Israeli Capital Market, 5765–2005 (the so-called Bachar law) in August 2005 led to a change in the mix of the banking system's activities. The Law required the banks to sell their holdings in provident and mutual funds¹² and to withdraw from their management. At the same time they started preparing themselves to operate, and started operating, in the filed of pension consultation.¹³

a. Main developments in banks' balance-sheet activities

The total balance sheet of the five banking groups, which accounts for 95 percent of the assets of the entire banking system, rose by 3.9 percent in 2006, and stood at NIS 911.9 billion. The degree of concentration in the banking system, as measured by the Herfindahl-Hirschman (H) Index, declined slightly from 0.228 in 2005 to 0.223 in 2006. This small change resulted from the rise in the share of the First International Bank in the total assets of the banking system, the outcome of the purchase by the First International Bank of Otsar Hahayal Bank from Bank Hapoalim in the course of the year¹⁴ (Figure 1.7). The level of concentration in Israel's banking system, however, remains higher than that in most advanced economies.¹⁵ The main items on the consolidated balance sheet of the five banking groups that showed changes in 2006 are given below.

On the liabilities side, total deposits of the public increased by 3.7 percent. The main increase came from the 7.7 percent increase in deposits in the unindexed segment, against the background of the continued lowering of the degree of uncertainty regarding inflation (Table 1.3 and Figure 1.8), which had the effect of reducing the balance of CPI-indexed deposits by about 9 percent (Table 1.3). In the foreign currency segment, too, the balance of foreign-currency denominated or indexed deposits increased, by

¹¹ Ownership of these entities is restricted to 20 percent of the banking corporation's equity and to 20 percent of the means of control of a company it has bought, and the bank cannot manage these companies.

¹² For a fuller discussion of this issue see the 2005 Survey of Israel's Banking System.

¹³ At the time of writing this Survey, Union Bank of Israel was the only bank that had been granted a licence to offer pension advice in the filed of pension funds and provident funds and to a limited degree also in insurance. (At this stage the bank can only offer advice to independent customers.)

¹⁴ In May 1993 the government decided to change the structure of the banking system: Bank Hapoalim was required to sell its entire holding in Otsar Hahayal bank to any other banking corporation except Bank Leumi.

¹⁵ For a fuller, detailed description of the H-Index see the 2003 Annual Survey of Israel's Banking System, Chapter 2—The Structure of the Banking System in Israel and Competition, From a Long-Term Perspective, and the discussion paper by David Ruthenberg "Competition in the Banking System: Theoretical Aspects and Empirical Evidence from Israel and Abroad," Working Paper No. 05.02 of the Banking Supervision Department Research Unit, May 2005 (in Hebrew).

Table 1.2
Israel's Banking System
Main Data from the Financial Statements of the Banking Institutions, December 2006

	Number of branches ^a	Total assets (NIS billion)	Share of total banking system assets (%)	Balance of credit to the public ^b (NIS billion)	Share of total banking system credit (%)	Total deposits of the public (NIS billion)	Share of total banking system deposits (%)
Hapoalim group^c	288	282.9	29.2	186.5	28.8	217.0	28.4
Bank Hapoalim	259	260.2		168.4		210.9	
Bank Yahav	16	8.6		1.7		8.1	
Bank Massad	13	3.1		1.6		2.8	
Bank Leumi group^d	229	289.3	29.9	183.8	28.4	231.8	30.3
Bank Leumi Le-Israel	195	241.1		125.5		200.1	
Arab Israel Bank	24	3.9		2.2		3.0	
Leumi Mortgage Bank	10	33.3		33.0		8.2	
Mortgage banks	195	162.5	16.8	90.2	13.9	130.5	17.1
Discount Bank group^e	125	107.0		51.5		84.7	
Israel Discount Bank	66	17.3		12.6		14.5	
Mercantile Discount Bank	4	10.5		9.9		1.5	
Discount Mortgage Bank	107	90.7	9.4	70.1	10.8	73.2	9.6
Mortgage banks	98	89.5		66.0		73.4	
United Mizrahi Bank	9	3.8		3.7		1.7	
Adanim Mortgage Bank							
First International Bank group^g	132	86.5	8.9	80.0	12.3	72.2	9.4
The First International Bank of Israel	80	65.8		52.2		53.9	
Bank Otsar Hahayal ^h	36	11.2		7.9		9.0	
Poalei Agudat Israel Bank	14	2.9		14.0		2.3	
UBank ⁱ	2	7.0		1.6		6.1	

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Table 1.2 (Cont'd)
Israel's Banking System
Main Data from the Financial Statements of the Banking Institutions, December 2006

	Number of branches ^a	Total assets	Share of total banking system assets	Balance of credit to the public ^b	Share of total banking system credit	Total deposits of the public	Share of total banking system deposits
Union Bank	31	29.1	3.0	18.4	2.8	25.3	3.3
Industrial Development Bank^c	1	7.5	0.8	6.5	1.0	0.7	0.1
Bank of Jerusalem	17	8.2	0.8	6.4	1.0	6.7	0.9
Otzar Hashilton Hamkomi	1	3.9	0.4	3.0	0.5	2.7	0.4
Foreign banks^k	2	7.3	0.8	3.3	0.5	4.2	0.5
Citibank	1	4.8		1.8		2.0	
HSBC	1	2.5		1.5		2.2	
Total	1003	968.0	100	648.2	100	764.5	100

^a Includes the branches where activity takes place.

^b Credit given in Israel and abroad.

^c This group also includes banking subsidiaries abroad: Bank Hapoalim (Switzerland), Bank Hapoalim (Luxembourg), Hapoalim (Latin America), and Bank Hapoalim (Cayman Islands), Bank Pozitif.

^d This group also includes banking subsidiaries abroad: Bank Leumi USA, Bank Leumi (UK), Bank Leumi Switzerland, Bank Leumi Luxembourg, Bank Leumi Romania, and Leumi International Investments.

^e This group also includes banking subsidiaries abroad: Discount Bankcorp (a banking holding company), Israel Discount Bank of New York, Discount Bank (Latin America), and Israel Discount Bank (Switzerland).

^f The United Mizrahi Bank changed its name to Mizrahi-Tefahot Bank in November 2005.

^g This group also includes banking subsidiaries abroad: FIBI Bank (UK) in London and FIBI Bank (Switzerland) in Zurich.

^h On August 17, 2006, Bank Hapoalim completed the purchase of this bank.

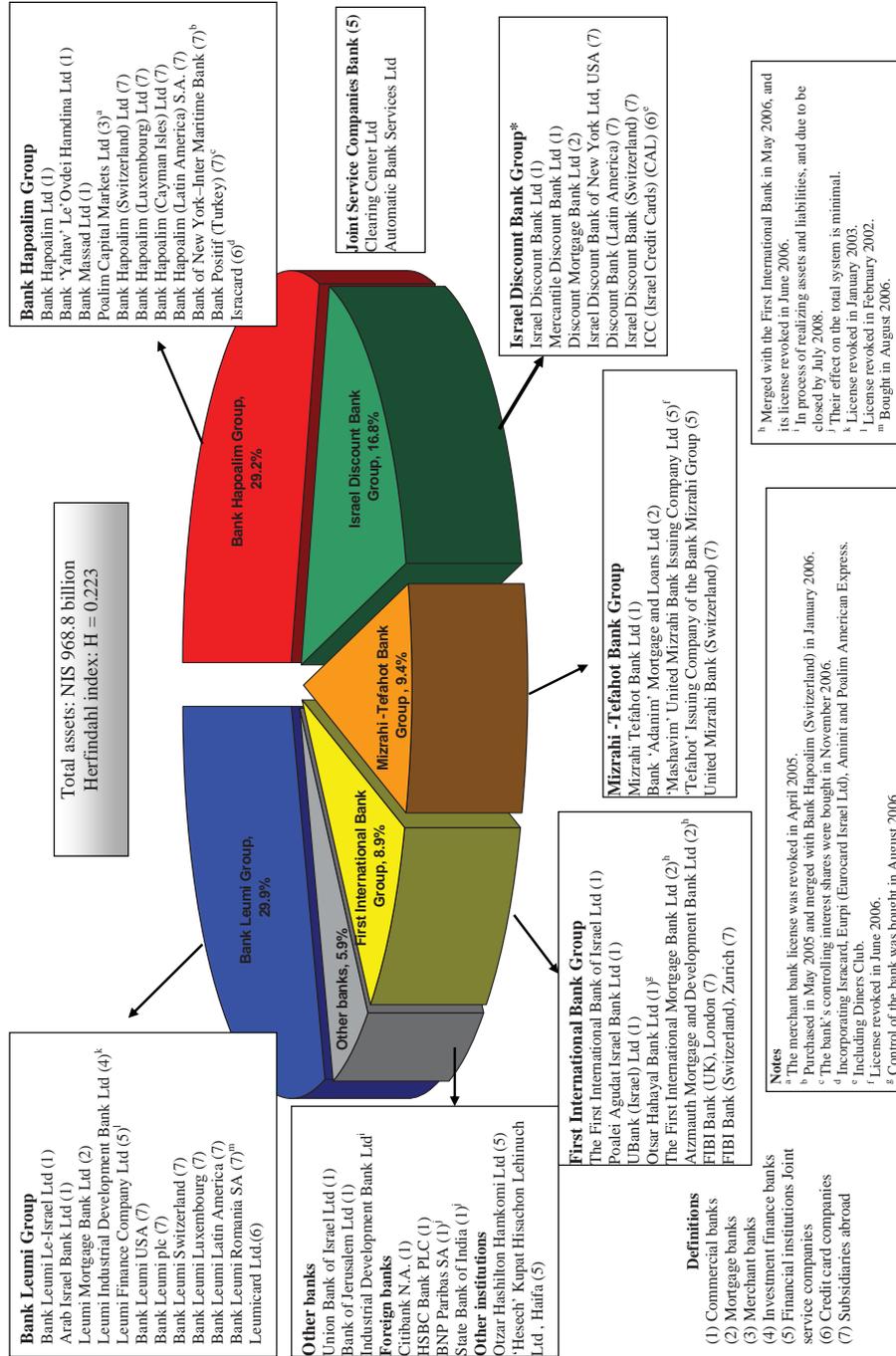
ⁱ In December 2004 control of this bank was bought by the First International Bank. Until March 2005 the bank was called Investec (Israel) Bank.

^j Scheduled to be closed on 31 July 2008.

^k During 2007, the foreign banks BNP Paribas and State Bank of India (SBI) intend to begin operations in Israel.

SOURCE: Published financial statements and reports to the Supervisor of Banks.

Figure 1.7



4.1 percent, apparently related to the rise in the dollar Libor and Fed funds interest rates (Figure 1.9). The banks also expanded their marketing of structured products,¹⁶ which are most common in the foreign currency segment. The equity of the five banking groups rose by 12 percent, mainly due to the increase in their accrued annual net income.

The main item in the banks' assets is credit to the public, which constitutes about 64 percent of the total assets of the five banking groups. Outstanding balance-sheet credit at the end of 2006 totaled NIS 582.7 billion, up from NIS 573.3 billion at the end of 2005, a rise of only 1.6 percent. This minimal increase was the outcome of equilibrium between the public's demand for bank credit and the supply of bank credit. The aggregate demand for bank credit was positively affected by the continued expansion of activity by businesses together with an increase in the income and wealth of the customers of the retail banking sector (households) (the income effect). On the other hand the substitution effect grew stronger in 2006, reducing the public's demand for bank credit, with the rise in substitutes for bank business credit¹⁷ (Figure 1.10), and the increase in the competitive threat¹⁸ to the banking system from nonbank intermediation institutions. It thus turns out that most of the business sector's credit requirements were met by nonbank sources, which reduced the sector's indebtedness to the banks and diversified their sources of finance.

Figure 1.8
Standard Deviation^a of Inflation Expectations^b for the Year, December 1996 to December 2006



^a Standard deviation was calculated at each point in time on the basis of 24 monthly observations.

^b According to data from the Monetary Department of the Bank of Israel.

SOURCE: Based on Bank of Israel data.

¹⁶ An investment that offers the customer the chance of obtaining a relatively high return against a risk of making a loss because of a cut in the bank interest rate, generally without risking the deposited principal. The rate of return on the deposit generally depends on the exchange rate, interest rates or a shares index or a basket of shares.

¹⁷ Until 2006 public companies and large private entities, who typically represent low credit risk (most of them with a credit rating between A and AAA) were the main beneficiaries of the spread of Non-bank alternative sources of credit. This year, however, capital was raised by issues of corporate bonds also by firms with relatively low credit ratings.

¹⁸ Institutional investors' investment in corporate bonds (tradable and nontradable) as a share of their total investments in the years from 2003 to 2005 was as follows: in the old and new pension funds, from 2.3 percent at the end of 2003 to 9.6 percent at the end of 2005; in profit-sharing policies, from 16.4 percent at end-2003 to 26.1 at end-2005; in provident funds, from 17.2 percent at end-2003 to 28.2 percent at end-2005.

Table 1.3
The Consolidated Balance Sheet of the Five Major Banking Groups, 2003-06

	Balance at the end of year					Distribution		Average quarterly balance at current prices		Annual rate of change in the balance at the end of year from 2005 to 2006
	2003	2004	2005	2006	2004	2005	2006	2005	2006	
Assets								(NIS million)		percent
Cash and Deposits in banks	95,099	102,263	118,226	133,726	12.6	13.5	14.7	112,157	125,081	13.1
<i>of which:</i>										
Cash ^b	45,379	31,038	23,171	20,980	3.8	2.6	2.3			-9.5
Deposits in commercial banks	43,634	66,135	91,335	109,181	8.1	10.4	12.0			19.5
Securities	117,539	135,004	147,615	156,467	16.6	16.8	17.2	138,451	154,286	6.0
Credit to the public ^c	535,202	536,236	573,342	582,745	66.0	65.3	63.9	546,759	564,094	1.6
<i>of which:</i>										
Unindexed local currency	167,742	182,345	223,144	250,041	34.0	38.9	42.9	197,814	221,803	12.1
CPI-indexed local currency	177,057	167,403	174,499	166,848	31.2	30.4	28.6	170,345	170,893	-4.4
In or indexed to foreign currency	190,317	186,290	175,203	164,875	34.7	30.6	28.3	178,000	170,617	-5.9
<i>of which: In dollars</i>	143,962	138,552	132,824	116,051	25.8	23.2	19.9	134,961	123,494	-12.6
Non-financial items	86	198	496	981	0.0	0.1	0.2	599	781	97.8
Credit to the government	4,684	3,301	2,441	2,043	0.4	0.3	0.2	2,791	2,032	-16.3
Investment in subsidiary and affiliated companies	3,561	4,000	4,364	3,933	0.5	0.5	0.4	4,223	3,870	-9.9
Buildings and equipment	10,117	10,243	10,805	11,700	1.3	1.2	1.3	10,475	11,319	8.3
Other assets	22,918	21,096	20,667	21,378	2.6	2.4	2.3	20,113	22,733	3.4
Total assets	789,120	812,143	877,460	911,992	100.0	100.0	100.0	834,968	883,415	3.9

(cont'd)

Table 1.3 (Cont'd)
The Consolidated Balance Sheet of the Five Major Banking Groups, 2003-06

	Balance at the end of year					Distribution (percent)		Average quarterly balance at current prices		Annual rate of change in the balance at the end of year from 2005 to 2006 percent
	2003	2004	2005	2006	2004	2005	2006	2005	2006	
	(NIS million)					(percent)		(NIS million)		
Liabilities and capital										
Deposits of the public	649,303	666,635	698,936	724,818	82.1	79.7	79.5	675,206	714,724	3.7
<i>of which:</i>										
Unindexed local currency	257,143	271,204	284,267	306,120	40.7	40.7	42.2	274,601	290,174	7.7
CPI-indexed local currency	131,977	115,894	106,977	97,615	17.4	15.3	13.5	109,517	102,332	-8.8
In or indexed to foreign currency	260,052	279,133	306,932	319,649	41.9	43.9	44.1	290,286	321,077	4.1
<i>of which: In dollars</i>	203,496	214,194	239,140	246,946	32.1	34.2	34.1	223,813	248,932	3.3
Deposits from banks	21,522	21,562	21,014	25,100	2.7	2.4	2.8	22,742	22,547	19.4
Government deposits	9,890	8,987	6,981	6,230	1.1	0.8	0.7	7,484	6,213	-10.8
Bonds and subordinated notes	37,718	39,957	51,595	48,811	4.9	5.9	5.4	47,370	49,958	-5.4
Other liabilities	27,180	28,590	49,800	51,994	3.5	5.7	5.7	33,400	36,491	4.4
Total liabilities	745,613	765,731	828,326	856,953	94.3	94.4	94.0	786,202	829,934	3.5
Minority interests	1,711	2,027	1,322	1,549	0.2	0.2	0.2	1,382	1,353	17.2
Equity	41,796	44,385	47,812	53,490	5.5	5.4	5.9	47,384	52,129	11.9
Total liabilities and capital	789,120	812,143	877,460	911,992	100.0	100.0	100.0	834,968	883,415	3.9

^a In accordance with Accounting Standards 12 and 17 of the Israel Accounting Standards Board, inflation adjustment of the financial statement ceased on 1 January 2004; data for 2004 and thereafter are shown in current terms.

^b Including deposits with the central bank.

^c From 2006 and in accordance with directives from the Supervisor of Banks, liabilities in respect of credit cards, which were hereto registered as guarantees (off-balance sheet item), will be recorded as part of the balance-sheet credit to the public. The 2005 data were adjusted accordingly, though data for 2004 do not include the liabilities in respect of credit cards.

SOURCE: Published financial statements.

Table 1.4
Average Annual Yields on Selected Assets and Liabilities in the Various Segments, 2005 and 2006

	Annual average		2006				2005					
	2005	2006	I	II	III	IV	2005	2006	I	II	III	IV
	(Nominal rates of return)						(Expected real rates of return)					
Unindexed local-currency segment												
Demand deposits ^a	1.1	1.2	1.1	1.2	1.1	1.1	-1.0	-0.6	-0.8	-0.8	-0.7	-0.2
SRO deposits ^a	2.8	4.1	3.7	4.1	4.3	4.1	0.7	2.3	1.7	2.1	2.5	2.8
Resident time deposits ^a	3.3	4.3	4.0	4.4	4.5	4.4	1.1	2.5	2.0	2.3	2.7	3.1
Total unindexed deposits	3.0	4.0	3.6	4.0	4.1	4.1	0.9	2.1	1.6	2.0	2.3	2.7
Term credit ^a	6.0	7.4	6.9	7.5	7.8	7.5	3.8	5.6	4.9	5.3	5.9	6.1
Overdraft accounts and facilities ^a	9.7	11.0	10.9	11.4	10.9	10.7	7.4	9.0	8.8	9.2	8.9	9.2
Total unindexed credit	6.8	8.1	7.8	8.2	8.3	8.0	4.6	6.2	5.7	6.1	6.4	6.6
Makam ^b	3.8	5.8	4.5	5.6	6.0	7.0	1.6	3.9	2.5	3.5	4.1	5.6
Banks' deposits with Bank of Israel ^c	3.8	5.2	4.7	5.3	5.5	5.5	1.6	3.4	2.7	3.2	3.6	4.1
Total unindexed assets	6.1	7.2	6.9	7.3	7.5	7.3	3.9	5.4	4.8	5.2	5.6	5.9
CPI-indexed local-currency segment												
Savings plans ^d	1.9	2.9	2.7	2.8	3.1	2.8	1.9	2.9	2.7	2.8	3.1	2.8
Indexed bonds ^e	.	.	.	.	.	.	3.0	3.7	3.5	3.8	3.9	3.6
CPI-indexed credit ^f	.	.	.	.	.	.	4.7	5.3	5.4	4.9	5.6	5.3
Mortgages ^g	.	.	.	.	.	.	.	.	.	.	.	.

(cont'd)

Table 1.4 (Cont'd)
Average Annual Yields on Selected Assets and Liabilities in the Various Segments, 2005 and 2006

	Annual average		2006				Annual average				2006			
	2005	2006	I	II	III	IV	2005	2006	I	II	III	IV		
Foreign-currency-denominated and indexed credit														
Time deposits	0.5	1.0	0.8	1.0	1.0	1.0	0.2	-2.0	5.9	-0.2	-5.2	-8.5		
Foreign-currency-denominated deposits ^j	2.8	4.4	4.0	4.4	4.7	4.7	2.5	1.4	9.2	3.2	-1.8	-5.2		
Foreign-currency-indexed credit	5.6	7.3	6.8	6.9	8.3	7.3	5.4	4.2	12.2	5.6	1.6	-2.8		
Foreign-currency credit to residents	5.0	6.5	6.1	6.5	6.7	6.8	4.8	3.4	11.4	5.3	0.1	-3.2		
Deposits abroad ^k	3.4	5.1	4.6	5.1	5.3	5.2	3.2	2.0	9.9	3.9	-1.3	-4.6		
Annual rates of change														
CPI	2.4	-0.1	2.4	3.9	-3.0	-3.4								
NIS/\$ exchange rate	6.8	-8.2	5.5	-17.9	-11.9	-7.0								
Tel Aviv 100 index	29.4	12.0												
General bonds index	5.9	4.6												
General corporate bonds index	6.2	3.2												

^a Effective annual yields/costs, as reported by the seven major banking groups.

^b The market yield for two months on unindexed bonds.

^c Calculated as the effective annual rate of return received on depositing with the Bank of Israel. Balances used in the calculation are average balances in the period.

^d Average rate of interest on savings deposits.

^e Average gross yield to maturity of all CPI-indexed bonds (market rate).

^f Based on reports of cost of credit extended during the month.

^g Weighted average interest on mortgage loans from non-earmarked sources.

^h The data refer to dollar denominated credit and deposit items.

ⁱ Real interest calculated on the basis of the public's inflation expectations, derived from the capital market, and the expected exchange rate, calculated from the rate of actual depreciation over the previous twelve months.

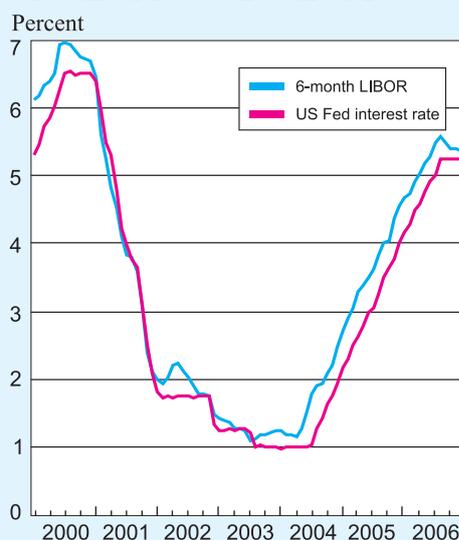
^j Including nonresidents' and residents' restitutions deposits.

^k 3-month Libor interest rate.

SOURCE: Based on the seven major banks' reports on costs and tariffs, reports to the Supervisor of the Banks and estimates from the Bank of Israel.

Thus the volume of stock exchange issues of capital in Israel and abroad increased very substantially, as did the substitution of direct debt to the public for debt to the banks. This can be seen clearly from the drop in the proportion of bank credit to the business sector in that sector's total credit¹⁹ over the last few years from 77 percent in 2001 to 56 percent at the end of 2006. The supply of bank credit rose as a result of the rise in capital adequacy (relative to excess capital) together with the reduction in borrowers' risk.²⁰ At the end of the process, as stated, there was a minimal increase in the balance of credit to the public. With regard to the distribution of credit by indexation base, it appears that the trends that started to become apparent in the last few years persisted in 2006. Thus the balance of unindexed credit increased while the balance of credit in the indexed segments (indexed to the CPI or to foreign currency) and credit in foreign currency declined (Figure 1.11). The substitution effect was probably reflected in the extent of nonbank long-term credit, which is normally associated with the indexed segment and in part with dollar credit. The main reason for the diversion of local currency credit from the indexed segment to the unindexed was the rise in the substitutes for bank business credit, chiefly the issue of CPI-indexed corporate bonds (Table 1.5). This took place concurrently with the reduction in domestic borrowing by the government²¹ and the lower level of uncertainty regarding inflation. Two developments acted to reduce outstanding credit in the foreign currency segment: (1) the lower shekel interest-rate environment over the last two years, and the contraction of the differential in the short-term interest rate between Israel and the US, that actually became a negative differential in December 2006 and that reached a

Figure 1.9
LIBOR^a Dollar 6-Month (Average Monthly) Interest, Against US Federal Reserve Board Interest Rate, December 1999 to December 2006



^a LIBOR - London Interbank Offered Rate; the average rate of interest that banks pay on deposits from other banks. Rates available for the five largest banks in the world of (UK, Japan, Germany, France and US).

SOURCE: Based on Bank of Israel data.

¹⁹ Total credit to the business sector includes loans and tradable bonds made available to the sector by the banks, institutional investors (insurance companies, provident funds and pension funds), nonresidents and households (via mutual funds).

²⁰ See Chapter 3 for a fuller discussion.

²¹ Total government issues on the domestic capital market declined again in 2006, for third year in succession. Total gross borrowing was NIS 29 billion, and net borrowing totaled only NIS 2 billion, the lowest since 2000.

Table 1.5
Changes in Bank Credit to the Business Sector and its Principal Non-Bank Substitutes, 1997-2006

	(NIS million, at current prices) ^a						Difference between changes in bank credit and its substitutes			
	Overall changes in bank credit and its substitutes	Funds from non-bank substitutes			Changes in credit from institutional investors ^f	Difference between changes in bank credit and its substitutes				
	Overall changes in bank credit and its substitutes	Changes in bank credit ^b	Overall funds from non-bank substitutes	Bond issues in Israel ^c	Share issues in Israel	Capital raised abroad ^d	Changes in direct credit from abroad ^e	Venture capital funds	Changes in credit from institutional investors ^f	Difference between changes in bank credit and its substitutes
1997	11,494	-6,663	18,157	1,546	8,256	6,895	3,160	1,730	-3,430	-24,820
1998	54,213	32,400	21,813	2,549	7,895	4,562	6,736	2,448	-2,377	10,587
1999	78,050	38,591	39,458	1,681	5,659	17,802	6,728	4,462	3,126	-867
2000	101,259	40,384	60,875	292	14,212	19,267	9,451	13,351	4,301	-20,491
2001	57,231	33,400	23,831	90	5,833	7,322	-250	8,708	2,129	9,569
2002	20,651	5,325	15,326	2,969	5,555	1,061	-104	5,289	555	-10,001
2003	10,397	-12,522	22,919	2,793	3,148	3,855	2,634	4,427	6,062	-35,441
2004	53,470	-8,987	62,457	12,551	8,251	11,341	13,219	6,268	10,826	-71,443
2005	70,440	10,458	59,982	14,169	10,994	4,876	9,384	6,154	14,404	-49,525
2006	97,205 ^g	-7,682	104,888	19,065	11,241	33,313 ^h	17,282	6,853	17,133	-112,570

^a In accordance with Accounting Standards 12 and 17 of the Israel Accounting Standards Board, inflation adjustment of the financial statement ceased on 1 January 2004; data for 2004 and thereafter are shown in current terms.

^b Credit to the public from the commercial banks (on a consolidated basis). Does not include credit to individuals and credit to borrowers for activity abroad. It is assumed that the change in credit balances reflects the flow of new credit granted.

^c Corporate bond issues and allocations by Tel Aviv Stock Exchange companies. From 2001 all bond issues that are not credit substitutes (financial issues, banking corporations' Tier 2 capital, financial exchange traded funds (ETFs), etc.), so that this refers to real issues.

^d Including issues of bonds and shares abroad, after offsetting early redemption of bonds and share buy-backs.

^e Defined as credit to the public or to the government given by banks abroad, and non-tradable (excluding commercial credit). This series was updated retroactively due to a new categorization of the data.

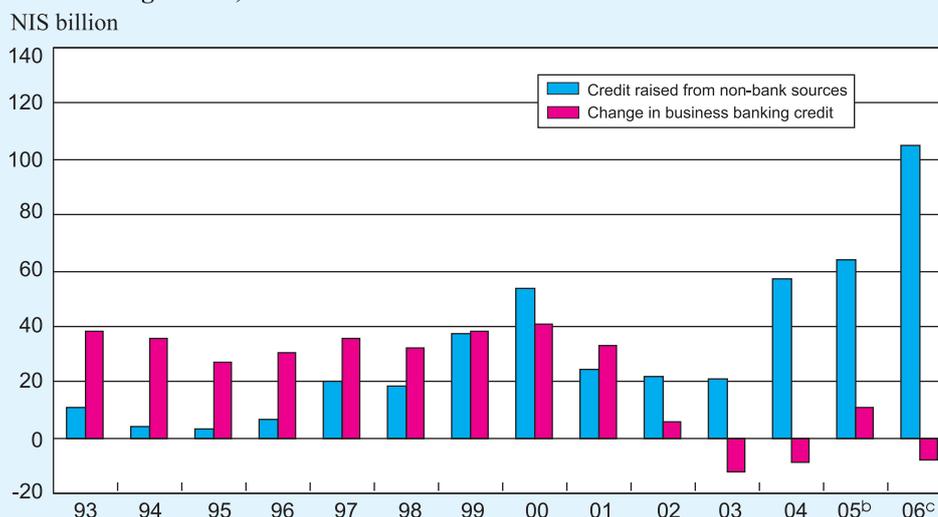
^f From 2005 this item includes non-negotiable bonds issued to institutional investors.

^g Discounting for the Teva deal: NIS 73 billion.

^h Of which some NIS 24 billion was raised by Teva to finance its merger with the American pharmaceuticals company IVAX.

SOURCE: Based on reports to the Supervisor of Banks.

Figure 1.10
Funds from Non-Bank Substitutes Compared to Change in business Banking Credit,^a 1993-2006



^a Business credit given throughout the year excluding credit to individuals.

^b Due to structural changes in the capital market, in 2005 assets held in and outside of the banking system were reclassified.

^c The considerable increase in non-bank credit in 2006 was a result, inter alia, of Teva's raising of NIS 24 billion to finance its merger with the American pharmaceutical firm IVAX.

SOURCE: Based on returns to the Supervisor of Banks; Annual Report of the Supervisor of Capital Markets Insurance and Savings in the Ministry of Finance; the Bank of Israel; and data from the Tel Aviv Stock Exchange.

negative 0.75 percentage points led to bank customers converting their dollar debts into shekel debts. (2) The 8.2 percent appreciation of the shekel against the dollar reduced the balance of dollar credit denominated in shekel, and encouraged borrowers to repay their outstanding dollar credit, thereby reducing the extent of credit in that segment.

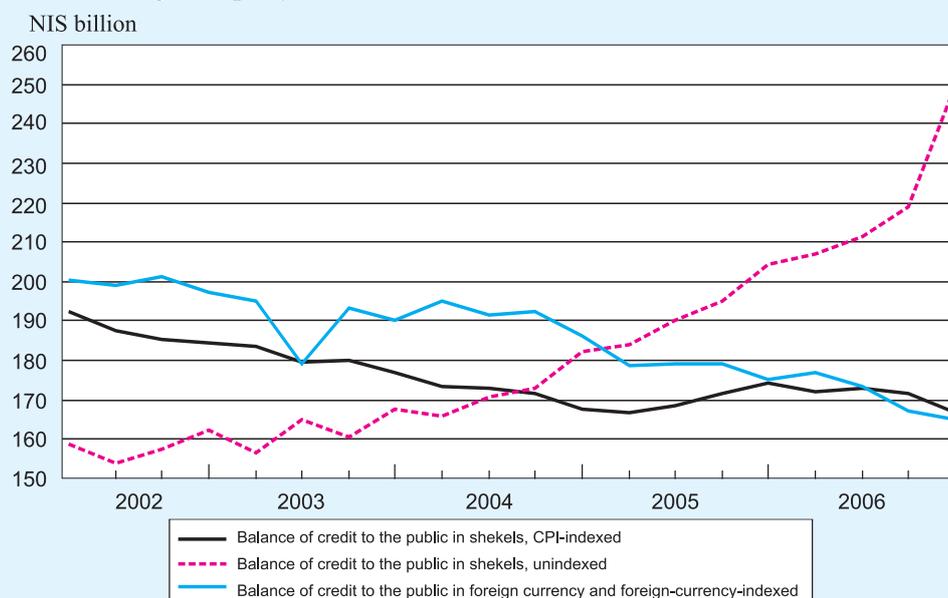
To summarize: in 2006 demand for credit rose considerably, and most was met via the capital market and nonbank entities. Total business capital raised²² via nonbank sources²³ totaled some NIS 105 billion in 2006, up from NIS 60 billion in 2005, continuing the trend evident in the last three years, whereas the change in the balance of bank credit to companies was a negative NIS 7.7 billion (Table 1.5 and Figure 1.10).

The processes outlined above were reflected in the banking system's uses of the resources raised principally from the public. In the unindexed segment the balance of credit to the public (both the business sector and the retail banking sector) rose, and the banking system raised a similar amount from the public. In the indexed segment,

²² Non-bank credit is available mainly to companies, while households do not have reasonable access to substitutes for bank credit.

²³ The capital market, insurance companies, provident funds, credit from banks abroad, and raising capital in capital markets abroad.

Figure 1.11
Quarterly Development of Balance of Credit to the Public of the Five Major Banking Groups by Indexation, March 2002-December 2006



SOURCE: Published financial statements.

in which most of the competitive threat to the banking system is focused, both the deposits of the public and outstanding credit to the public declined. The steady rise in Israel's credit rating and its positive economic fundamentals made it easier to attract deposits from nonresident customers. Most of this activity was performed by banking subsidiaries in the US.²⁴ Nonresidents increased the balance of their foreign currency deposits, mainly their dollar deposits. On the other hand, in reaction to the fall in the public's demand for foreign currency credit, due mostly to the rise in the dollar interest rate, and against the background of the increase in the public's deposits (including those of nonresidents), the banks increased their deposits in foreign banks abroad and also their portfolio of foreign-currency-denominated securities.

In contrast to the reduction in credit given to the business sector, and due to the intensification of the competitive threat to bank credit to companies from nonbank sources, the amount of bank credit granted to the retail banking sector increased: total credit to individuals rose by 9.0 percent—housing credit by 10.0 percent, and other credit by 8.0 percent. It seems that the relatively low risk associated with the retail

²⁴ Total deposits of the public in overseas offices rose by 13.3 percent in 2006, and reached \$ 27.6 billion at the end of the year, up from \$ 24.3 billion at the end of 2005. Deposits from banks increased by 5.8 percent, and deposits from Israeli banks by 8.2 percent.

banking sector also encouraged the banks to increase credit and the services it provides to it. The increase in retail banking activity was also expressed by the banking groups buying smaller banks that specialized in that sector: The First International group bought UBank in December 2004 and Otsar Hahayal Bank in August 2006, and the Mizrahi-Tefahot group bought Bank Yahav in March 2007. These purchases are expressions of the trend of banks, most notable the medium-sized ones, trying to increase their share of the retail banking market. This trend derived from banks' need to extend and improve the advice and the range of services they offer their customers, following the enactment of the Bachar law that allows other financial institutions, in addition to the banking system, to provide these services.

The implementation of Directive 325 of the Proper Conduct of Banking Business that deals with the management of credit arrangements²⁵ acted in the same direction, encouraging banks to offer the retail banking customers additional term credit, to avoid deviations from the credit limit when the directive went into effect, as shown below.

b. Major developments in off-balance-sheet activity

Off-balance-sheet activity inherent in credit risk liability in respect of customer liabilities to the bank mostly from two aspects:

1) Transactions in off-balance-sheet financial instruments where the nominal value represents the credit risk. This activity includes documentary credit, guarantees²⁶ and liabilities for issue of approved credit that's has not yet been extended.²⁷ Most of the transactions in this line of activity were credit frameworks of current loan accounts and other unutilized credit frameworks to the public, as well as irrevocable obligations for approved credit that has not yet been extended, which constituted 31 percent and 25 percent of the total respectively (Table 1.6). Activity in off-balance-sheet financial instruments involves exposure to credit risk. Due to the positive trends in the Israeli economy of the last three years, the risk and uncertainty inherent in issuing guarantees and assuming liabilities by the banks have fallen, while the level of this activity has increased by about 13 percent, the same rate of increase as in the preceding year. The greatest growth of 20 percent was registered in the issue of other guarantees and

²⁵ According to this directive, banks set a credit limit for each customer that is appropriate to his needs, his repayment ability and his collateral, based on a documented analysis. As a result of concern that the banks would not reach a sufficient state of preparedness and sign credit arrangements with all customers by the due date, the date of commencement of the directive was put back from 1 January 2006 to 1 July 2007.

²⁶ Credit guarantees, guarantees for home buyers and other guarantees and liabilities on the customer's account.

²⁷ Unutilized credit facilities on credit cards, unutilized balance of credit in credit frameworks on current loan accounts, irrevocable obligations for approved credit that has not yet been extended and irrevocable obligations to issue guarantees.

Table 1.6
Distribution of Off-Balance-Sheet Financial Instruments, the Five Major Banking Groups, 2004-06

	End-of-year balances (NIS billion)		Rate of change (relative to the previous period) (percent)		Distribution (percent)		
	2004	2005	2005	2006	2004	2005	2006
Documentary credit	7	6	-11.0	-2.0	2.8	2.2	1.9
Credit guarantees	17	20	16.8	8.2	6.8	7.0	6.7
Guarantees for home buyers	20	20	1.0	0.0	7.9	7.1	6.3
Other guarantees and liabilities	25	27	10.4	19.9	9.8	9.6	10.2
Non-recurring commitments for approved credit that has not yet been extended	53	70	30.8	13.5	21.3	24.6	24.6
Commitments to issue guarantees	14	16	15.7	17.8	5.5	5.6	5.8
Overdraft facilities and other credit facilities to the public not yet utilized	76	84	10.4	18.1	30.3	29.6	30.8
Credit card facilities not yet utilized	39	41	4.4	8.6	15.6	14.3	13.7
Total	251	284	13.0	13.4	100	100	100.0

SOURCE: Published financial reports.

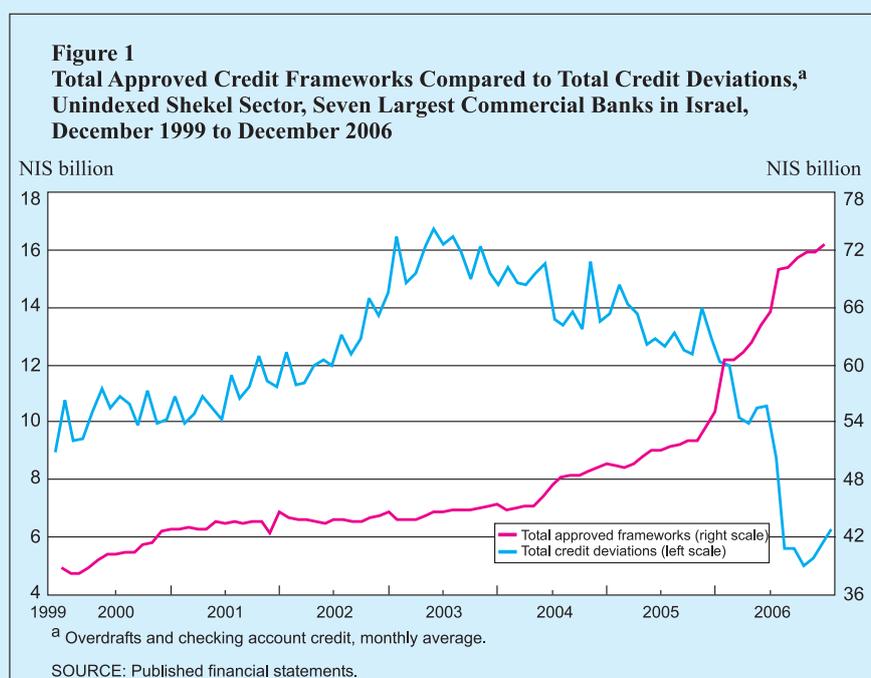
liabilities.²⁸ Credit arrangements for current loan accounts and other unutilized credit arrangements for the public grew by 18 percent, apparently affected by the growth in credit arrangements as a result of Directive 325²⁹ (Figure 1 below).

2) Activity in derivatives.³⁰ Derivatives are split according to their exposure to basic risk into four groups: interest rate contracts,³¹ currency contracts, share contracts,

Box 1.1

Credit frameworks in current accounts and overdraft facilities

During 2005, the Proper Conduct of Banking Business Directive 325 on credit arrangements for current accounts and current loan accounts,¹ according to which



¹ The draft of the directive had been issued in 2004.

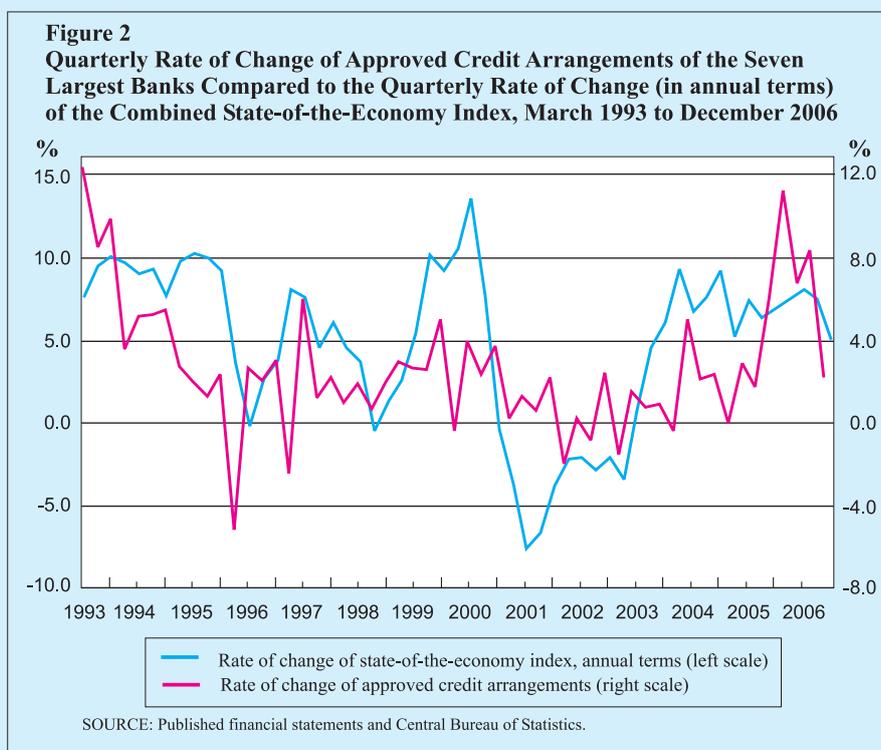
²⁸ These are guarantees and liabilities on customers' accounts that are not included in credit guarantees or in guarantees for home buyers.

²⁹ For further details, see Box 1 above.

³⁰ Transactions are expressed in gross nominal sums before conversion into balance-sheet equivalents.

³¹ Contracts for buying/selling shekels, indexed to the CPI in Israel in exchange for unindexed shekels, or other interest rate contracts.

banks were required to withhold approval of unauthorized credit frameworks in their clients' accounts. If the bank and customer wishes to increase the credit, then the bank must increase the framework and not approve an exceptional deviation from it. On December 17, 2006, the Banking Supervisions issued an amendment to the Directive, which permitted the banks to honor checks and debits if the account has surpassed its credit limit, but only by a small amount—up to NIS 1,000—and only if the deviation does not persist for any length of time. The amendment also extended the period the banks may manage unilateral credit frameworks for clients that had yet to reach an arrangement on their accounts, to July 1, 2007 (instead of January 1, 2007).



As part of the banking corporations' preparation for implementing the Directive, credit arrangements increased,² unilateral arrangements were granted, and solutions were drawn up that suited both the bank customers' needs and ability to repay. As a result of these serial changes credit arrangements grew rapidly in the years 2005 and 2006 by 11 percent and 32 percent respectively (compared

² Total approved frameworks grew as a result of both the increase in economic activity and the implementation of Directive 325.

to an average annual increase of 5 percent in the period 2000-2004) and as of December 2006, they reached a total of NIS 73 billion (Figure 1). As a result of this large increase in credit frameworks, the level of deviation from credit limits during the past two years fell by about 50 percent (from NIS 13.75 billion in December 2004 to NIS 6.3 billion in December 2006).

Generally, it is expected that there is a positive correlation between the business cycle in the economy and changes in credit arrangements at the service of bank customers: at times of economic boom both demand for, and supply of, credit increase; increased demand stems from the improved economic situation and the multitude of investments in the economy, while supply increases due to the improved ability of borrowers to repay (i.e., credit quality improves), which reduces the risk that banks take on themselves in granting credit.³ These two processes lead to an acceleration in the expansion of credit arrangements by banks. During times of economic slowdown, both demand for, and supply of, credit fall, and so does the level of credit arrangements (Figure 2). This positive correlation has existed in Israeli banking since 1993. In mid-2005 a new factor arrived, the effect of Directive 325, which prompted the considerable increase in credit arrangements both by banks and by credit card companies. The increase in credit frameworks was greater than the increase derived from economic growth, and we would therefore expect that this will reduce the probability of deviating from credit limits.

³ Statistical tests (such as the Granger Test) show that the composite state-of-the-economy index affects credit limits with a one-quarter lag, but as expected, in the opposite direction.

and commodity contracts and others. In terms of use, derivatives can be split into the following: 1) hedging derivatives;³² 2) derivatives for asset liability management (ALM);³³ 3) other derivatives;³⁴ 4) credit derivatives³⁵ and spot currency swaps.

³² A derivative that the bank management intends to use for hedging, on condition that the derivative is capable of being used in this way, when the nature of the derivative's risk exposure is identical to that of the asset being hedged. The item being hedged must be specifically identified. At the start of hedging, there is a formal documentation of the hedging relationship and of the aim and strategy of the banking corporation's risk management in hedging, including the identity of the hedging instrument, the hedged item, the nature of the hedged risk and an effective assessment of the hedging instrument offset by the exposure to changes in fair value of the hedged item, which can be ascribed as the hedged risk. A reasonable base is required for an effective assessment of the hedging instrument.

³³ A derivative that the bank management regards as hedging but does not meet the hedging conditions as set by its statement.

³⁴ A derivative that is neither a hedging derivative nor ALM.

³⁵ A contract that transfers the credit risk from the buyer to the seller. Credit derivatives can take different forms: options for protecting credit failure, bill for partial cover of credit risk, SWAP for total risk cover, etc.

Derivative activity expanded in 2006 by 6 percent and totaled NIS 1,096 billion in nominal value, encompassing all types of contract (Table 1.7). The largest increase, of 21 percent, was registered in "other contracts" (contracts in respect of shares and commodity contracts and others). Activity in share contracts³⁶ rose parallel to the increase in trading volumes on the Tel Aviv Stock Exchange: daily volume of trading in options on the TA-25 index grew in 2006 by 20 percent (compared to 65 percent in the preceding year) and totaled some 305,000 units.

4. THE PUBLIC'S ASSET PORTFOLIO AND THE SUPPLY OF DEPOSITS TO THE BANKING SYSTEM

The public's asset portfolio includes the total financial assets of the population in Israel managed by financial intermediaries—commercial banks, insurance companies, pension funds, provident funds, etc—or directly through the capital market. In 2006, the trend of an increase in the public's asset portfolio continued, a trend which began three years ago. The value of the public's financial assets totaled NIS 1,860 billion, a rise of 11.6 percent on the preceding year (Table 1.8). During the year two major effects influenced the total public's assets and its composition: the income effect acted to increase the public's assets, mostly due to the accelerated growth in economic activity; and the substitution effect acted, further to the trend of recent years, mostly in changing the composition between assets deposited in the banking system (nontradable assets) and those managed outside of the banking system (tradable assets).³⁷ In the past three years the substitution effect has grown mostly due to the relatively high expected yields in the money and capital markets (compared to the relatively low expected yields offered by the banking system). As a result of this effect, the share of the public's financial assets deposited in banks in Israel stood at the end of the year at only 31.3 percent (despite an increase of 5.1 percent in its size relative to the preceding year), while the share of the tradable financial assets stood at 39.3 percent, an increase of 20.4 percent on 2005 (Figure 1.12). Several reforms contributed to the increased share of the tradable assets out of the total public's financial portfolio: pension reform, change in the method of revaluing nontradable assets held by provident funds; the cancellation of the *makam* ceiling. These developments contributed to the deepening and sophistication of the capital market, as well as to the reduced involvement of the banks in managing the public's assets.³⁸ As for the developments

³⁶ Based on the annual Stock Exchange survey for 2006.

³⁷ The change that occurred in the composition of the public's financial asset portfolio in Israel is part of a global trend: a consistent fall in deposits, bonds and savings plans managed by the banking system, as a proportion of the public's financial assets portfolio. Source: IMF, Global Financial Stability Report: Market developments and issues, April 2005.

³⁸ The tax reform, which canceled the tax advantage that investing in unindexed shekel deposits and saving plans had enjoyed over investments in bonds, also had a significant effect on the composition of the public's asset portfolio, contributing to a rise in the share of the portfolio in tradable assets.

Table 1.7
Distribution of Balances of Financial Derivatives, the Five Major Banking Groups,
December 2005 and December 2006
(NIS billion)^a

	2005				2006			
	Interest rate contracts	Exchange rate contracts	Other ^b	Total	Interest rate contracts	Exchange rate contracts	Other ^b	Total
Hapoalim	172	228	34	433	186	247	40	472
Leumi	78	144	32	255	63	135	34	232
Discount	20	76	9	105	26	58	17	101
Mizrahi-Tefahot	19	69	19	107	31	80	27	139
First International	9	76	50	135	8	87	57	152
Total	297	592	145	1,035	314	607	175	1,096

^a In terms of notional principal, in current prices.

^b Contracts based on shares, commodities and others.

SOURCE: Published financial reports.

in the public's deposits in the banking system by indexation, there was a considerable increase of 9.2 percent in unindexed shekel deposits, and an increase of 7 percent in the foreign currency segment,³⁹ compared to a drop of 6.5 percent in the CPI-indexed shekel segment. The growth in unindexed shekel deposits stemmed mostly from the continued fall in inflation uncertainty, which was expressed in a fall in the standard deviation of inflation expectations (Figure 1.8). In contrast, the growth in the balance of deposits in the foreign currency segment, of 7 percent, stemmed mostly from a rise in the LIBOR rate on the dollar—due to the rise in the US Fed interest rate (Figure 1.9)—though also from the growth in structured products,⁴⁰ which diverted some of the public's assets to this segment. The balance of deposits in foreign currency grew despite the appreciation of the shekel against the dollar, which was partly offset by the depreciation of the shekel against the basket of currencies (Table 1.8, Figure 1.12).

³⁹ Both indexed to, and denominated in, foreign currency.

⁴⁰ According to the Banking Supervision's research unit, total balance of deposits in structured products in the five major banking groups stood at NIS 23.8 billion at the end of 2006.

Table 1.8
The Public's^a Assets Portfolio in Banks and not in Banks, 2002-06

	Balances						Composition			Rate of change		
	2002	2003	2004	2005	2006	2006	2002	2003	2004	2005	2006	
Financial Assets												
	NIS billion						(percent)			(percent)		
	(December 2003 prices)						(current prices)			(percent)		
1. The public's assets in banks^b	519.4	523.6	526.2	553.5	581.5	44.7	39.9	36.2	33.2	31.3	5.2	5.1
Unindexed local-currency deposits ^c	261.2	278.0	219.0	305.3	333.4	22.5	21.2	15.1	18.3	17.9	39.4	9.2
Deposits in and indexed to foreign currency ^d	86.9	91.9	100.7	119.0	127.4	7.5	7.0	6.9	7.1	6.8	18.2	7.1
Indexed deposits ^e	171.3	153.7	134.5	129.2	120.8	14.7	11.7	9.2	7.7	6.5	-3.9	-6.5
<i>of which</i> Bank deposits of provident and pension funds and insurance companies ^f	66.7	60.8	62.7	56.5	61.5	5.7	4.6	4.3	3.4	3.3	-9.9	8.8
2. The public's tradable assets	314.5	409.5	514.8	607.2	731.3	27.1	31.2	35.4	36.4	39.3	17.9	20.4
Shares ^g	106.1	163.1	198.9	265.1	339.1	9.1	12.4	13.7	15.9	18.2	33.3	27.9
Traded bonds and <i>makam</i> ^h	101.2	138.2	170.9	201.9	239.4	8.7	10.5	11.7	12.1	12.9	18.1	18.6
Residents' investments abroad	107.2	108.0	145.0	140.2	152.4	9.2	8.2	10.0	8.4	8.2	-3.3	8.7
3. Cash held by the public	15.3	16.2	17.8	20.9	21.3	1.3	1.2	1.2	1.3	1.1	17.4	1.9
4. Assets of provident and pension funds and insurance companies (excluding bank deposits)ⁱ	312.6	363.6	395.8	486.1	526.7	26.9	27.7	27.2	29.1	28.3	22.8	8.4
Total assets of the public (1+2+3+4)	1,161.8	1,312.9	1,454.6	1,667.7	1,860.8	100.0	100.0	100.0	100.0	100.0	14.7	11.6

^a The public does not include the government, the Bank of Israel, the commercial banks or the mortgage banks.

^b Including commercial and mortgage banks.

^c Including unindexed earmarked deposits.

^d Including time deposits, unrestricted resident deposits, unrestricted resident restitution deposits, residents' foreign currency deposits and non-resident deposits of residents of Israel.

^e Including savings plans and deposits approved for the granting of loans of related companies and others.

^f Of total bank deposits.

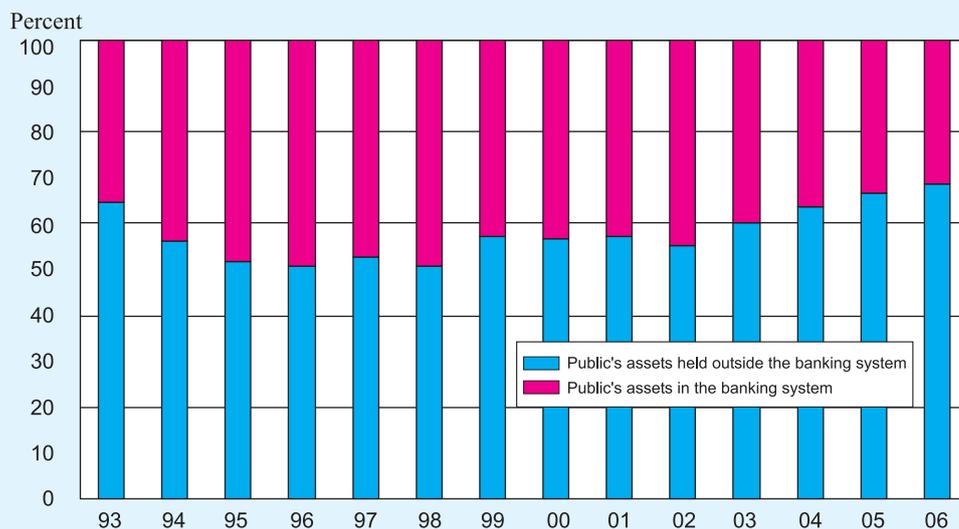
^g Shares held by the public not including the holdings of nonresidents and the government.

^h Including government bonds (indexed and unindexed) and corporate bonds.

ⁱ Includes provident and compensation funds, advanced study funds, pensions and life insurance funds in the "guaranteed return" and "participating in profits" programs.

SOURCE: Based on reports to the Bank of Israel and data of the Monetary Department.

Figure 1.12
Proportion of the Public's Assets in the Banking System Compared to its Assets outside the Banking System, 1993-2006^a



^a Due to structural changes in the capital market, in 2005 assets held in and outside of the banking system were reclassified.

SOURCE: Reports to the Supervisor of Banks; Annual Report of the Supervisor of Capital Markets, Insurance and Savings in the Ministry of Finance; the Bank of Israel; and data from the Tel Aviv Stock Exchange.

5. THE BANKS' INVESTMENT IN SUBSIDIARIES

The changes in parent banks' policy regarding activity in various fields is expressed in changes in their investment in companies in which the bank has a holding⁴¹ (Table 1.9). Two fields of activity in which investment increased considerably in 2006 were the capital market (underwriting and management) and the credit card market. The move to investments in these areas was self-evident in light of the increasing yields on investment and in risk-adjusted returns (measured by the Sharp Index).

The improved performance of capital market activity stemmed mostly from the upside of the business cycle and the reforms in the capital market. On the other hand, the increase in credit card activity stemmed from the following factors: ease of credit card use for households which made the credit card a substitute for traditional methods of payment (cash, check, direct debit, etc.); increased use of buying and paying with credit card on the phone or internet; issue of revolving credit cards with credit lines that replace banking credit. As opposed to the increase in investment in the above-

⁴¹ The investment in companies in which the bank has a holding is split between investments in consolidated companies—whose financial statements are consolidated with those of the banking corporation—and investment in companies included on an equity basis, which is on a balance-sheet equivalent base.

mentioned fields of activity, investment in mortgage banks fell. This was the result of the trend of merging mortgage banks with commercial banks,⁴² in order to save on operating expenses in this field of activity⁴³ and to enjoy economics of scope. Activities abroad continued in the year to be a central field of activity that the banks invest in. In this area there was seen a trend of increasing⁴⁴ bank activity particularly in the developing countries, which enjoy a comparative advantage against the local banks in granting credit to corporate firms and retailers. Though overseas activity has opened up additional possibilities of activity in Israel (principally in the business sector), the revaluation of general investment in this field fell slightly, due to the effect of a change in the exchange rate.

Below we will concentrate on banking activity in the fields of banking and financial companies abroad and in credit card companies. In this fields the banks increased their activity, as stated. In terms of investment composition, banking and financial companies abroad hold the largest market segment, of 29 percent of total investment (Table 1.9). The credit card field brought particularly high rates of growth and performance, and furthermore, in 2006 credit card companies for the first time issued separate financial statements, which allow for closer analysis.

a. Activity abroad

Israeli banks operate abroad both directly and through banking subsidiaries, branches, agents and representatives. In 2006 some 147 different branches were active abroad (as opposed to 110 at the end of 2005),⁴⁵ 59 percent of which were offices of subsidiaries (Table 1.10). These branches are located mainly in the European economic centers (Switzerland, Germany, England, France, etc.); the US; South America (Argentina, Brazil, Chile); South Africa; Australia; as well as in the large off-shore banking centers. However in the past two years most of the activity abroad has focused on opening branches and buying local banks in the developing countries, whose rates of growth have been high. For example, Bank Leumi completed its purchase of Bank Leumi Romania⁴⁶ (formerly Eurom Bank SA) in 2006. Bank Hapoalim completed its purchase of Bank Pozitif Kredi Ve Kalkinma Bankasi Anonim Sirketi (hereafter: Bank Pozitif),

⁴² Mishkan with Hapoalim in 2003, Tefahot with Mizrahi in 2004, First International Mortgage and Atzmouth in First International in 2005.

⁴³ Evidence of this trend can be seen most clearly in the bank's self investment, and accordingly the considerable improvement in the return on investment in the bank itself.

⁴⁴ Particularly in Hapoalim and Leumi.

⁴⁵ Most of this rise in the number of offices stemmed from the purchase of Bank Pozitif (Turkey) by Bank Hapoalim, and Bank Leumi's purchase of Bank Leumi Romania (formerly Eurom Bank SA).

⁴⁶ Bank Leumi Romania is a banking corporation in Romania, which operates 33 branches and offices and which deals in a wide range of financing activity including receipt of deposits, granting credit, international trade and foreign currency activity.

Table 1.9
Investment and Contribution to Profit of Companies in which the Bank has a Holding, and the Bank Itself, for the Five Major Banking Groups, 2005-2006

	Book value of investment at end of year		Rate of change		Contribution to net profit ^a		Rate of change		Investment distribution		Yield on investment		Yield on investment in 1996-2006		
	2005	2006	2004-	2005-	2005	2006	2005	2006	2005	2006	2005	2006	Mean	S.D.	
	NIS million		2004-	2005-	NIS million		2005-	2006-	2005	2006	2005	2006	Mean	S.D.	Mean/ S.D. ^b
a. Major consolidated companies															
Commercial banks	3,426	3,937	6.3	14.9	385	514	33.5	10.1	10.7	11.9	15.0	10.0	2.9	3.4	1.865
Mortgage banks ^d	3,344	2,777	-33.8	-17.0	212	95	-55.2	9.9	7.5	6.4	6.1	8.6	4.2	2.0	0.936
Holdings, investments and others ^e	7,225	7,790	2.7	7.8	382	875	129	21.3	21.2	5.4	12.1	6.5	3.5	1.8	0.545
Banking and financial companies abroad ^f	10,672	10,802	11.6	1.2	1,834	31	-98.3	31.5	29.4	19.2	0.3	8.4	8.1	1.0	0.474
Capital market (underwriting and management)	1,012	1,923	10.7	90.0	142	844	494.4	3.0	5.2	15.5	83.4	11.4	24.9	0.5	0.273
Credit cards	1,308	1,801	15.6	37.7	219	299	36.5	3.9	4.9	19.4	22.9	13.5	9.9	1.4	0.903
Leasing	224	230	3.7	2.7	5	6	20.0	0.7	0.6	2.3	2.7	2.1	1.4	1.5	-1.755
Total major consolidated companies	27,211	29,260	0.3	7.5	3,179	2,664	-16.2	80.4	79.5	11.7	9.8	8.3	2.6	3.1	1.389
b. Major companies included on an equity basis															
Commercial banks ^g	930	1,254	15.7	34.8	43	133	209.3	2.7	3.4	5.3	14.3	7.9	4.6	1.7	0.736
Non-financial companies and insurance ^h	1,625	400	8.0	-75.4	274	147	-46.4	4.8	1.1	18.2	9.0	9.7	9.3	1.0	0.546
Holdings, investment, financial and other (including abroad)	1,407	1,435	13.8	2.0	66	215	225.8	4.2	3.9	5.3	15.3	7.8	12.2	0.6	0.265
Total major companies included on an equity basis	3,962	3,089	11.8	-22.0	383	495	29.2	11.7	8.4	10.8	12.5	9.1	8.2	1.1	0.545

(cont'd)

Table 1.9 (cont'd)
Investment and Contribution to Profit of Companies in which the Bank has a Holding, and the Bank Itself, for the Five Major Banking Groups, 2005-2006

	Book value of investment at end of year		Rate of change		Contribution to net profit ^a		Rate of change		Investment distribution		Yield on investment		Yield on investment in 1996-2006		
	2005	2006	2004-2005	2005-2006	2005	2006	2005	2006	2005	2006	2005	2006	Mean	S.D.	
	NIS million		%		NIS million		%		%		%		Mean	S.D.	
Total major companies in which the banks have a holding	31,173	32,349	1.6	3.8	3,562	3,159	-11.3	92.1	87.9	11.6	10.1	8.0	2.6	3.0	1.277
Non-major companies ⁱ	2,684	4,434	49.7	65.2	22	194	781.8	7.9	12.1	1.2	7.2				
Total companies in which the banks have a holding	33,857	36,783	4.3	8.6	3,584	3,353	-6.4	100.0	100.0	11.0	9.9	8.9	5.2	1.7	0.838
The bank itself^f	13,985	16,707	17.3	19.5	2,358	6,670	182.9			19.8	47.7	15.4	12.9	1.2	0.839

^a Profits in the companies in which the banks have a holding include "profits from ordinary activities and profits from extraordinary activities" and do not include dividends or receipts from the sale of surplus holdings.

^b The average yield divided by the standard deviation measures the yield on an investment adjusted by the inherent risk.

^c The Sharpe index was calculated for the period 1996-2006. The risk-free interest rate is 4.59 percent, obtained from the average yield to maturity for CPI-indexed five-year government bonds.

^d This item has been reclassified and does not include profits from the activities of Bank Mishkan following its merger within Bank Hapoalim on 3/1/2003. In 2004 profits in respect of mortgage activities of Mishkan were included in Bank Hapoalim. These profits totaled NIS 110 million.

^e This includes merchant and investment finance banks as well holding and investment companies and other financial companies, mainly those of Bank Hapoalim.

^f The contribution to net profits and the yield of the investment in banking and financial companies abroad in 2006 was biased downward considerably, due to the significant negative profit statement of Discount Bank.

^g Discount Bank's holdings in First International Bank were not discounted from the total investments nor from the contribution to profits.

^h The yield on investment in these companies was downwardly biased, as the investment in non-banking companies does not have to maintain a minimum capital requirement, and therefore the capital invested in them can serve fully for profit-earning banking activity, which was not taken into account in the yield above.

ⁱ Companies in which the banks have a holding which are not detailed as major companies in Note 6 of the Financial Statements.

^j The investment in the bank itself is derived from deducting the investment in companies in which the bank has a holding, according to balance sheet value, from total shareholders equity, and this differs from the definition of shareholders equity for purposes of calculating item 23a according to the Banking Law (Licensing). The contribution to net profits of the bank itself was calculated as the net ordinary profits after tax plus extraordinary profits, by bank. This is in effect the profits from ordinary activities (and from extraordinary activities) of the bank, discounted by the (net) profits from ordinary activities and from extraordinary profits of all companies in which the bank has a holding (both major and non-major).

SOURCE: Published financial reports.

which operates in Turkey and specializes in business and investment banking.⁴⁷ The wide spread of banking branches abroad was intended to satisfy the business potential of the Israeli banking system through the provision of financial services (in wholesale and private banking fields), both to international parties operating in Israel and to the Jewish community in those areas where the branches are located. Total representative assets abroad, which constitute 17 percent of total assets of the five major banking groups, stood at \$37 billion in 2006, compared to \$34 billion in the previous year (an increase of 9 percent), though due to the appreciation of the dollar the total assets of the branches abroad fell in shekel terms (Table 1.11). During 2006 total credit in branches abroad grew, further to the upward trend in credit extended by branches abroad (Table 1.11). The background of banks' purchases abroad and the opening up of branches and representative offices of subsidiaries over recent years is as said the desire of the Israeli banking system to expand its international activity and to reduce its exposure to the local economy.

b. Credit card activity

The reduction in the use of cash as a means of payment in both Israel and globally in the past ten years has been expressed in the increasing use of credit cards.⁴⁸ During the year use of credit cards expanded as did additional services offered by the credit card companies, also against the background of increased activity in the economy. This development brought a considerable improvement in business for those operating in this field.

Three credit card companies operate in Israel today, all controlled by the major banking groups: 1) the Isracard concern, fully owned by Bank Hapoalim, and which provides the managerial and operational umbrella for three credit card companies controlled by the bank—Isracard, Europay (Eurocard) Israel, and Poalim Express; 2) LeumiCard, fully owned by Bank Leumi; and 3) Israel Credit Cards (ICC-CAL), owned by Discount Bank and First International Bank of Israel,⁴⁹ and today holds 51 percent of shares in Diners Club.⁵⁰ The credit card companies operate both in issuing and clearing several brand cards (mostly Visa and Mastercard).

⁴⁷ Bank Hapoalim's investment in Bank Pozitif totaled NIS 434 million in December 2006.

⁴⁸ Up until recently most of the cards issued in Israel were deferred debit cards, though today there are also other types: revolving credit cards, where the cardholder chooses the monthly repayment, and the remainder is deferred to the next month and accrues interest; prepaid, where the card is loaded in advance with a sum of money, and the card is then used for transactions.

⁴⁹ In December 2006 First International completed an additional purchase of voting and share capital in ICC-CAL, and after the purchase controls about 20 percent of the voting rights and 27 percent of the share capital.

⁵⁰ In December 2006 the company completed a sale of 49 percent of shares in Diners to the Dor-Alon-Blue Square group, and following the sale the company holds 51 percent of Diners' shares.

Table 1.10
Banking Representation Abroad: Branches, Offices and Positions, 1991-2006

Year	Total offices	Number of branches and representative offices ^a	Number of offices of subsidiaries ^b	Number of positions ^c
1991-1995 average	120	72	48	2,827
1996-2000 average	97	63	34	2,084
2001-2005 average	114	63	51	2,413
2004	120	64	56	2,502
2005	110	63	47	2,296
2006	147	61	86	3,050

^a Branches and representative offices of Israeli banking groups abroad.

^b Branches of subsidiaries abroad.

^c Not including overtime.

SOURCE: Reports to the Supervisor of Banks.

Table 1.11
Overseas Offices' Role in Total Credit and Assets in the Five Major Banking Groups in Israel, 1999-2006

(NIS billion)

	Assets			Credit		
	Total assets in the five banking groups	<i>Of which:</i> Overseas offices ^a	Assets of overseas offices as share of total assets (%)	Total credit ^b in the five banking groups	<i>Of which:</i> Overseas offices ^a	Credit from overseas offices as share of total credit (%)
1999	637.6	88.9	13.9	407.3	38.6	9.5
2000	699.6	100.0	14.3	464.9	42.0	9.0
2001	795.6	117.1	14.7	543.4	45.5	8.4
2002	778.6	139.4	17.9	541.8	51.1	9.4
2003	789.1	135.6	17.2	535.2	52.0	9.7
2004	812.1	148.1	18.2	536.2	57.1	10.7
2005	877.5	157.7	18.0	573.3	58.7	10.2
2006	912.0	157.5	17.3	582.7	62.2	10.7

^a Overseas offices in the US, Western Europe, South America and the Cayman Islands.

^b Balance sheet credit.

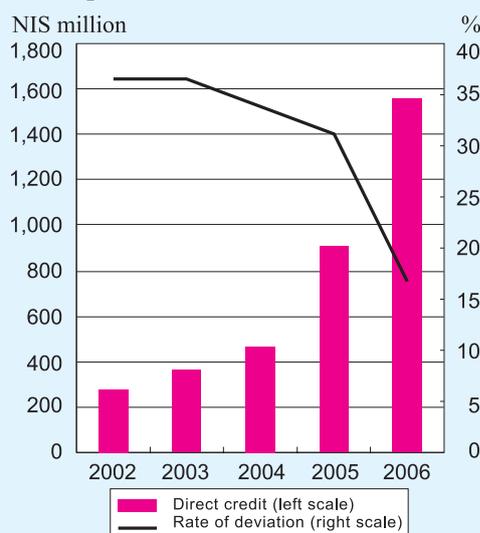
SOURCE: Reports to the Supervisor of Banks.

The number of active credit cards⁵¹ and the number of transactions (in Israel and abroad) was higher this year than in 2005. Transactions using credit cards totaled NIS 131.5 billion (of which NIS 125.8 billion took place in Israel), an increase of 9.9 percent on the previous year. The average value of a credit card transaction remained relatively unchanged this year (Table 1.12).

Active cards issued by the credit card companies are marketed to bank customers not connected to the banking group that controls them. These cards, connected mostly to customer loyalty clubs or other consumer organizations and which grant the cardholder various benefits connected to the customer club, made up 19.6 percent of all active cards in December 2006, compared to 12.4 percent a year earlier. Furthermore the credit card companies expanded their range of services through the issue of revolving credit cards⁵² which offer the cardholder more flexibility, by setting the level and the monthly date of repayment according to the customer's wishes and ability. Here, the issuing company is exposed to

the credit risk inherent in the use of a credit card.⁵³ The level of the approved credit line is set based on the use of credit-scoring systems. The expanded use of this type of credit card stems mostly from the credit card companies' strategy to increase their market share by issuing cards to more than the potential customer base of the parent bank. The increase registered also stemmed from the implementation of Directive 325, which forbade deviations from approved credit arrangements in current accounts and current loan accounts at the banks. Those customers restricted in their use of credit from

Figure 1.13
Rate of Deviation^a in Unindexed Local-Currency Credit at Commercial Banks in Israel Compared to Direct Credit Given from All Credit Card Companies,^b 2002-2006



^a Total credit deviation as a proportion of total credit in current loan accounts and current accounts owing to the seven largest commercial banks in Israel.

^b ICC-CAL, LeumiCard, Isracard, Aminit, Eurocard (Europay Israel), and American Express.

SOURCE: Based on reports to the Supervisor of Banks.

⁵¹ Including cards for transactions only, which are mostly connected to customer loyalty clubs, and cards for transactions and cash withdrawals.

⁵² A revolving credit card provides the cardholder with a separate credit line independent of his bank account, which allows him to manage his expenditure in an alternative account to his current bank account. LeumiCard offers the Multi card, ICC-CAL offers the Active, and Isracard the More.

⁵³ The credit to the customer is extended by the credit card company and is not connected to the bank.

their accounts found an alternative source of credit to the deviation from their credit framework (overdraft) on their bank accounts (Figure 1.13, Box 1.1).

These two developments—the rise in issue of credit cards under the auspices of the company and the increased use of revolving credit cards—were the major factor behind the rise of 61.1 percent in the balance of credit under the responsibility of the credit card companies, which was granted mostly to the retail sector.

The rise in the number of cards and the expansion in economic activity were the major factors in the improvement in total income⁵⁴ of the credit card companies, which reached NIS 2,463 million in December 2006, a rise of 14.6 percent on the previous year. The share of the income from households stood at 60 percent. Total expenses of these companies grew by 13.8 percent, and hence their net profit totaled NIS 328 million, a rise of 25.2 percent on 2005, while the return on equity stood on average at 36.1 percent (Table 1.13). At the same time as the rise in the balance of credit that the credit card companies extended to the retail sector, their credit risk also rose, and this was seen in the increase in their loan-loss provisions (from 3.2 percent at the end of 2005 to 3.8 percent at the end of 2006). Most of the growth in risk stemmed from the failure to collect debts from holders of revolving credit cards.

⁵⁴ Resulting mostly from the growth in issuing and clearing activity.

Table 1.12
Credit Card Activity, 2003-06

	2003	2004	2005	2006	Rate of change from 2004 to 2005 (percent)	Rate of change from 2005 to 2006 (percent)
Number of cards active at the end of the year <i>of which: Cards at the sole responsibility of the credit card company</i>	3.6 0.34	3.8 0.39	4.2 0.52	4.8 0.95	10.3 33.9	15.2 81.5
Number of transactions <i>of which: in Israel</i>	411.8 404.5	449.9 442.5	490.4 482.5	541.2 532.0	9.0 9.0	10.4 10.3
Amount of transactions <i>of which: in Israel</i>	97.4 92.7	107.5 102.4	118.1 113.1	131.5 125.8	9.9 10.4	11.3 11.2
Average credit card transaction (NIS)	236.5	238.8	240.8	242.9	0.83	0.88
Average monthly expenditure per credit card (NIS)	2,260	2,350	2,342	2,264	-0.33	-3.34
Average number of transactions per card per year	114.7	118.1	116.7	111.8	-1.15	-4.18

SOURCE: Reports to the Supervisor of the Banks.

Table 1.13
Main Data from the Financial Statements of the Credit Card Companies, 2005 and 2006

	2005			2006			Change from 2005 to 2006 (percent)		
	Visa CAL	Isracard	Leumi Card	Total	Visa CAL	Isracard		Leumi Card	Total
Income	(NIS million)								
Credit card transactions	627	905	480	2,012	710	1,007	545	2,262	12.4
<i>of which:</i> Income from businesses ^a	325	753	214	1,292	368	833	241	1,442	11.6
Income in respect of credit card holders	302	152	266	720	342	174	304	820	13.9
Other income	76	53	8	137	92	69	40	201	46.7
<i>of which:</i> Net interest income before loan-loss provision	75	40	8	123	89	53	36	178	44.7
Other	1	13	-	14	3	16	4	23	64.3
Total income	703	958	488	2,149	802	1,076	585	2,463	14.6
Expenses									
Operating	247	279	228	754	276	326	251	853	13.1
Sales and marketing	105	106	104	315	123	142	128	393	24.8
Payment to banks ^b	125	364	57	546	138	386	63	587	7.5
Other expenses ^c	54	51	24	129	75	47	29	151	17.1
Total expenses	531	800	413	1,744	612	901	471	1,984	13.8
Ordinary before-tax income	172	158	75	405	190	175	114	479	18.3
Tax provision	62	54	24	140	61	55	36	152	8.6
Ordinary after-tax income	110	104	51	265	129	120	78	327	23.4

(cont'd)

Table 1.13 (cont'd)
Main Data from the Financial Statements of the Credit Card Companies, 2005 and 2006

	2005			2006			Change from 2005 to 2006 (percent)	
	Visa CAL	Isracard	Leumi Card	Total	Visa CAL	Isracard		Leumi Card	Total
Share of the company and external shareholders in profits (losses) from ordinary after-tax income	(2)	(2)	1	(3)	(3)	0	4	1
Net income	108	102	52	262	126	120	82	328
Shareholders equity	321	584	4	909	335	704	86	1,125
Total balance sheet	5,622	8,676	4,048	18,346	6,148	9,516	5,068	20,732
Return on equity ^d (ROE)					39.3	20.5	2050.0	36.1
Return on assets (ROA)					2.2	1.4	2.0	1.8

^a Revenues less any overlapping fees.

^b Payment for issue and distribution of credit cards to bank customers.

^c Includes loan-loss provision and management fees.

^d Return on equity was calculated as total net income at the end of the year relative to shareholders equity at the beginning of the year.

SOURCE: Published financial statements.