

CHAPTER 2

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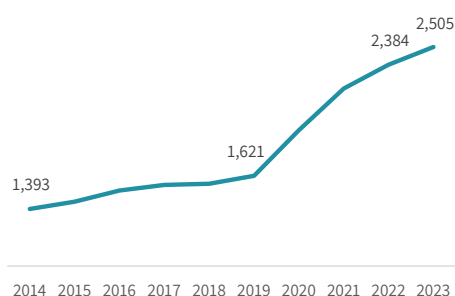
SUMMARY OF THE MAIN DEVELOPMENTS IN BALANCE-SHEET AND OFF-BALANCE-SHEET ACTIVITY

1. Background

The aggregate balance sheet of the banking system increased by 5 percent during 2023, reaching approximately NIS 2,505 billion, compared to approximately NIS 2,384 billion in 2022 (Figure 2.1). The growth rate this year was relatively low compared to the annual growth rates since the COVID-19 crisis (a peak of 19 percent in 2020), but was still higher than in the years prior to 2020 (Figure 2.2).

Moderation in growth rates of the banking system's total balance sheet, particularly since the COVID-19 crisis.

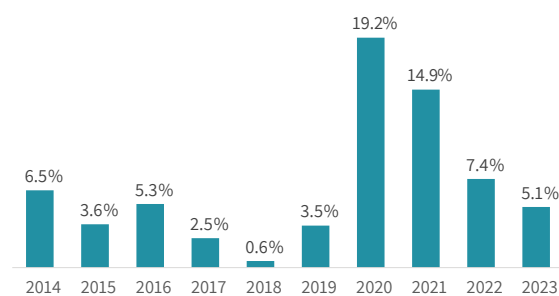
Figure 2.1 The Banking System's Balance Sheet, 2014–2023 (NIS billion)



SOURCE: Based on published financial statements.

Continued growth in the banking system's total balance sheet

Figure 2.2 Increase in the Banking System's Balance Sheet, 2014–2023 (percent)



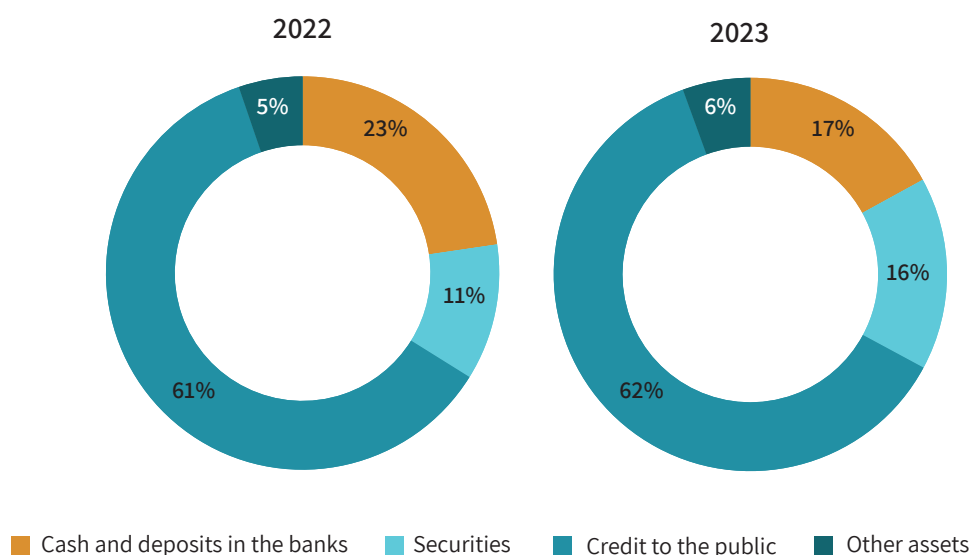
SOURCE: Based on published financial statements.

2. MAIN DEVELOPMENTS ON THE ASSETS SIDE OF THE BANKING SYSTEM

Net credit to the public, which constitutes the main component of the assets side of the banks' balance sheet (62 percent; Figure 2.3), increased by 6.3 percent during the year, which is less than in the previous year (12.3 percent). Total credit was NIS 1,567 billion as of December 2023, with most of the growth occurring in the first half of 2023, while it slowed significantly during the second half of the year (for further details, see Section 5.2 in this survey).

The share of credit to the public and of the securities portfolio increased this year alongside a decline in the share of cash and bank deposits.

Figure 2.3 Distribution of Total Assets in the Banking System, 2022 and 2023 (percent)

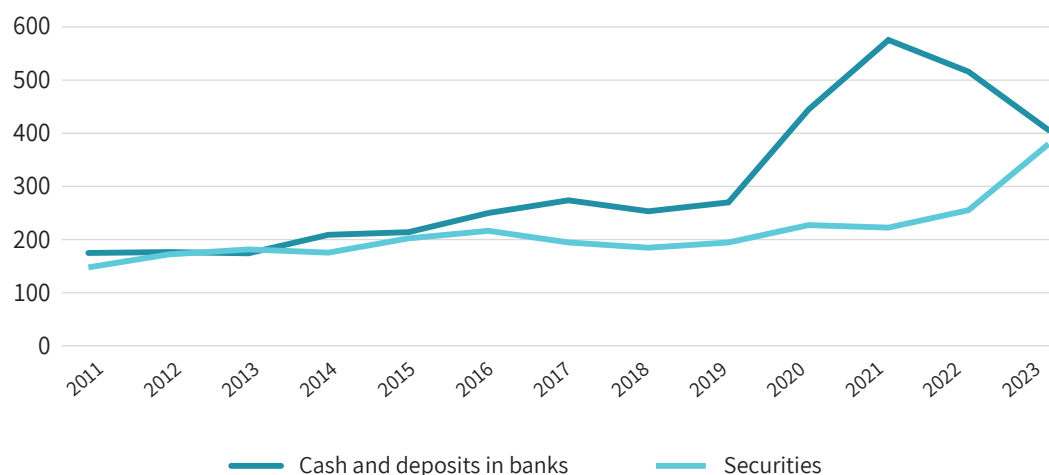


SOURCE: Based on published financial statements.

For 2023 overall, there was a decline in the banks' total cash and deposits of 21 percent (NIS 425 billion as of December 2023), **alongside a significant increase in the banks' securities portfolio**, which was NIS 398 billion as of December 2023 (an increase of 48.7 percent compared to 2022; Figure 2.4). This increase was due to a rise in bank holdings of Makam (central bank bills) along with an increase in the issuance of Makam by the Bank of Israel, and a significant decrease in the volume of monetary deposit auctions conducted by the Bank of Israel in the first nine months of the year. However, the situation reversed in the last quarter of 2023, thus moderating the annual trend, where the volume of monetary deposit auctions increased at the expense of Makam auctions, leading to an increase in the banks' cash and deposits. Furthermore, there was an increase in cash and bank deposits in the last quarter of the year, partly due to increased government flows to the public's deposits as part of an expansionary fiscal policy in response to the war.

During 2023, there was a sharp increase in the securities portfolio alongside a decline in the banks' cash and deposits.

Figure 2.4 Securities and Cash, Total Banking System, 2011–2023 (NIS billion)



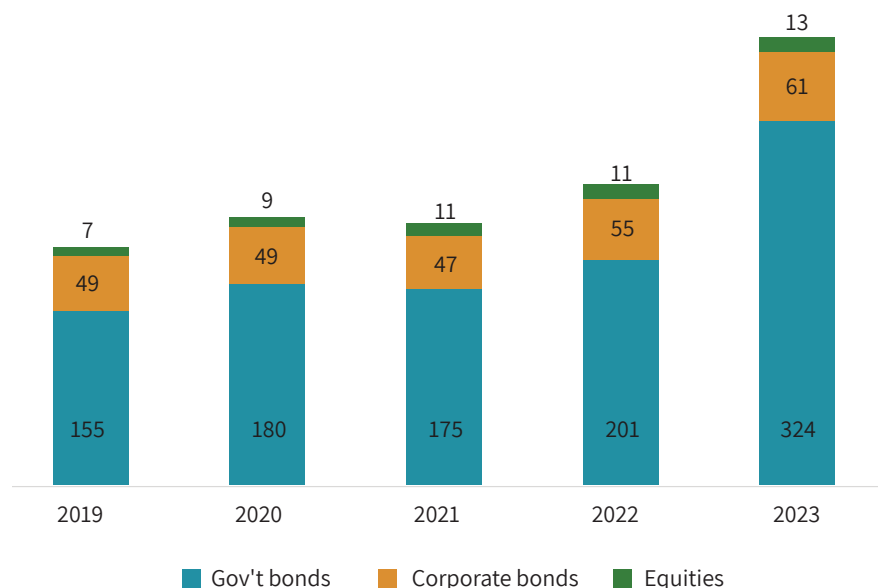
SOURCE: Based on published financial statements.

The increase in the banking system's securities portfolio during the year was due mainly to a rise in the holdings of government bonds (NIS 324 billion as of December 2023, an increase of approximately 61 percent compared to 2022; Figure 2.5). The increase in government expenditures, alongside a contraction in revenues, led to a rise in public debt issuance. Accordingly, there was an increase in the pace of government bond purchases by banking corporations in the last quarter of 2023. This development, along with continued purchases of Makam¹, led to a significant increase in the securities portfolio's share within the banking system's balance sheet, which grew to 16 percent (compared to 11 percent in 2022; Figure 2.3).

¹ The growth in the purchase of Makam in the fourth quarter occurred primarily in the month of October, prior to the outbreak of the war. Subsequently, there was a decline in holdings of Makam by the banking corporations.

During 2023, there was an increase of 61 percent in government bonds held in the banks' shares portfolio.

Figure 2.5 Composition of the Securities Portfolio of the Total Banking System, 2019–2023 (NIS billion)



SOURCE: Based on published financial statements.

Banks classify their investments in securities into three main portfolios: the hold-to-maturity portfolio, the trading portfolio, and the available-for-sale portfolio. The available-for-sale portfolio constitutes the main part (approximately 72 percent). It is worth noting that the trading portfolio nearly tripled in size during 2023, to an estimated value of NIS 48 billion, compared to NIS 16 billion in the previous year. The share of the trading portfolio, along with stocks not held for trading (which remained essentially unchanged this year), within the total portfolio increased from 11 percent in 2022 to 15 percent at the end of 2023 (Figure 2.6).

During the past year, there was an increase in the share of the trading portfolio within the banks' total securities portfolio.

Figure 2.6 Composition of the Securities Portfolio of the Total Banking System, 2021–2023 (percent)



SOURCE: Based on published financial statements.

3. MAIN DEVELOPMENTS ON THE LIABILITIES AND EQUITY SIDE OF THE BANKING SYSTEM

On the liabilities side, **there was an increase in the public's deposits** (which constitute the majority of the liabilities side of the balance sheet) of approximately 4 percent (compared to a 7 percent increase in 2022), to a total of NIS 1,986 billion as of December 2023 (Figure 2.7). The rapid growth in credit to the public during the first half of 2023, compared to more moderate growth in the public's deposits (partly due to the transfer of funds from deposits to Makam holdings), led to a continued upward trend in the credit to deposit ratio. In the second half of 2023, and especially in the fourth quarter, the growth rate of credit to the public slowed (for further details, see Section 5.2 in this survey), and there was a larger increase in the public's deposits. This was due to expansionary fiscal measures in light of the Swords of Iron War and a reduction in the volume of Makam issues by the Bank of Israel. In the fourth quarter of 2023, there was an increase in public deposits without a corresponding increase in total credit (due to the economic slowdown), resulting in surplus resources among the banking corporations. These were deposited as monetary deposits at the Bank of Israel (due to the increase in monetary auctions against the backdrop of expansionary fiscal measures). These changes moderated the annual growth rate of the credit to deposit ratio, which increased by 2 percent on a year over year basis (Figure 2.8).

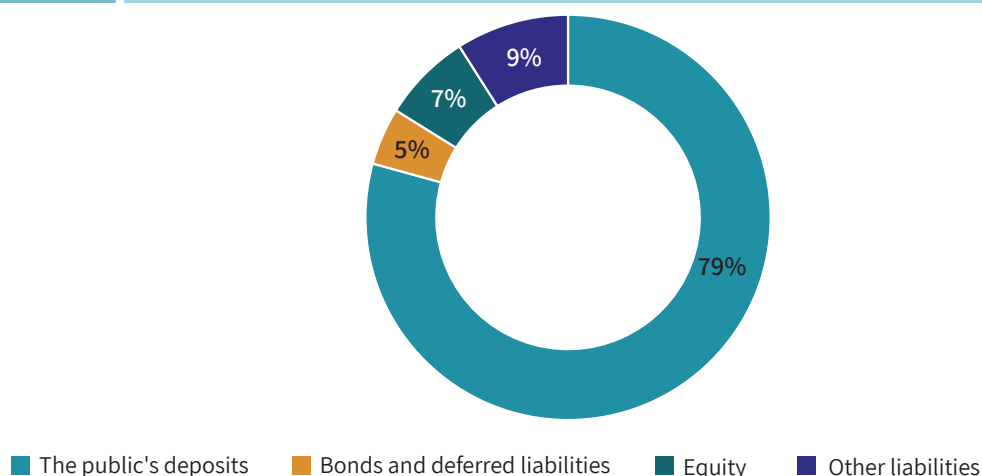
The total equity of the banking system also grew in 2023 (by 12.8 percent), reaching NIS 179 billion as of December 2023. This growth rate is the result of the high profitability of the banking system, alongside conservative dividend distributions due to the Swords of Iron War (for further details, see Chapters 3.1 and 4 in this survey).

During the course of the year, there was a significant increase of about 5 percent in total bonds and subordinated debt notes, reaching a total of approximately NIS 115 billion as of December 2023. This increase was due to several banks in the system, and included the issuance of new bond series, tradable securities, and contingent convertible (CoCo) notes (which have a loss absorption mechanism), alongside the redemption of bonds and early redemption of subordinated debt notes.

The assets and liabilities due to derivatives activity also grew significantly in 2023 as a result of increased activity in these instruments, including interest rate contracts against the backdrop of developments in the interest rate environments in various markets. However, the increase in liabilities related to derivatives in 2023 was higher than the increase in assets related to derivatives, resulting in a net decrease in balance sheet exposure due to derivatives this year.

There was an increase in the public's deposits and equity this year; however, their share within the total balance sheet remained unchanged.

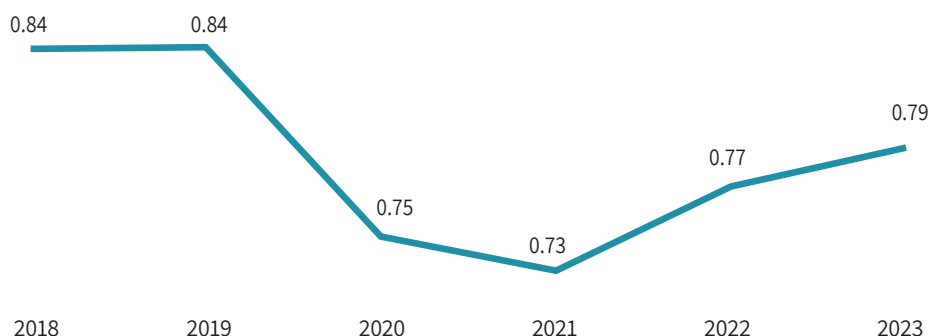
Figure 2.7 Distribution of the Main Liability and Equity Items, Total Banking System, 2023 (percent)



SOURCE: Based on published financial statements.

There was an increase in the credit to deposits ratio relative to the previous year, following the more rapid rise in credit relative to the rise in the public's deposits.

Figure 2.8 Ratio of Credit to the Public's Deposits, Total Banking System, 2018–2023 (percent)

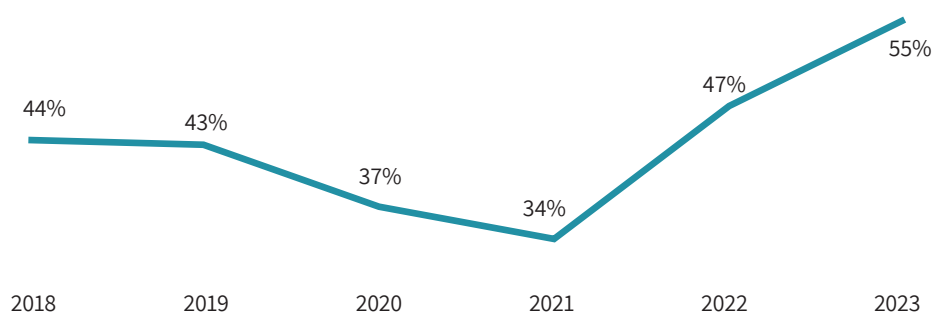


SOURCE: Based on published financial statements.

The proportion of the public's funds held in interest-bearing deposits, which began to rise in the second half of 2022 (during which the Bank of Israel's interest rate was raised), continued to increase during 2023, reaching approximately 55 percent. This is explained by the high interest rates this year compared to previous years and measures taken by the Bank of Israel to encourage the transfer of funds to interest-bearing balances (Figure 2.9). Similarly, households' money market fund holdings also increased, as a result of the high interest rates. In 2023, there was continued growth in (interest bearing) time deposits (22.3 percent; Figure 2.10), at the expense of a decrease in the growth rate of demand deposits (noninterest bearing and interest bearing, with a decrease of 20.7 percent and an increase of 1.4 percent, respectively). However, in 2023, the growth rate of interest-bearing deposits moderated relative to 2022. This was mainly due to the fact that since the outbreak of the Swords of Iron War, the trend has reversed, resulting in a slight decrease in the share of interest-bearing deposits within the public's total deposits. The decrease was due to a sharp decline in the total volume of deposits, driven by fiscal expansion in light of the war as well as by the public's tendency to hold liquid funds during emergencies due to increased uncertainty.

The share of interest bearing deposits within the public's total deposits continued to rise during the course of the year.

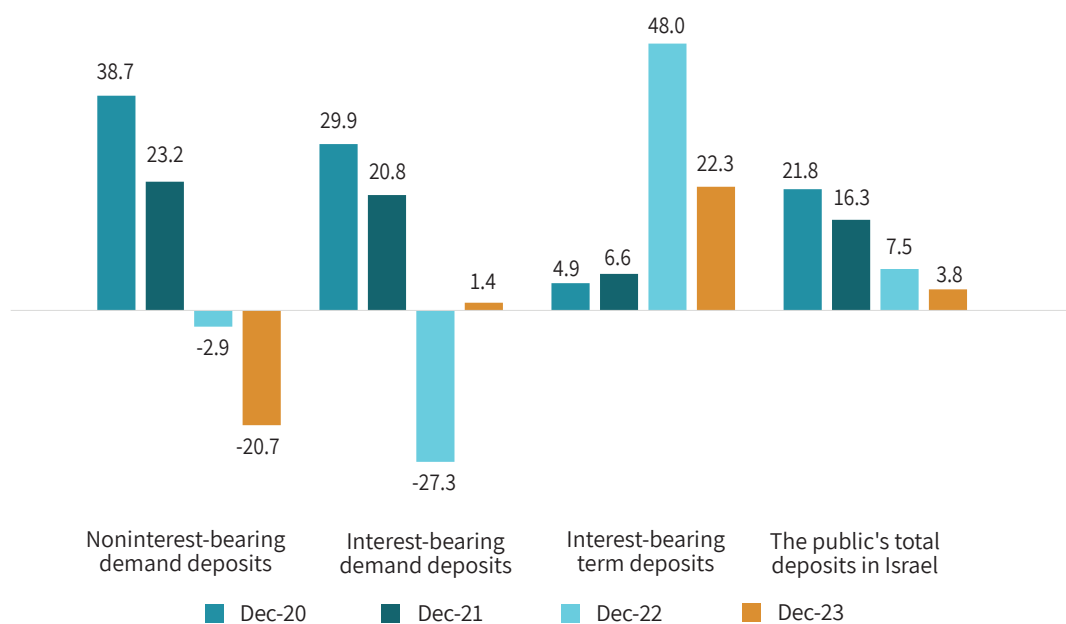
Figure 2.9 The Public's Interest-Bearing Deposits as a Share of Total Public Deposits, Total Banking System, 2018–2023 (percent)



SOURCE: Based on published financial statements.

The increase in the public's deposits during the course of the year was the result of an increase in interest bearing deposits, part of which was due to the shift from noninterest bearing demand deposits.

Figure 2.10 Rate of Change in the Public's Deposits by Deposit Type, Total Banking System, 2020–2023 (annual terms, percent)



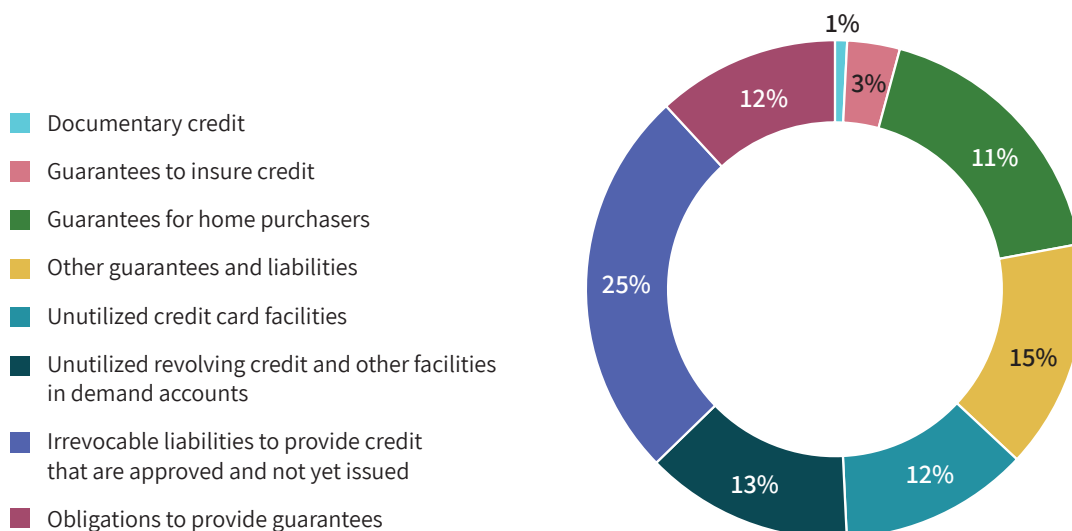
SOURCE: Based on published financial statements.

4. MAIN DEVELOPMENTS IN OFF-BALANCE SHEET ACTIVITY

In the off-balance sheet items, total off-balance sheet exposure grew due to transactions in off-balance sheet financial instruments, whose nominal amount represents credit risk, grew by 9.2 percent (a higher growth rate than in the previous year, when it was only 2.5 percent). The increase in off-balance sheet liabilities was due to four main factors: growth of approximately 30 percent in obligations to issue guarantees; growth of approximately 21 percent in unused credit card credit lines; growth of approximately 14 percent in irrevocable commitments to provide approved credit that has not yet been disbursed (also including approvals in principle for housing credit); and growth of approximately 12 percent in unused overdrafts and other credit lines in demand accounts (the majority of which occurred in the fourth quarter of the year due to the war; Figure 2.11, Table 5). The increase in off-balance sheet liabilities was tempered by a decrease of approximately 11 percent in guarantees for home buyers, against the background of a slowdown in residential home transactions during the year (following growth of approximately 22.2 percent during 2022; for further details, see Section 5.2 in this survey).

During the year, there was an increase of about 9.2 percent in exposure due to transactions in off-balance sheet financial instruments.

Figure 2.11 Exposure in Respect of Off-Balance-Sheet Financial Instrument Transactions Where the Denominated Amount Represents Credit Risk, Total Banking System, December 2023 (percent)



SOURCE: Based on published financial statements.