CHAPTER IX

ACTIVITIES OF THE BANK OF ISRAEL

1. SUMMARY OF THE BALANCE SHEET AT THE END OF 1983[1]

The Bank of Israel's balance sheet totaled IS1,002 billion at at the end of 1983, compared with IS264 billion the year before—an increase of 280 percent (31 percent in real terms). This rapid growth stemmed primarily from a big increase in credit to the government on the assets side and in foreign currency deposits of Israeli banking institutions against Patam deposits[2] on the liabilities side. It also reflected the predominant weight in the balance sheet of assets and liabilities denominated in or linked to foreign currency, as well as the depreciation of the sheqel against the dollar, which exceeded the rise of prices (220 vs. 191 percent).

Foreign reserves held at the Bank of Israel[3] shrank by $121 million during the year (4 percent) to stand at $2,873 million. Most of the decline occurred in the second half of the year, following an increase in the early months.

2. MONETARY POLICY MEASURES IN 1983

The Bank of Israel conducted a restrictive monetary policy in 1983, which succeeded in maintaining an appropriate real rate of interest and sharply reduced the real volume of bank credit to the public. A secondary policy target this year was to increase the weight of unlinked nondirected credit in total bank credit to the public, in order to restrain the automatic growth of credit, thereby giving monetary policy greater leverage.

In 1983 the Bank of Israel changed its system of curbing nondirected bank credit. After several years of administrative ceilings, these were abolished at the end of 1982, and the Bank resumed the employment of conventional monetary policy tools while striving to adjust interest rates in line with the rise of domestic prices. This explains the special stress placed on the narrowing of the differential between the bank lending rate and the rate paid on sheqel deposits, which was intended to prevent the mushrooming of a credit market outside the banking system. In the

[1] This section appeared in full in the Bank of Israel's Financial Statements for the Year 1983.

[2] Sheqel accounts denominated in foreign currency.

[3] Defined as gold, foreign currency, and securities denominated in foreign currency, net of the deposits of banks abroad and the foreign currency deposits of banks in Israel against nonresident deposits.

Table IX–1

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR ENDED DECEMBER 31, 1983

	Total assets and liabilities (IS million)					Assets and liabilities in or linked to foreign currency (in terms of U.S. $ million)			
			Increase						
				Percent				Increase	
	Balance on 31.12.82	Balance on 31.12.83	ISm.	Nominal	Real[a]	Balance on 31.12.82	Balance on 31.12.83	$m.	%
Assets									
Foreign assets	136,417	405,648	269,231	197.4	2.3	4,054	3,764	–290	–7.2
Government debt									
In or linked to foreign currency	29,612	74,883	45,271	152.9	–13.0	880	695	–185	–21.0
In local currency	51,725	348,356	296,631	573.5	131.7				
Loans									
In foreign currency	5,207	17,224	12,017	230.8	13.8	155	160	5	3.2
In local currency	13,148	65,378	52,230	397.2	71.1				
Securities	22,044	70,450	48,406	219.6	16.3				
Other accounts	5,634[b]	19,736[b]	14,102	250.3	20.5	130	97	–33	–25.4
Total assets	**263,787**	**1,001,675**	**737,888**	**279.7**	**30.6**	**5,219**	**4,716**	**–503**	**–9.6**
Liabilities									
Banknotes and coins in circulation	10,722	30,954	20,232	188.7	–0.7				
Foreign liabilities	1,501[b]	1,450[b]	–51	–3.4	–66.8	45	13	–32	–71.1
Foreign currency deposits of the government and National Institutions	14,866	86,531	71,665	482.1	100.2	442	803	361	81.7

Foreign currency deposits of banking institutions in Israel									
Against residents' deposits—restitution	84,122	259,383	175,261	208.3	6.1	2,500	2,407	–93	–3.7
Against residents' deposits—other	86,371	427,503	341,132	395.0	70.3	2,567	3,967	1,400	54.5
Against nonresidents' deposits	28,306	88,499	60,193	212.7	7.6	841	821	–20	–2.4
Deposits of banking and financial institutions in Israel	12,687	21,528	8,841	69.7	–41.6				
Capital and general reserve	1,000	1,000			–65.6				
Other liabilities	24,212[b]	84,827[b]	60,615	250.4	20.5	309	262	–47	–15.2
Total liabilities	**263,787**	**1,001,675**	**737,888**	**279.7**	**30.6**	**6,704**	**8,273**	**1,569**	**23.4**
Foreign exchange reserves held by the Bank of Israel[c]						**2,994**	**2,873**	**–121**	**–4.0**

NOTE: The accompanying notes (at the end of the chapter) are an integral part of the financial statements.

[a] The nominal change deflated by the increase in the consumer price index (190.7 percent in December levels), apart from the securities item, which was deflated by the November-to-November increase in the index (174.9 percent)—see note 1e.

[b] Consists of sums in or linked to foreign currency and unlinked sums.

[c] Defined as gold, foreign exchange and foreign securities, less deposits of foreign banks (see note 8) and foreign currency deposits of banking institutions in Israel against nonresidents' deposits.

past, when sheqel credit ceilings were the principal monetary instrument employed, competition between the banks in raising funds from the public diminished greatly, interest rate differentials widened appreciably, and the tightening of bank credit to the public speeded up the process of disintermediation outside the banking system. This impaired the effectiveness of the Bank's monetary measures. A low deposit interest rate relative to that charged on sheqel credits frustrates all temporary liquidity remedial action by the Bank of Israel, since there is no motivation for the public to hold sheqel bank deposits to the extent required to overcome the liquidity deficiencies.

The principal monetary policy instruments available to the Bank of Israel in 1983 were the required liquidity ratios and the interest paid on such cover, lending at the discount window (quotas and the interest charged on these loans), and the penalties for liquidity deficiencies. These largely determined the supply of liquidity to the commercial banking system for meeting its needs during the year.

At the end of 1982 the Bank of Israel requested that it be provided with an additional monetary instrument for conducting open-market operations—short-term treasury bills—so that it could quickly and effectively influence the monetary base and interest rates. Coordination with the various authorities involved and the required legislation were completed only in 1984. In 1983 the Bank was therefore compelled to employ its other tools more intensively, even though the revision of liquidity ratios, for instance, is not the best way to cope with current monetary

Table IX–2

BANK OF ISRAEL CLAIMS ON AND LIABILITIES TO FOREIGNERS IN GOLD AND FOREIGN EXCHANGE, 1982–83

($ million)

	1982	1983	Increase
Assets			
Gold, foreign exchange, and foreign securities	3,836	3,694	–142
Other foreign currency assets	218	70	–148
Total claims on foreigners	**4,054**	**3,764**	**–290**
Liabilities			
Allocation of Special Drawing Rights	117	111	–6
Liabilities to IMF	30	–	–30
Foreign currency deposits of foreign banks	1	–	–1
Other liabilities	14	13	–1
Nonresidents' deposits	841	821	–20
Total liabilities to foreigners	**1,003**	**945**	**–58**
Net claims on foreigners (net foreign currency assets)	**3,051**	**2,819**	**–232**
Net foreign exchange reserves at the Bank of Israel[a]	2,994	2,873	–121

[a] Defined in note 2.

problems. Moreover, during the first half of the year reviewed the Bank had to conduct a tight monetary policy at a time when the Ministry of Finance, under its policy of slowing inflation, prevented the raising of the base interest rate on nondirected credit (overdraft facilities, etc.). Nevertheless credit was curbed in the first months of 1983 by making excess drawings on overdraft accounts costlier through the stiffening of penalties for liquidity shortfalls; on the other hand, the Bank extended the commercial banking system a low-interest loan, which was allocated among the banks on the basis of the sheqel funds raised from the public.

In the second half of 1983, after the Finance Ministry's anti-inflation policy restraints on the bank lending rate were lifted, the Bank of Israel was able to conduct a more flexible monetary policy calculated to directly influence interest rates in the money market.

Another tool used in 1983 was administrative ceilings on nondirected foreign currency credit. These ceilings remained in force even after they were abolished on nondirected sheqel credit; this was to avoid exposing the monetary system to the dangers of a large short-term capital import, which was liable to thwart the achievement of the monetary policy objectives.

The Bank of Israel allowed the prices of linked bonds traded on the stock exchange to fluctuate in accordance with market conditions, but it intervened to prevent sharp swings, which were liable to detrimentally affect the capital market in general and the bond market in particular. It should be noted that tradable government bonds are the least expensive component of the public sector's long-term domestic debt.

Following are some of the most salient monetary policy measures implemented during 1983 and the beginning of 1984.

(a) First quarter of 1983

(1) The ceiling on nondirected foreign currency credit was reduced by 20 percent, equivalent to approximately $100 million.

(2) The liquidity ratios on sheqel deposits and credit were raised, and the discount-window loan made available to the banks was increased by an equivalent amount—IS5.5 billion; this brought the outstanding balance up to IS7.5 billion. The latter step was intended to give the Bank of Israel a potential source of absorption, and it will therefore be possible to reduce the loan without having to repeatedly revise the liquidity ratios.

(b) Third quarter of 1983

The banks' liquidity deficiencies reached sizable dimensions because of the halting of the uptrend in sheqel deposits at the expense of an increase in Patam. To help solve this problem, albeit only partially, the Bank of Israel introduced several changes which led to a significant rise in the bank lending rate.

(1) The liquidity ratios on sheqel deposits and nondirected credit were lowered, reducing the required liquid sheqel cover by IS3.5 billion.

(2) The discount-window loan to the banks was increased by IS6 billion.

(3) The interest rates on the banks' deposits with the Bank of Israel were

raised, and the interest paid on the banks' excess liquidity and that charged on the discount-window loan were adjusted.

(4) Demand deposits were eliminated for purposes of calculating the basis for allocating the discount-window loan; this was intended to encourage the mobilization of interest-bearing sheqel deposits.

(c) Fourth quarter of 1983

The banks' liquidity deficiencies grew enormously, causing the Bank of Israel to decide on the following additional action:

(1) The liquidity requirement on interest-bearing sheqel deposits (time deposits and CDs) was lowered, reducing the total required cover by IS 6.5 billion and encouraging the solicitation of such deposits.

(2) The discount-window loan quota was increased by IS15 billion. This sum was allocated according to a new formula at a high rate of interest, which induced the banking system to raise the deposit interest rate and to narrow the differential between it and the bank lending rate.

(3) To forestall the transfer of foreign currency out of the country following its large-scale purchase by the public, the liquidity ratios on the various types of Patam deposits were progressively scaled up to 100 percent.

These measures greatly improved the banks' liquidity position in the first quarter of 1984, after a big increase in the public's sheqel deposits with them. At the beginning of 1984 the deficiencies were completely eliminated, and the banks even paid back much of the loan they had received from the Bank of Israel.

At the beginning of 1984 the Bank of Israel continued to currently adjust the interest on both liquid assets and the loan extended to the banks. This was to keep the interest rate structure of the money market in line with domestic inflation, for the Bank believes that an appropriate real positive interest rate will help to curb the growth of bank credit to the public.

Bank of Israel Open-Market Operations

In 1983 net sales of indexed government bonds on the secondary market by the Bank of Israel totaled IS1 billion (at current prices), compared with IS4.6 billion in 1982. (The data do not include the purchase of original-issue bonds for the Bank's own portfolio, or redemptions and interest on account of these holdings.)

Demand for bonds was heaviest in May, August, October, and November, when the Bank's net sales totaled IS8.7 billion (at current prices). Selling pressure was greatest in March, April, September, and December, when the Bank bought approximately IS7 billion worth of bonds from the public. The real monthly price fluctuations ranged between +7.4 percent (May) and –5 percent (April and September). They were particularly sharp in bonds with short maturities and those linked 80 percent to the consumer price index (between +8.9 and –6 percent). In the first part of 1984 the Bank intervened in order to damp down the especially sharp fluctuations in demand: in January it purchased some IS13 billion of bonds at a 9 percent real drop in price, and in February and March it sold some IS6 billion worth (net) at a 10 percent real price increase.

Bonds were more volatile this year because of the special developments in the capital market and the Bank's policy of intervening to smooth only very sharp oscillations. In the five months in which bond prices rose in real terms, the average monthly increase was 3.2 percent, as against 2.7 percent in the same months the year before; in the seven months in which real bond prices softened, the average monthly decline was 3 percent, compared with 1.9 percent in the corresponding months of 1982.

The Bank of Israel dealt with the following types of bonds:

(a) 80 percent indexed with a 4–7 percent interest coupon (5–7 years to maturity)—net sale of approximately IS1.5 billion.

(b) Bonds linked to the dollar, with a variable interest rate (8–10 years to maturity)—net sale of approximately IS750 million.

(c) 100 percent indexed with a 4 percent coupon (up to two years to redemption)—net sale of about IS300 million.

(d) Double-option bonds (5–7 years to maturity)—net purchase of IS540 million.

(e) 100 percent indexed with a 3 percent coupon (7–10 years to maturity)—net purchase of about IS400 million.

(f) 90 percent indexed with a 4 percent coupon (3–4 years to maturity)—net purchase of IS680 million.

The Bank of Israel's share in total secondary market bond trade (average daily trading volume) averaged 34 percent for the year, compared with 36.6 percent in 1982, and ranged between 30 percent in February and 43 percent in May.

In the final quarter of 1983 the government requested the Bank to handle on its behalf the trade in the shares included in the October arrangement with the banking groups that had been supporting their equities. During this period the Bank purchased IS54 billion of shares for the government.

3. FOREIGN EXCHANGE CONTROL

The General Permit defines those activities which Israeli residents are permitted to undertake in foreign currency and with foreign residents. From time to time the Permit is amended in the light of general economic and monetary developments and in accordance with the policy of the government and Bank of Israel. In 1983 and the first quarter of 1984 the following amendments were introduced:

(a) June and July 1983

(1) Israeli residents were prohibited from acquiring social rights from a foreign country unless they began their contribution payments when they were permanently residing abroad, or before the prohibition went into force. A Special Permit to acquire social rights from a foreign country is issued to Israeli victims of Nazi persecution.

(2) Restrictions were placed on transactions in futures: they may be carried out only if the contract is traded on an authorized exchange and if the transaction is for the purpose of covering risks. An Israeli resident may carry out commodity futures transactions only if he deals in such goods. An Israeli resident may also carry out futures transactions in financial contracts if the transactions are connected with lawfully procured foreign currency loans.

(3) It is permissible for an Israeli resident to receive a direct loan from a foreign resident for a period of 30 months or more, as before, but such a loan will no longer be guaranteed by a bank in Israel (including its offices abroad), or by any other financial institution in Israel.

(b) November 1983

At the beginning of November it was stipulated that the foreign travel allowance may be obtained only upon presentation of the flight ticket and passport and the recording therein of the amount of foreign currency received. An authorized dealer may not sell foreign currency to an Israeli resident for the purpose of holding it in his possession.

(c) January 1984

(1) The amount of foreign currency an Israeli resident may take out of the country with him was reduced from $3,000 to $2,000.

(2) The amount of lawfully acquired foreign currency an Israeli resident may hold was reduced to $2,000.

(3) The transfer abroad of support payments and gifts was permitted only to residents aged 18 or over, and the amount was reduced to $2,000 a year.

(4) An Israeli resident may not acquire securities abroad, apart from securities of Israeli companies especially approved for this purpose. Those holding foreign securities acquired before the amendment went into force may continue to hold them.

(5) The permission granted to an Israeli resident to invest in gold was rescinded.

(6) The permission granted to an Israeli resident to hold foreign currency in a foreign bank account was rescinded, except in the case of exporters and shipping companies, which may continue to hold accounts abroad. A transition period of one year is allowed for closing such accounts.

(7) The permission given to a tourist to freely acquire $3,000 was rescinded. A tourist may now acquire only $500 upon his departure from Israel. (The right to reconvert Israeli currency into foreign currency upon termination of the visit to Israel remains unchanged.)

(8) The value of assets which a resident who has emigrated from Israel is entitled to take out of the country was reduced from 20 percent of the balance of his assets each year to $2,000 a year.

4. ISSUE OF CURRENCY AND COMMEMORATIVE COINS AND MEDALS

On November 17, 1983 a 1,000 sheqel note, bearing the portrait of Maimonides (Rambam), was put into circulation.

On November 1, 1983 a special edition of the ten-sheqel coin, depicting a small Hanukka candelabrum and the word "Hanukka" in Hebrew and English, was issued.

On January 10, 1984 another special edition of the ten-sheqel coin, depicting the likeness of Theodor (Benjamin Zev) Herzl, was put into circulation.

The 1983 Independence Day coin was devoted to the Israel Defense Forces on the occasion of the Year of Valor proclaimed by the government.

At the end of 1983 there were 84.4 million banknotes and 759.4 million trade coins of the sheqel series in circulation, with a total value of IS30,954.1 million.

5. BANK OF ISRAEL PUBLICATIONS

In 1983 the Bank of Israel brought out the following publications:

(a) Research Department

(1) Annual Report 1982 (Hebrew and English).
(2) Main Points of the Annual Report 1982 (Hebrew and English).
(3) Calendar of Economic Events, 1982 (Hebrew).
(4) Recent Economic Developments, No. 34 (bilingual: Hebrew and English).
(5) Economic Review, No. 56 (Hebrew, English forthcoming).
(6) Economic Review, No. 57 (Hebrew, English forthcoming).
(7) National Budget for 1983 (Hebrew).
(8) Economic Development in Judea-Samaria and the Gaza District 1970–80 (English).
(9) Governor's Report on the Increase in the Money Supply between September 30, 1982 and January 31, 1983 and between January 31, 1983 and March 31, 1983 (Hebrew).
(10) Main Israeli Economic Data (binder and weekly updates—bilingual: Hebrew and English).
(11) Catalog of Monetary Data Series (Hebrew).
(12) Road User Charges and Automobile Taxation in Israel (Hebrew).
(13) Changes in Wage Structure in the Public Sector in a Period of Rising Inflation, 1974–1981 (Hebrew).
(14) Economic Review, No. 54 (English).
(15) Economic Review, No. 55 (English).
(16) The Israeli Economy—Facts in Figures, 1983 (English and French).

(b) Department of the Examiner of Banks

(1) Annual Survey of Israel's Banking System, 1982 (Hebrew).
(2) Main Points of the Annual Survey of Israel's Banking System, 1982 (Hebrew).

(3) Annual Statistics of Israel's Banking System, 1978–82 (bilingual: Hebrew and English).
(4) Banking Statistics (monthly—bilingual: Hebrew and English).
(5) Bank Credit by Economic Sector (quarterly, Hebrew).
(6) Issues in Banking, No. 4 (Hebrew).
(7) Directory of Israeli Bank Branches on 1.1.83 (Hebrew).
(8) Deposits in Banking Institutions, 1982 (Hebrew).
(9) Israel's Banking System, 1982 (English).
(10) Banks in Israel—Selected Figures, 1983 (English).

(c) Bank of Israel Comptroller
(1) Financial Statements for the Year 1982 (Hebrew and English).

(d) State Loans Administration
(1) Explanatory Notes and Tables for Calculating Government Bond Redemptions (quarterly, Hebrew).
(2) State of Israel Bonds—Coupon Bonds and Savings Certificates: List of Stop Payments (monthly, Hebrew).

(e) Currency Department
(1) Annual Survey, 1982 (Hebrew).

(f) General Counsel
(1) Legislation and Directives (updates, Hebrew).
(2) Israel's Banking Legislation (2nd ed., English).

(g) Controller of Foreign Exchange
(1) Foreign Currency Control Directives (updates, Hebrew).
(2) Foreign Currency Liabilities (quarterly, Hebrew).

(h) Monetary Department
(1) Capital Market Developments (monthly, Hebrew).

(i) Foreign Department
(1) Exchange Rates of the Israeli Currency in Terms of the U.S. Dollar and the Currency Basket, 1948–1982 (bilingual: Hebrew and English).

(j) Public Relations Office
(1) This Debt We Owe—Israel's External Debt (Hebrew).

In addition to the above publications, the Research Department publishes a Discussion Paper Series, which presents to Israeli economists the drafts of studies before their final publication. The series has two main purposes: to make this research on the Israeli economy available to economists sooner than would be possible where final publication is involved; and to stimulate, prior to final publication of the articles, fruitful discussion by non-Bank economists, thereby helping to improve them. In 1983 the following studies appeared (in Hebrew unless otherwise indicated):

(1) "Inflationary Expectations in Israel: A Multiple Indicators Approach" (Hebrew and English).
(2) "Influence of Rising Raw Material Prices on Industrial Productivity and Profitability in Israel, 1965–1980".

(3) "Incorporation of Liquid Assets In a Dynamic Consumption Function for the 1970s".
(4) "An Outline of Basic Macro-Economic Policy Alternatives" (English).
(5) "Two Issues in the Demand for Money in Israel, 1970–1981".
(6) "Educational Structure and Wage Differentials of the Israeli Labor Force in the 1970s" (Hebrew and English).
(7) "Productivity and Productive Factors of the Construction Industry, 1960–1981".
(8) "New Estimates of the Demand for Money in Israel".
(9) "The Weight of Value Added in Exports, 1971–1981".
(10) "Factor Proportions in Israel's Trade in Manufactures, 1965–1980" (Hebrew and English).
(11) "Nonreversibility of the Interactions between Inflation and Real Money Balances".