

## CHAPTER XVIII

### MONEY SUPPLY, CREDIT AND THE BANKING INSTITUTIONS

#### 1. MAIN DEVELOPMENTS

A rapid and nonuniform monetary expansion took place in the economy in 1977. In the first part of the year, until the introduction of the reform, a quick real<sup>1</sup> expansion of the major non-linked monetary variables occurred following their real decline in 1976. In the latter part of the year, there was a quick growth in the assets and some of the liabilities of the public in foreign currency (beyond the influence of the change of the exchange rate), while simultaneously a real decrease in non-linked variables in Israeli currency occurred. The rapid monetary expansion found its main expression in the adjustments made in the public's portfolios, while its influence on the volume of economic activity and the development of prices was apparently secondary.

In the period before the reform, money supply, fixed term deposits of the public, free credit, directed credit and the money base increased at a rate over 30 percent, while prices increased by only 21 percent. The public turned in this period to non-linked financial assets (money supply and fixed term deposits) mainly owing to the decrease that took place at the beginning of the year in the pace of price increases and the great boom on the share market. The rapid monetary expansion in this period was fed primarily by huge governmental injections. At the same time the decrease in liquidity deficits was halted, and the banks increased their reliance on sources with no liquidity requirements, mainly equity capital, to finance their activities.

The period following the reform was characterized by the adaptation of the monetary system to the new conditions created by the reform. During this period there was a real decrease in non-linked financial assets and in share rates, and the public channeled its demand first into savings schemes and subsequently into foreign currency deposits, whose liquidity increased considerably. The Bank of Israel froze free credit for Israeli and foreign currency. Following this freeze and the imposition of restrictions on increased directed credit in Israeli currency, there was a real decrease in the value of IL credit. In contrast to this, the volume of directed credit from the Bank of Israel to export

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<sup>1</sup> The consumer price index is used in this chapter for the calculation of real values, unless stated otherwise.

TABLE XVIII-1

THE MONEY BASE AND LIQUIDITY DEFICITS OF THE BANKS, 1975-1977<sup>a</sup>

Year	Narrow money base		Broad money base		Liquidity deficit of the banks
	Balance	Increase or (-) decrease <sup>b</sup>	Balance	Increase or (-) decrease <sup>b</sup>	
	(IL million)	(percent)	(IL million)	(percent)	(IL million)
	(annual average) <sup>c</sup>				
1975	7,329	26.4	8,579	27.8	-810
1976	8,650	18.0	9,989	16.4	-754
1977 <sup>f</sup>	13,136	49.0	14,523	42.9	-872
	(Balances at end of period)				
1975	7,224	4.9	8,569	6.3	-1,519
1976	10,549	46.0	11,957	39.0	-381
1977 <sup>d</sup>	15,993	48.1	17,540	43.6	-783
26 October	14,880	37.5 <sup>d</sup>	16,064	31.2 <sup>e</sup>	-524
December <sup>d</sup>	15,993	7.5 <sup>e</sup>	17,540	9.2 <sup>f</sup>	-783
1977 I	12,419	17.7	13,766	15.1	-888
II	12,958	1.3	14,377	1.7	-784
III	14,366	10.9	15,600	8.5	-863
IV <sup>d</sup>	15,993	11.3	17,540	12.4	-783

<sup>a</sup> From May 1977 about IL 370 million in deposits for export financing were transferred to the liquid assets item, due to a change in reporting instructions. Growth rates do not include this growth.

<sup>b</sup> Annual or quarterly changes as appropriate.

<sup>c</sup> Annual averages are based on monthly data.

<sup>d</sup> See note n in Table XVIII-10.

<sup>e</sup> Rate of change between end of December 1976 and 26 October 1977.

<sup>f</sup> Rate of change between 26 October 1977 and end of December 1977.

SOURCE: Tables XVIII-i and XVIII-ii.

increased. Considering the rapid development of this credit and of the foreign currency deposits of the public, it can be said that the monetary expansion that characterized the first part of the year was not stopped but was turned to other channels. At the same time it should be stressed that more experience is required in order to evaluate the extent of actual substitution between assets and liabilities in Israeli currency and those in foreign currency.

In the course of the year there was an increase in interest rates for non-linked credit and assets in Israeli currency. Real interest rates were high at the beginning of the year and decreased in the course of the year with the rise of inflationary expectations.

In the first part of the year, the Bank of Israel acted moderately in order to stall monetary expansion and reduce the discrepancy between the rate of interest on free credit in Israeli currency and other interest rates. Preparations were also made for a gradual reduction of working capital funds which were put into play at the beginning of 1978. In the period following the reform the policy of the Bank of Israel was directed mainly to forestalling shocks during the economy's period of adaptation to the new conditions, by freezing free credit in Israeli and in foreign currency and curbing the influence of temporary factors on the development of the exchange rate. After a short transition period, the Bank of Israel abolished credit restrictions at the beginning of 1978.

Monetary expansion continued in the first quarter of 1978 in a direction similar to that at the end of the year. There was a considerable growth of deposits and directed credit in foreign currency, and the increase of money supply and free credit in Israeli currency kept pace with price increases.

## 2. MONETARY DEVELOPMENT AND MONETARY POLICY UNTIL THE REFORM

In the first part of the year, until the introduction of the reform, a rapid monetary expansion took place in the economy. As compared to the previous year, the rate of growth for the money supply, for fixed term deposits of the public, and for free and directed credit was enhanced, while their real value increased (after the 1976 growth of the first three variables had lagged behind price increases). The rapid monetary expansion was made possible by great liquidity injections to the system, mainly by the government, on the one hand, and by the mobilization of capital by banks and their liquidity deficits on the other.

Following trends that had become apparent mainly towards the close of the previous year, there were considerable changes in the composition of portfolios in the hands of the public. The expanded demand for shares stood out in particular, leading to quick rises in

TABLE XVIII-2

**TURNOVER VELOCITY OF DEMAND DEPOSITS  
AND MONEY SUPPLY, 1973-1977**

	Average turn- over velocity of demand deposits <sup>a</sup>	Annual average turnover velocity of the money supply		
		Relative to GNP <sup>b</sup>	Relative to economy's uses <sup>c</sup>	Relative to domestic uses <sup>d</sup>
1973	24.2	5.99	9.07	7.04
1974	28.7	6.96	11.05	8.62
1975	31.9	7.60	11.99	9.30
1976	35.8	8.23	13.20	9.84
1977	38.4	8.19	13.44	9.56
January-September	36.7	7.94	12.84	9.28
October-December	47.5	8.95	15.20	10.39

<sup>a</sup> Total debiting of demand deposits in Israeli currency in the banks divided by the annual average volume of these deposits.

<sup>b</sup> GNP at current prices (based on effective exchange rate), divided by the average annual level of the money supply.

<sup>c</sup> GNP at current prices, plus import, but excluding ships, aircraft, and direct defense imports (based on the effective rate of exchange), divided in the same way as mentioned in the previous footnote.

<sup>d</sup> Domestic uses: the economy's, as defined in the previous footnote; excluding export.

SOURCE: Turnover of demand deposits – Department of the Examiner of Banks, statistics of the banking institutions; the money supply and unlinked assets – Table XVIII-ix GNP, the economy's uses and domestic uses – Table II-1.

their prices, thus creating huge capital gains and facilitating the extensive mobilization of capital through the Stock Exchange (See Chapter XX).

The turnabout on the Stock Market stems partly from the poor terms offered for the issue of linked securities, which also raised fears concerning deteriorating conditions

for existing securities as well. Following this process, to which the attenuation of inflationary expectations was appended at the beginning of 1977, the level of net direct sales of securities to the public declined and touched bottom; on the secondary market for these securities there were real drops, while price fluctuations increased. The public's demand for index-linked assets was channelled to a greater extent into indirect holdings – savings schemes, trust funds, etc. Accumulation in the public's foreign currency deposits continued at a sluggish pace. At the same time, real demand for non-linked financial assets (money supply and fixed-term deposits) increased, as mentioned<sup>2</sup>. It seems that this development should be attributed primarily to the decrease in the cost of holding these assets that took place at the beginning of the year. This resulted from a decline in the pace of inflation, and the expanded activity on the Stock Market that tied up money supply for trading purposes, particularly in anticipation of large issues<sup>3</sup>. The change in the composition of the portfolios and the increase in their real value may have also acted in similar direction. The increase in the weight of shares in the asset portfolios and the increased degree of fluctuation in security prices considerably aggravated the extent of risk incurred by the asset portfolio and laid the framework for the increased demand for non-linked financial assets, which lack nominal risk and have a relatively low real risk<sup>4</sup>.

The development that characterized the period prior to the reform was most prominent at the beginning of the year and, with the growth in the rate of price increases, it changed toward a course more resembling that prevailing in the past. The increase in the real value of money supply and fixed-term deposits of the public, which was rapid at the beginning of the year, was halted subsequently. In tandem the accumulation of foreign currency

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<sup>2</sup> Since there was no considerable increase of real activity in the economy this change was expressed by the reduction of the speed of turnover with respect to the product and the sources.

<sup>3</sup> It can be assumed that the increase in the volume of the unconsumed deals and orders also contributed to the increase of demand for liquidity (although the rapid price increases served to abbreviate the waiting period between sale and purchase). At the same time it is not clear how the effect of this factor was distributed between the increased demand for money supply and the reduced withdrawals from debitory credit accounts and overdraft from demand deposits.

<sup>4</sup> Since part of the liabilities of the public are expressed in nominal terms, the amount of nominal risk inherent in a portfolio is also important; in addition to the real risk. Table X4 attests to the fact that despite the increased fluctuations in the real value of money in 1977, the gap between the standard deviation of this value and that of other assets increased. In addition, it should be pointed out that during the period prior to the reform, the pace of price increases accelerated gradually.

TABLE XVIII-3

FREE MEANS OF THE BANKING SYSTEM -- SOURCES AND USES,<sup>a,b</sup> 1975 1977  
(IL. million)

	1975	1976	1977 <sup>c</sup>	1977			
				January- September	October	November	December
<b>SOURCES</b>							
1. Public's deposits <sup>d</sup>	275	1,293 <sup>e</sup>	2,055	1,766	-12	-70	371
2. Savings programs and long-term linked deposits	969	6,193 <sup>f</sup>	2,757	1,493	217	521	526
3. Equity capital and capital promissory notes	879	1,093	3,863	2,450	-25	125	1,313
4. Rediscount in the Bank of Israel and recognized differentials	-33	297	-23	-211	139	59	-10
5. Other sources, net	278	223	1,702	345	153	-530	1,734
6. Total sources	2,368	4,099	10,354	5,843	472	105	3,934
<b>USES</b>							
7. Credit from the banks' own means, incl. participation in directed credit & credit from deposits (excl. approved loans)	2,366	2,517	5,108	4,759	977	-1,033	405
8. Required liquidity on credit	341	83	194	120	111	-55	18
9. Net credit to the government, excl. government bonds & deposits in the Treasury against savings for housing	135	-323	1,454	-335	-36	1,531	294
10. Net accumulation of assets above debt holding <sup>g</sup>	978	684	3,999	1,780	842	-1,177	2,554
11. Total uses	3,820	2,961	10,755	6,324	1,894	-734	3,271
12. Change in liquidity deficit	1,452	-1,138	401	481	1,422	-839	-663

<sup>a</sup> The data of this table are in relation to the net effect of the various components of free means.

<sup>b</sup> The difference between this table and Table XVIII-iii is that here the heading "required liquidity on credit" appears under uses and not sources.

<sup>c</sup> See note a in Table XVIII-iii.

<sup>d</sup> Includes demand deposits, other deposits and time deposits.

<sup>e</sup> Of this sum, IL. 240 million is attributed to a drop in the rate of liquidity requirement.

<sup>f</sup> In April 1976 the required deposit against savings schemes was raised from 75 to 83 percent.

<sup>g</sup> Including bonds and shares beyond the required investment, surplus assets in foreign currency, plant and equipment, interbank deposits and net sums in transit.

SOURCE: Table XVIII-iii.

deposits in the hands of the public increased in the second quarter of the year, and in the third quarter deposits in savings schemes increased. Although these developments were apparently influenced by special factors (expectations of devaluation and the improved terms of savings schemes), they accord with a deceleration in the real growth of non-linked financial assets as a result of the acceleration of price increases.

From the development of a number of variables it appears that in the second quarter the public tended to increase the weight of its net assets in foreign currency, in expectation of a massive devaluation after the elections, and that this tendency weakened in the third quarter when it seemed that such a devaluation would not materialize. The premium rate on the Natad dollar, which constituted a barometer of the intensity of expectations surrounding a devaluation, increased steeply in the second quarter and decreased in the third quarter (although this development was also affected by bank demand for Natad for the financing of investments abroad). In the second quarter there was a rapid accumulation of foreign currency deposits (those not maintained by receivers of personal restitutions) that had in the past been very sensitive to expectations of devaluation, and it weakened in the third quarter. In the second quarter the exploitation of directed foreign currency credit decreased -- a phenomenon influenced partly by seasonal factors. It should be noted that balance of payments data do not point to the migration abroad of short-term capital in the second quarter (this development took place in the first quarter, and it might have stemmed from an earlier reaction of short-term capital movements).

The rapid monetary expansion during this period did not skip over credit. Free credit in Israeli currency, whose pace of growth had been limited in 1976 owing to an arrangement between the Bank of Israel and the banks, increased in the first three quarters of the year by 38 percent, with a growth of about 14 percent in its real value. It seems that this rapid growth was related to the increased activity on the share market, among other factors.

Directed credit increased by 34 percent, with a slow increase of directed credit for domestic activity and a more rapid increase of directed credit for exports.

During this period, the interest rates on non-linked assets and credit in Israeli currency continued to grow. The Bank of Israel raised the interest rate on directed credit in Israeli currency for domestic activity and the revenue of banks from their participation in directed credit. The interest rate on the short-term loan was also raised. The banks on their part raised interest on fixed term deposits, as well as the tariffal interest on free credit.

Considering the high cost of expanding credit under conditions of liquidity deficit, it

seems that there was an increase of effective interest on free credit as well (being also affected by other factors, in addition to the tariffal interest<sup>5</sup>). It appears that the difference between interest rates on free and directed credit was somewhat reduced, but it seems that it increased again following the freezing of free credit at the end of the year.

At the beginning of the year prices increased at a relatively sluggish rate, and it appears that inflationary expectations were also low, at least in relation to the pre-election period.

Since changes in the rate of price increases were great when compared to changes in interest rates on non-linked assets and liabilities in Israeli currency, it appears that the real level of these interest rates was high at the beginning of the year and it decreased with the acceleration of price increases.

The rapid monetary expansion during this period was fed mainly by government liquidity injection of great dimensions and by rediscounts of the Bank of Israel, in the framework of directed credit arrangements. This liquidity injection, as well as the injection stemming from the actions of other parts of the public sector, was partially halted by the actions of the private sector in foreign currency. (See below: the money base.)

Although the growth rate of the money base in annual terms during this period was similar to that of the previous year, the growth of monetary variables subject to liquidity requirements was considerably accelerated – current deposits, fixed-term deposits, and free credit in Israeli currency. This accelerated expansion took place without an increase in liquidity deficits, since the banks increased considerably the volume of mobilized resources which bear no liquidity requirements. At the same time, the sharp decrease of liquidity deficits that had taken place in 1976 was halted during this period. Following a decrease of about IL 1.1 billion, deficits remained at an average level of about IL 400 million for 1977 (until the reform).

In the first nine months of the year, the banks raised about IL 2.5 billion, or about 42 percent of the additional resources at their disposal, through equity capital promissory notes (as against 27 percent in 1976<sup>6</sup>). The mobilization of resources through savings schemes and long-term linked deposits increased as well, although their share in total additional resources decreased somewhat. It seems that the greater resort to resources from

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<sup>5</sup> See the discussion below on free credit, and footnote 32 in particular. It should be noted that despite the fact that the cost of the enlargement of credit was higher, from the point of view of the banks, in the period in which the previous credit freeze was effective, it did not necessarily determine the price of credit, since banks did not exceed the credit ceiling.

<sup>6</sup> See Table XVIII-3.

the capital market can be related to the high cost of credit expansion under conditions of liquidity deficit on the one hand, and to the favorable conditions prevalent in the Stock Market on the other.

In recent years, the Israeli economy underwent a rapid process of price increases, accompanied by stagnation in economic activity and an accumulation of unexploited production capacity. There is no doubt that had this process continued for a long time without a suitable monetary expansion, it would have meant further damages to the level of economic activity. However, it seems that the monetary developments were not the decisive factor in determining developments in prices and in real demand; the short-term fluctuations that took place in the volume of monetary expansion found their main expression in adjustments of the asset portfolios of the public<sup>7</sup> (partly by means affecting the balance of payments). It seems that this picture has not changed materially in the period under review. It is possible that the speed of monetary expansion in real terms had a certain stimulating effect on demand at the beginning of the year, although, as mentioned, a high level of real interest rates prevailed during that period.

In the period prior to the reform, the monetary policy predicated on restraining the pace of monetary expansion, on preventing a widening of the gap between various interest rates and reducing directed credit for domestic activity.

At the beginning of 1976, the Bank of Israel initiated with the banks an arrangement whose purpose it was to assist them in reducing the heavy liquidity deficits. In this framework a special loan, amounting to IL 400 million, was granted to the banks, conditional upon a regulated increase of free credit. After having lost its effectiveness at the beginning of the year, this arrangement was cancelled by the Bank of Israel as from the month of April.

With the decision to cancel restrictions on free credit, the Bank of Israel collected from the banks, between January and April, the special loan for alleviating the liquidity situation. It also acted to increase the cost of monetary expansion to the banks, by raising fines on liquidity deficits (that are not a recognized expenditure for taxation purposes) from a maximum rate of 16 percent to 18 percent<sup>8</sup>. Later on, the Bank of Israel initiated

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<sup>7</sup> It should be noted that the monetary expansion is itself directly influenced by the process of price increases, since the government and the Bank of Israel adjust their injection to ensure the real value to expenditure plans and of credit for preferred activities.

<sup>8</sup> At the same time, the cost was lower than in the period in which restriction of the volume was effective. See below the discussion of the free credit.

changes in export funds that increased the deposit requirements of banks in respect of this credit<sup>9</sup>. Despite the influence of these restraint measures, there was, as mentioned, a rapid monetary expansion in the period prior to the reform. Considering the relatively high level of interest rates on free credit, it is hard to determine whether sharper restraint measures would have significantly limited the pace of monetary expansion or would only have encouraged the flow of capital from abroad to the economy.

In the course of this period, the Bank of Israel stepped in to raise interest rates on non-linked directed credit in Israeli currency, on the bank's financing of directed credit from their own resources, and on the short-term loan. These increases were intended a) to prevent a widening of the gap between interest on free credit in Israeli currency and other interest rates, b) to enhance the efficiency of the activity of the money market, c) to forestall a rise in the subsidy comprised in direct and d) to encourage saving.

Towards the close of the above-mentioned period, the Bank of Israel started to firm up arrangements for a gradual reduction of working capital funds, while permitting an early redemption of securities in order to prevent liquidity difficulties to creditors (see below).

### 3. THE REFORM AND THE MONETARY DEVELOPMENT FOLLOWING IT

On October 28th, the government decided to implement a reform of the exchange rate method and of foreign currency control. The reform was based on the following main principles: a) liberalization of foreign currency control; b) floating of the exchange rate; c) unification of exchange rates. Extensive and important influences on the monetary system are inherent in this reform, and some of these already made their mark by the end of the year.

a) Within the framework of the liberalization of foreign currency control, limitations on the maintenance of foreign currency deposits by Israeli residents in local banks were abolished, and the possibility of holding foreign currency assets was expanded. In addition,

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<sup>9</sup> This refers to the increased role of the banks in financing these funds from their own resources which rose from 12.5 percent to 15 percent, and to the transfer of the financing of export shipments from the resources of banks in foreign currency to the shipment fund (see below). At the time of their introduction these changes increased deposit requirements by banks from their own Israeli currency by about IL 100 million and about IL 270 million respectively (although the change in export shipments was gradual).

the limitations on receiving foreign currency credit from local and foreign banks were reduced<sup>10</sup>.

These changes contribute to the increased liquidity of foreign currency assets, and create a basis for fuller and more frequent adjustments in the structure of the portfolios of assets and liabilities between Israeli and foreign currency. It can also be expected that the changes will lead to a reduction of the cycles of speculative fluctuation in the inventories of import commodities.

The greater substitution between the various currencies increases the range of assets and liabilities, the development of which might affect demand, and necessitates a balanced monetary policy in order to prevent a sharp transition from Israeli to foreign currency. In principle, the said substitution reduces the difference between return rates in local currency and the price of capital mobilization in foreign currency (the external interest rate, together with the expected rate of change of the exchange rate).

b) The practical significance of the floating of the currency depends on the extent of direct intervention by the Bank of Israel in the determination of the exchange rate. The smaller this intervention is, the more extensive will be the changes eventuated in the operation of the system by the float.

1. The smaller the intervention the greater will be the influence of the balance of payments of the private sector on determining the exchange rate. This expanded influence possesses an additional significance, given the liberalization and the equalization of exchange rates that raised the exchange rate for financial transactions as compared with exchange rates in foreign trade. These changes magnify the influence which expectations of changes in the exchange rate exert on its actual development.

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<sup>10</sup> According to the Currency Control Law 1978, Israeli residents were permitted, among other things, (a) to purchase foreign currency from authorized agents for deposition in resident deposits in the name of Israeli residents and to transfer foreign currency from one resident deposit to the other; (b) to purchase foreign currency through authorized agents in the value of up to \$3,000, for holding in cash in Israel; (c) to purchase and sell foreign securities through authorized agents (excepting Israel Government Bonds) registered for trade at the Stock Exchange of certain countries, conditional on the deposit of the security with an authorized agent in a custodial account in the name of the Israeli resident; (d) to borrow foreign currency from an authorized agent or from a foreign resident, provided the amount of the loan is exchanged into Israeli currency through an authorized agent or is deposited in a resident deposit in the name of an Israeli resident, and that the fairness of the terms of the loan from the foreign resident is proved to the satisfaction of the authorized agent; (e) to purchase foreign currency from an authorized agent for the repayment of a loan in foreign currency, as mentioned, provided it is proved to the satisfaction of the agent that income tax on the interest has been paid.

2. In the absence of a stabilizing intervention on the foreign currency market, and in the absence of a regular market for future transactions<sup>11</sup> in foreign currency, the uncertainty concerning the development of exchange rates increases. This uncertainty could permit the continued existence of gaps between expected return rates on local currency and those on foreign currency, and neutralize the reduction inherent in the liberalization. It should be noted that uncertainty concerning exchange rates might prove damaging to exports.

3. Reduced intervention creates a situation where surplus demand for foreign currency by the private sector influences exchange rates and diminishes the influence of this demand on the money base and on foreign currency balances. As a result a balance in the portfolios of assets and liabilities of the public is obtained more through value adjustment than via quantitative adjustments.

4. The smaller the direct intervention in the determination of the exchange rate, the greater will be the indirect influence exerted by monetary and fiscal policy on the exchange rate, via their influence on excess plus demand for foreign currency of the private sector. The action of this indirect mechanism imposes a heavy responsibility on policy makers, especially since the repercussions of their measures on expectations of changes of the exchange rate might have a destabilizing effect on it.

5. In the absence of direct intervention in the determination of the exchange rate, the ability of money policy to influence the level of domestic economic activity increases, since its influence on domestic demand is not cancelled by changes in the money base, and this influence becomes even more powerful through its direct effect on the exchange rate and on the current account of the balance of payments<sup>12</sup>. In addition, the uncertainty concerning the exchange rate extends, as mentioned, the possible difference between domestic and foreign interest rates. At the same time, limitations on the use of monetary policy for macro-economic regulation increase due to its indirect effects on the current account.

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<sup>11</sup> Although possibilities exist for circumventing exchange rate risks through a balance of linkage, at the moment there is no institutionalized market where commitment can be obtained concerning a future foreign currency transaction at a rate agreed upon in advance.

<sup>12</sup> Thus, a restrained monetary policy leads to an augmented capital movement to the economy through the increase of interest rates; this capital movement not only does not neutralize the effect on the money base, but it also leads to revaluation, and thus to the enhancement of the restraining effect through the current account. On the other hand, a fiscal restraint policy lowers interest rates, thus leading to the outflow of capital from the economy, to currency devaluation and to the improvement of the current account.

With the introduction of the reform it has been decided that the intervention of the Bank of Israel in the foreign currency market will not be geared towards influencing the development of the exchange rate, as dictated by the basic factors of the balance of payments, but will be restricted to the moderation of exchange rate fluctuations stemming from circumstantial short-term factors. In order to moderate the influence of fluctuations in demand for foreign currency deposits on the reserves of the economy, the Bank of Israel fixed high liquidity rates for deposits of local residents in foreign currency (Patam)<sup>13</sup>. Since the demand for deposits in foreign currency of local residents is one aspect of public demand for foreign currency, the development of these deposits affects the rate of exchange.

c) The unification of exchange rates<sup>14</sup>. In the past there existed a cyclical reduction of differences between effective exchange rates in foreign trade and the currency transfer rates during periods of massive devaluation, and a widening of these gaps between devaluations. This time as well, the great change in the exchange rate was accompanied by a reduction of the gaps, but no expectations of their future widening have been created. This change, which is significant mainly for holders of reparations accounts, had apparently no great influence on their behavior (see below). The increased rates for currency transfers enhances, as mentioned, their monetary effects on capital movements.

With the introduction of the reform, an increase of 47 percent took place in the rate of exchange, and an increase of 12 percent in the consumer price index. These sharp changes raised the real value of foreign currency components in the asset and liability portfolios of the public, and reduced the real value of the non-linked components in Israeli currency, creating profits and losses according to the weight of foreign currency in the portfolios. These changes were not accompanied by a substantial movement of realization of capital profits, and there was no compensatory transfer from foreign currency assets and liabilities to assets and liabilities in Israeli currency; on the contrary, there was a rapid increase of deposits in foreign currency of the public, with only a partial

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<sup>13</sup> Deposits of local residents in foreign currency not stemming from personal reparation revenues. The rate of liquidity for the "Patam" deposits has been fixed at 80 percent, and that of fixed-term deposits of local residents in foreign currency – at 90 percent. (The rate of liquidity for reparation accounts of recipients is 100 percent). The required liquidity is in foreign currency, deposited with the Bank of Israel.

<sup>14</sup> The main changes leading to a consolidation of exchange rates were the abolition of tax refunds that had been awarded as export incentives, the abolition of import duty (including duties on the import of services), the reduction of customs rates and the abolition of foreign travel tax.

correction of the real decrease in non-linked financial assets of the public. In addition, recourse to directed credit in foreign currency increased considerably, and there was a certain increase of foreign exchange credit outside the foreign currency funds, while the increase of credit in Israeli currency was slow. Development in short-term capital movements in the balance of payments, on the other hand, do not present a clear picture<sup>15</sup>.

The rapid growth that took place simultaneously in foreign currency assets of the public and in at least part of its foreign currency liabilities may be explained on the one hand in the light of the public's wish to increase the weight of its foreign currency assets (which until now had been restricted by control). On the other hand the context of restrictions on the expansion of credit in Israeli currency, as well as special factors that affected demand for directed credit in foreign currency should also be kept in view (see below).

In general it should be emphasized that the structure of the differences between interest to borrowers and interest rates to lenders in Israeli currency and between those in foreign currency, might have encouraged a movement of borrowers as well as depositors towards foreign currency<sup>16</sup>. Finally, it is possible that, following the liberalization, part of the public (mainly businesses, most of whose activity is in foreign currency) chose to increase the weight of foreign currency both in its assets and its liabilities<sup>17</sup>.

The most striking reaction of the public in the first days following the introduction of the reform was expressed in deposits of considerable dimensions in savings schemes, taking advantage of the possibility of accumulating capital profits by these deposits (see below). During this period the public converted part of its foreign currency deposits, but at a relatively moderate rate, and very soon the public altered its behavior and embarked upon a rapid accumulation of foreign currency deposits. The increase in local residents' foreign currency deposits was particularly prominent.

In contradistinction, there was a considerable real decrease in non-linked assets of the public in Israeli currency. Money supply increased until the end of the year, but at a rate

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<sup>15</sup> See discussions of action of the private sector in foreign currency in section 4 (The Money Base).

<sup>16</sup> Differences between interest rates to borrowers and to deposits in foreign currency are considerably lower than those between interest rates on free credit and fixed-term deposits. It seems that at the end of the year the above mentioned interest rates in foreign currency were lower than the interest rate on free credit in Israeli currency, and higher than the interest rate to depositors in Israeli currency.

<sup>17</sup> The difference between the price of directed credit in foreign currency and the return in local residents' foreign currency accounts might also have acted in a similar direction.

lower than that of price increases, and fixed-term deposits even decreased. Stock prices also decreased considerably, and it is possible that this development affected demand for money supply as at the beginning of the year. Demand for securities was slack in November, but recovered in December.

The rapid growth of the public's foreign deposits, together with a real decrease in non-linked financial assets in Israeli currency, reflects a transition to liquidity holding in foreign currency on the part of economic units whose economic activity is in foreign currency, as well as on the part of the public as a whole. This transition was caused on the one hand by the increase that apparently took place in inflationary expectations, and on the other hand by the possibility of holding linked assets with high liquidity levels and high revenues for an indefinite period<sup>18 19</sup>.

The striking preference for foreign currency deposits over the direct holding index of linked bonds during this period apparently reflects the greater confidence of the public that exchange rates would indeed change more than the rates of bonds. It is also possible that the increased accumulation in savings schemes occurred at the expense of demand for the direct holding of bonds. The demand for foreign currency schemes was channeled mainly to deposits in Israeli banks and it apparently affected the balance of payments only slightly.

The development of credit, too, is characterized by the rapid expansion of its foreign currency components as compared to those in Israeli currency. As a result of the freeze on nondirected credit and of seasonal factors that affected the availability of directed credit in Israeli currency, the growth of credit in local currency lagged behind the price increases, and the interest rate on nondirected credit in Israeli currency apparently increased. In contradistinction, directed credit in foreign currency increased at a rapid pace (13 percent, after deduction of the change of the exchange rate, and 50 percent after deduction of the change of the effective rate of export). This development was undoubtedly affected by the growth in the volume of exports and by special factors active in the diamond sector, but it apparently also reflects the reaction to the increased cost of nondirected credit in Israeli currency and to lowered expectations of short-term changes in the exchange rate. Credit outside the foreign currency funds increased by about 5 percent, which was possible despite the government injection and foreign currency acquisitions by the public, which brought about a non-uniform development of the money base throughout the year<sup>24</sup>.

<sup>18</sup>It appears that at the end of the year there were no high expectations for a change of the exchange rate in the short term, but there certainly were expectations of its continued rapid change in the long term as a result of the continued inflationary process.

<sup>19</sup>From the point of view of individuals, this revenue is also affected by tax regulations.

TABLE

## INFLUENCE OF PUBLIC AND PRIVATE SECTORS

(Change in

	1975	1976	1977
1. Public sector operations	5,460	8,142	11,098
From this: Government operations	(4,255)	(6,009)	(8,629)
2. Foreign currency sales by the private sector <sup>a</sup>			
Excluding influence of shipment credit from credit lines <sup>b</sup>	-5,083	-5,749	-5,572
From this: import fund deposits in foreign currency	(332)	(-134)	(-378)
3. Change in foreign currency deposits of the public	-1,431	-2,085	-5,064
4. Foreign currency credit to the private sector excl. influence of shipment credit from credit lines <sup>b,c</sup>	38	923	3,173
5. Israeli currency credit to the private sector excl. influence of shipment credit from credit lines <sup>c</sup>	757	1,181	983
6. Influence of shipment credit arrangement from credit lines	-	490	55
7. Open market operations	140	647	117
8. Other factors	454	-224	281 <sup>d</sup>
9. Total narrow money base	335	3,325	5,071 <sup>d</sup>
10. Liquidity exemptions and recognized differentials	171	63	138
11. From this: influence of shipment credit lines	(-)	(-315)	(-35)
12. Total broad money base	506	388	5,209 <sup>d</sup>

<sup>a</sup> See notes in Table XVIII-iv.

<sup>b</sup> Including influence of deposits in foreign currency export funds – see note c in Table XVIII-iv.

<sup>c</sup> Influence of shipment arrangement from credit lines was deducted up to December

## XVIII-4

ON THE MONEY BASE,<sup>a</sup> 1975-1977

IL million)

1977					
I	II	III	IV	January to 26 October	26 October to December
3,281 (2,466)	3,155 (2,650)	3,787 (3,022)	875 (490)	11,148 (8,939)	-50 (-310)
-916 (-378)	-2,410 (-)	-2,283 (-)	37 (-)	-6,811 (-)	1,239 (-)
-692	-961	-664	-2,747	-2,602	-2,462
1,026	-156	608	1,695	1,484	1,689
-435	619	344	455	1,471	-488
55	-	-	-	55	-
-65	-120	18	284	-36	153
-384	39	-402	1,028 <sup>d</sup>	-752	1,033 <sup>d</sup>
1,870	166	1,408	1,627 <sup>d</sup>	3,957	1,114 <sup>d</sup>
-63	73	-185	313	-224	362
(-35)	(-)	(-)	(-)	(-35)	(-)
1,807	239	1,223	1,940 <sup>d</sup>	3,733	1,476

1976 from credit in Israeli currency to the private sector, and from January 1977 - from credit in foreign currency to the private sector; see Note d in Table XVIII-iv.

<sup>d</sup> See note j in Table XVIII-10.

SOURCE: Tables XVIII-ii and XVIII-iv.

freeze on nondirected credit in foreign currency<sup>20</sup>.

In the first days following the introduction of the reform there was a sharp contraction of the money base, resulting from government absorption inherent in the increase of deposits in savings schemes and the advanced purchase of securities by institutional investors. At the same time, the liquidity deficits of banks increased from about IL 500 million to about IL 1.3 billion. Despite the high absorption through the increase of deposits by the public in foreign currency, the money base continued to grow as a result of expanded injections of direct credit in foreign currency, the renewal of government injection and a considerable decrease of foreign currency purchases by the public. At the same time the liquidity deficits of the banks decreased again to about IL 800 million.

A correct evaluation of the extent of monetary expansion following the reform depends on an evaluation of the extent of substitution created between foreign and Israeli currency, and the extent of liquidity attributed by the public to local residents' foreign currency deposits. For such examination a longer period and more extensive experience than we have are required. At the same time it seems that caution obliges one to attribute similar significance to monetary expansion in Israeli and in foreign currency from the point of view of their potential influence on domestic demand. Thus it can be said that even following the reform, the rapid monetary expansion that had characterized the first part of the year continued, although with a considerably altered composition.

The activity of the Bank of Israel at the close of the year was concentrated in two main spheres – managing the float of the exchange rate and restricting of the volume of nondirected credit. In the first days after the reform, the Bank of Israel absorbed surplus of foreign currency from the public originating in the short lived movement of realizing profits from foreign currency deposits. When the public turned to local residents' foreign currency accounts, the Bank of Israel supplied foreign currency to the public. The Bank of Israel absorbed during the period between the reform and the end of the year a total of about \$30 million, through its various foreign currency activities with the public (see discussion of the money base). The exchange rate in relation to the dollar remained stable up to the end of the year, so that the drop in the value of the dollar on international currency markets was expressed by a drop in the value of the IL in relation to the currency basket.

The restriction of credit was intended to smooth the transition to the new system,

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<sup>20</sup> In contrast to the decrease of nondirected credit in foreign currency, there was an increase in credit from deposits for foreign currency loans (see below the discussion on foreign currency credit from outside funds). It should be noted that credit from foreign currency loan deposits is destined for special needs, and does not necessarily replace other types of credit.

i.e. to prevent financing a panic buying and extensive speculative movements in foreign currency immediately after the introduction of the reform. This restriction, which was a temporary measure, was cancelled in January 1978.

In the first quarter of 1978, the main monetary trends that had characterized the period from the reform until the end of the year continued<sup>21</sup>. Deposits of the public in foreign currency increased at a rapid rate in January and February, and this increase petered out afterwards. Money supply kept a pace with price increases, while fixed-term deposits continued to decrease. Directed credit in Israeli currency for domestic activity and for export decreased, while credit in foreign currency for export continued to grow rapidly – developments that are partially explained by seasonal factors and inventory accumulation in the diamond sector. The money base decreased in January, following the extensive accumulation in foreign currency deposits, and afterwards it continued to grow in response to rapid government injection and a low level of absorption through the foreign currency activities of the private sector. Liquidity deficits were subject to sharp fluctuation, and their average level until March was much higher than at the end of the year. In order to alleviate the liquidity situation of the banks, the Bank of Israel at the beginning of April reduced their liquidity requirements against directed credit for export from 15 percent to 10 percent.

#### 4. THE MONEY BASE

The broad money base<sup>22</sup> increased in 1977 by 44 percent as compared to an increase of 40 percent in the previous year, and amounted to IL 17.5 billion. Its average annual level increase by 43 percent as compared with an increase of 16 percent in 1976<sup>23</sup>.

As in previous years, there were considerable monthly and seasonal fluctuations this year in the main components that affect the money base (and in particular in

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<sup>21</sup> Data given below in this chapter on monetary developments at the beginning of 1978 are provisional.

<sup>22</sup> The narrow money base is defined as cash held by the public and liquid assets held by the banks, while the broad money base also includes various kinds of liquidity exemptions. The differentiation between the two concepts is mostly arbitrary, being dependent mainly on decisions concerning the composition of the financing of directed credit. In the last two years, a process of reduction of liquidity exemptions took place, following which the difference between the two series decreased and the similarity in their development increased.

<sup>23</sup> The rate of growth for the average annual level was more accelerated than that of the balance at the end of the year as a result of a different distribution in growth throughout of the year.

government injection and foreign currency acquisitions by the public), which brought about a non-uniform development of the money base throughout the year<sup>24</sup>.

In the first quarter of the year, there was a particularly high government injection (contrary to the seasonal trend of reducing injection in this quarter, which is the last quarter of the budget year). In this quarter, foreign currency acquisitions by the public were low, resulting in a rapid growth of the money base. In the second quarter, government injection stabilized, and it increased in the third quarter. Absorption through foreign currency acquisitions by the private sector and accumulation in its foreign currency accounts increased in the second quarter and decreased in the third quarter. Following these changes, the growth of the money base was slowed considerably in the second quarter and it increased again in the third quarter. Between the beginning of 1977 and the introduction of the reform in October, the total money base increased by 31 percent.

In the first week following the introduction of the reform, the money base shrank by about IL 2.5 billion (about 15 percent). This contraction was caused by a great government absorption stemming from extensive capital mobilization through savings schemes and the advanced acquisition of bonds by institutional investors. During November and December, the rapid government injection was renewed, and was augmented by an extensive injection through foreign currency credit granted by the Bank of Israel to the public. Despite a rapid growth of absorption through the foreign currency deposits of the public, the rapid growth of the money base was renewed, so that in annual terms its growth rate between the introduction of the reform and the end of the year was similar to that from the beginning of the year until the reform.

During the entire year, government injection constituted the main contributor to the growth of the money base. It amounted to IL 8.6 billion, a growth of 44 percent as compared to last year. This growth was below that of public consumption prices, but higher than the growth of other price indices (such as GNP and consumption), which are more significant in the evaluation of the influence of government injection on economic activity. Government injection was concentrated in the period prior to the reform (and was negative at the end of the year – as a result of capital mobilization), and during that period it was 19 percent higher, in real terms, than in the entire year in 1976. The growth of injection stemmed mainly from an increase of surplus domestic government demand (see Table XI-3). One of the important factors leading to a considerable increase in injection was the huge increases in the public sector. Injection originating from activities

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<sup>24</sup> In some cases the various injection components were related to each other in negative way (for example, a large government injection which makes possible the increase of foreign currency acquisitions), but there were nevertheless extensive fluctuations in the total money base.

of other parts of the public sector increased in 1977 only by 16 percent at current prices and amounted to IL 2.5 billion.

Foreign currency acquisitions by the private sector from the Bank of Israel led, after deduction of the technical effect of the change in the way of financing credit for export shipments<sup>25</sup>, to the absorption of about IL 5.6 billion in 1977 – an amount similar to that of last year. In terms of foreign currency, these acquisitions, which finance the surplus payments of the private sector in the balance of payments, decreased by some \$120 million and amounted to about \$620 million. In the course of the year, the deficit of the private sector in the current account decreased by \$147 million, and imports of short-term and medium-term private capital decreased by \$42 million. Thus developments in acquisitions point to an increase of about \$15 million in imports of short-term private capital<sup>26</sup>. Using this estimate, there was in the first and last quarters of the year a movement of short-term private capital from the economy in the amount of about \$40 million per quarter, while in the second and third quarter of the year there was a flow of short-term private capital to the economy amounting to about \$50 million per quarter. These data

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<sup>25</sup> Data on acquisitions and injection through credit of the Bank of Israel deduct the technical effects of the transfer of the financing of Export Shipments Fund of the Bank of Israel (see discussion on direct credit for export). Until May 1977, this transfer had a certain net effect on the money base (see the Bank of Israel Annual Report 1976, page 360), but since then it has led to equal changes in acquisitions and in the rediscount of the Bank of Israel, without affecting liquidity exemptions and it does not alter the money base. However, the transfer to the Shipments Fund entails a certain increase of the liquidity requirement of the banks (15 percent until March 1978).

<sup>26</sup> The source for data on the deficit of the public sector in the current account and on its long- and medium-term capital imports is Table VI-12. It should be emphasized that the estimate of the short-term capital imports given here differs from that contained in Table VI-12 in the items of capital imports of the private sector (financial and other); because partly the table does not deduct the effect of the change in the financing of export shipments. After this correction, the above-mentioned table points to a decrease in short-term private capital imports: from a level of about \$120 million in 1976 to about \$30 million in 1977 (while the estimate of acquisitions points to an increase: from about \$5 million to about \$20 million). In addition, there are differences in the patterns of development throughout the year: the data based on Table VI-12 point to a flow of capital to the economy at the end of the year, while data based on acquisitions show an outflow of capital from the economy during this quarter. It should be pointed out that if one considers errors and omissions in the balance of payments as unregistered imports of short-term private capital, data on the balance of payments show an increase of \$20 million in these capital imports between 1976 and 1977, and an outflow of short-term private capital at the end of 1977.

TABLE

## OUTSTANDING CREDIT GRANTED TO THE

	Nondirected IL credit <sup>b</sup>	For domestic activity <sup>c,d</sup>	Directed for		
			In IL <sup>e</sup>	In foreign currency <sup>f</sup>	In IL linked to foreign currency <sup>g</sup>
	(1)	(2)	(3)	(4)	(5)
Annual average (IL million)					
1975	6,076	1,820	1,884	1,764	1,002
1976	7,913	2,145	2,474	2,760	1,512
1977	11,006	2,741	3,586	5,735	2,494
Increase or (-) decrease (percent)					
1975	20	63	68	77	76
1976	30	18	31	56	51
1977	39	28	45	108	65
Balances at end of period (IL million)					
1975	7,072	1,856	2,423	2,125	1,280
1976	8,958	2,308	3,078	3,559	1,905
1977	13,268	3,068	4,579	9,658	4,340
Annual increase or (-) decrease (percent)					
1975	30	9	63	51	59
1976	24	24	27	67	49
1977	48	33	49	171	128
January-September	37	24	32	58	11
Quarterly increase or (-) decrease (percent)					
1977 I	16	10	-20	23	12
II	5	14	43	1	-5
III	13	-2	16	27	5
IV	8	7	13	72	105

<sup>a</sup> Does not include credit to the government or national institutions. For monthly developments and secondary details, see Tables XVIII-v and XVIII-vi.

<sup>b</sup> In the framework of nondirected credit are included long-range linked loans. These loans increased by about IL 430 million during 1977 (including linkage differentials).

<sup>c</sup> Not including linkage differentials on that part of the credit linked to the Consumer Price Index. The linkage differentials on the nondirected credit in IL totalled IL 830 million at the end of 1976 and increased to IL 1,320 million at the end of 1977. The linkage differentials on Employers' Loan Fund totalled IL 275 million at the end of 1976 and increased to IL 470 million at the end of 1977.

PUBLIC<sup>a</sup> BY THE BANKING SYSTEM 1975-1977

credit					
export					
Total	Other in foreign currency	Total	Total directed & nondirecte <sup>d</sup> credit	Foreign curren- cy approved credit from the banks' own means	Total
(3)+(4)+(5) = (6)	(7)	(2)+(6)+(7) = (8)	(1)+(8)= (9)	(10)	(9)+(10) = (11)
4,650	265	6,735	12,811	4,322	17,133
6,746	274	9,165	17,078	5,951	23,029
11,815	277	14,833	25,839	9,978	35,817
73	72	70	38	43	53
45	3	36	33	38	34
75	1	62	51	68	56
5,828	267	7,951	15,023	4,933	19,956
8,542	269	11,119	20,077	7,602	27,679
18,577	300	21,945	35,213	16,101	51,314
27	10	41	36	47	38
47	1	40	32	54	39
117	12	97	75	112	85
38	-16	34	35	25	33
5	0	6	10	4	8
11	-10	11	8	3	7
19	-6	14	14	17	15
57	25	47	29	70	40

<sup>d</sup> Mostly working capital funds for industry and agriculture, The Supervised Agriculture Fund, and the Employers' Loan Fund.

<sup>e</sup> Including Export Production Fund, indirect Export Fund and Citrus Fruit Fund.

<sup>f</sup> Including Diamonds Fund and Import for Export Production Fund.

<sup>g</sup> Including Export Shipments Fund and credit for export shipments from banks' own means.

SOURCE: Tables XVIII-v and XVIII-vi.

deduct, as mentioned, the technical effect of the financing of export shipments, which term capital exports of \$126 million this year.

The behavior of acquisitions throughout the year was dictated mainly by the development of the deficit in the current account of the private sector; its level in the second and third quarter was \$200 million higher than in the first quarter, and it decreased by \$250 million in the last quarter. As a result of this decrease, and of the increase of exports of long- and medium-term private capital, the private sector changed its role in the period between the introduction of the reform and the end of the year from buyer to net seller of foreign currency to the Bank of Israel<sup>27</sup>.

Accumulation in the foreign currency deposits of the public led in the course of the year to the absorption of about IL 5.1 billion (about \$480 million<sup>28</sup>) as against about IL 2.1 billion last year (about \$ 320 million). Most of this accumulation took place after the reform.

In the course of the year, the Bank of Israel injected about IL 3.2 billion (about \$285 million) through rediscount within the framework of directed credit in foreign currency to the public, as against about IL 0.9 billion last year (about \$140 million). Thus, overall activities of the public in foreign currency (through acquisitions, deposits and credit from the Bank of Israel) led to the absorption of about IL 7.5 billion in 1977 (about \$820 million), as against about IL 6.9 billion in 1976 (about \$920 million). In the period preceding the reform, transactions by the public in foreign currency led to an absorption of about IL 7.9 billion (about \$850 million), and subsequently – an injection of about IL 470 million (about \$30 million).

In addition to granting credit in foreign currency to the public, the Bank of Israel in 1977 also injected about IL 1 billion through rediscount on credit in Israeli currency to

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<sup>27</sup> According to an estimate based on acquisitions, there was, as mentioned, an outflow of short-term private capital in the last quarter, amounting to about \$40 million (after deduction of the effect of shipments). This does not necessarily prove that there was an outflow of short-term private capital after the reform, since the level of acquisitions was high in October, prior to the reform (about \$130 million).

<sup>28</sup> Due to the difference in rates between the mark and the dollar, this figure is lower than the growth of foreign currency deposits of the public.

the public. It also injected about IL 120 million through activities on the open market<sup>29</sup> and about IL 280 million through other factors connected with its activities<sup>30</sup>. The activities of the public, the open market, liquidity exemptions, and other factors, led to a total injection of about IL 4.7 billion in 1977, as against about IL 2.6 billion<sup>31</sup> in 1976.

In the first two months of 1978, there was a decrease of the money base, as a result of extensive absorption through foreign currency deposits by the public and its acquisitions from the Bank of Israel, the influence of which was greater than that of the government injection, and the continued rapid growth of foreign currency credit to the public (which increased mainly as a result of the accumulation of diamond stocks, which contributed to the increase of acquisitions). In March and April, the effect of restraining factors weakened and government injection increased, so that the money base started to expand rapidly again.

#### 5. CREDIT TO THE PUBLIC

Total free and directed credit increased in 1977 by 75%, as compared with an increase of 32% in 1976. Total free and directed credit, with the addition of foreign exchange credit from funds other than the foreign currency funds (partially used to finance long term activities or for purposes not connected with current economic activity) also increased rapidly – by 85% in the course of the year and 56% per annum.

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<sup>29</sup>The item of activities on the open market in Table XVIII-4 constitutes in fact a change in the securities of portfolio of the Bank of Israel after deduction of profits. In 1977 the Bank of Israel injected about IL 530 million through the acquisition of linked securities on the Stock Exchange (as against about IL 420 million in 1976) and absorbed through sales outside the Stock Exchange about IL 160 million, as compared to an acquisition of about IL 375 million in 1976 (made as part of the endeavors to alleviate the liquidity situation of the banks). Proceeds from securities in the portfolio led to the absorption of about IL 250 million in 1977, as against about IL 150 million in 1976. The Bank of Israel also sold short-term loans amounting to about IL 10 million in 1977.

<sup>30</sup>This item in Table XVIII-4 concentrates the net effect of the collection of interest on rediscount (about IL 1.4 billion in 1977, as against about IL 900 million in 1976), the payment of interest on deposits of banking and financial institutions in Israel (about IL 1.2 billion in 1977, as against about IL 700 million in 1976), as well as other actions mainly connected with the profit and loss account of the Bank of Israel.

<sup>31</sup>This figure does not include the effect of changes in the composition of financing of export shipments, on injection which totalled IL 175 million in 1976 and IL 20 million in 1977 (see footnote 25).

In the course of the year, the particularly rapid growth of directed credit to exports is striking, together with the increasing proportion of export credit in foreign currency (which is more expensive) within this credit. Nondirected credit in Israeli currency increased rapidly (until the freeze following the reform) while growing in real value. In contrast, there was real decrease of directed credit for domestic activity in Israeli currency, and toward the end of the year, arrangements were made for the gradual abolishment of part of this credit.

In the course of the year there was a connection between the development of the various types of credit, and particularly between the availability of the cheap types of credit (directed credit for exports in Israeli currency and for domestic activity in Israeli currency) and the demand for more expensive credit (free credit in Israeli currency and foreign currency credit). The freezing of free credit in Israeli currency at the end of the year apparently caused greater exploitation of foreign currency credit in this period.

#### A. FREE CREDIT IN ISRAELI CURRENCY

Free credit in Israeli currency increased in the course of the year by 48 percent, as compared to an increase of 24 percent in the previous year; after deduction of the change in the Consumer Price Index, it increased in real terms by about 4 percent, against a decrease of about 8 percent in 1976.

In April, the restriction on the increase of free credit, imposed in February 1976, was abolished. Within the framework of this restriction, the ceiling of free credit had been adjusted upwards from time to time, and additional expansion had also been permitted, following the mobilization of capital from special sources (such as savings schemes and the mobilization of equity capital). Following the introduction of this arrangement, the pace of growth of free credit decreased in the course of 1976, and the process of upward adjustment of debitory interest continued, but in the first quarter of 1977 the restriction lost some of its effectivity, for two reasons:

(a) Liquidity deficits, in which the deterrent force of the arrangement with the banks had been inherent, decreased to a low level, and the possibility was created for the banks to abandon the arrangement, waiving their share in the special loan for the improvement of liquidity that had gone with it.

(b) In the first quarter, an expansion of 16 percent in the volume of free credit was made possible (greater than in the last three quarters of 1976) without creating a deviation from the arrangement.

Under these conditions, the Bank of Israel preferred to cancel the restriction, in which it had seen a temporary measure (while at the same time increasing the fine on liquidity

deficits and interest on liquid assets of the banks). Following the rapid growth of free credit in the first quarter, the cancellation of the restriction did not lead to the acceleration of its growth rate in the second quarter (although it increased again in the third quarter). In the first three quarters of the year, the real value of free credit increased by 14 percent.

In May, the banks raised the tariffal interest on credit in the framework of working accounts (the main framework in which this credit is granted) from 28 to 31 percent. The extent of parallel increase of effective interest is not clear; this depends partly on the allocation commission, on the volume of additional payments for overdraft and on the volume of activity in various accounts<sup>32</sup>.

From partial indicators it appears that during the period until the reform effective interest was not raised at the same rate of acceleration as inflation.

With the introduction of the liberalization of foreign currency control, the Bank of Israel again imposed volume restrictions<sup>33</sup> on free credit in Israeli currency (and in foreign currency as well), and imposed a fine of 30 percent (not recognized for taxation purposes) on deviations from the ceiling. Since liquidity deficits increased during that period, the marginal cost of the expansion of credit was very high from the point of view of the banks, and it prevented deviations from the ceiling<sup>34</sup>.

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<sup>32</sup> Since the banks collect, at the end of each quarter, one quarter of the annual interest, and interest of 31 percent is in fact 35 percent in annual terms (taking into account interest on interest), so that after adding an allotment commission of 2 percent, this interest amounts to a least 37-38 percent on an annual basis. It should be noted that a partial sampling by the Controller of Banks revealed an average effective interest rate of 48 percent in annual terms in the third quarter of the year.

<sup>33</sup> A basic ceiling was determined according to the actual volume of credit in October. This ceiling could be heightened by the addition of one's own means in approved savings schemes. An addition in respect of the arrears in the collection of the quarterly interest debited to working accounts was also permitted.

<sup>34</sup> From the point of view of the banks, the cost of credit expansion exceeding the ceiling (and taking into account the existence of liquidity deficits) also increased compared to the period in which the previous volume restrictions were effective. It should be noted that even in that part of 1977 in which the volume restrictions were not effective, expansion of credit under conditions of liquidity deficit was connected with losses on the part of the banks; it is possible that the banks were prepared to bear these losses as a means of attracting clients to more profitable activities, or that on the margin they collected particularly high interest for short periods.

Following the freeze, the real value of free credit decreased by about 9 percent in the last quarter of the year. At the beginning of 1978, the credit freeze was abolished, and in the first quarter of the year free credit in Israeli currency increased by 8 percent, approximating the rate of price increases.

## B. DIRECTED CREDIT FOR DOMESTIC ACTIVITY IN ISRAELI CURRENCY

Directed credit for domestic activity in Israeli currency (including mainly the Working Capital Funds for Industry and Agriculture, the Supervised Agriculture Fund and the Employers' Loan Fund) increased during the year by 33 percent as opposed to 24 percent in 1976, and amounted to IL 3.1 billion. Thus, the drop in the real value of this credit continued this year as well.

The policy of the Bank of Israel was aimed this year at increasing interest on non-linked directed credit for domestic activity<sup>35</sup> and at a reduction of its availability. Interest rates on this credit were raised in January by 2.4 percent, and again in August by 2 percent, reaching a level of 24-29 percent.

Towards the end of the year, it was decided to gradually abolish part of the directed credit funds for domestic activity, while enabling borrowers to sell to the Bank of Israel Security and Employers' Loan Bonds in order to forestall liquidity difficulties resulting from this step. These changes went into force at the beginning of 1978, and the Bank of Israel started to purchase bonds against the reduction of credit quotas. In the first months of 1978 there was a decrease in total credit for domestic activity in Israeli currency (as against an increase at the beginning of 1977).

## C. DIRECTED CREDIT FOR EXPORTS<sup>36</sup>

Directed credit for exports increased in the course of the year by 117 percent, as against 41 percent last year, and amounted to IL 186 billion. After deducting the change in the exchange rate, its increase amounted to 24 percent (as against 19 percent last year), and after deducting the change of the effective rate for exports in the group with the highest added value, its growth reached about 60 percent (as against 75 percent in 1976). This rapid change, concentrated at the end of the year, led to an increase in the ratio between the value of financing exports in Israeli currency and the value of exports calculated according to the effective exchange rate.

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<sup>35</sup> Credit granted from the Employers' Loan Fund is fully linked to the index.

<sup>36</sup> Including the financing of exports shipments from the banks' own means in foreign currency, granted on terms similar to those of the Shipments Fund.

Credit for exports in Israeli currency (in the Export Production Fund, the Citrus Fund and the Indirect Export Fund) increased in the course of the year by 49 percent and amounted to IL 4.6 billion. After deducting the change in the effective rate for exports, this credit increased by 10 percent (as against a minimal increase in 1976). The share of Israeli currency credit in total credit for exports decreased during the year, from 36 percent to 25 percent. Given the low interest rate on credit for exports in Israeli currency, this change effectively increased the price of credit for exports.

Credit for exports in foreign currency and that linked to it (including the Diamond Fund, the Import for Export Production Fund, the Shipments Fund, and financing of shipments from the banks' own means in foreign currency) reached IL 14 billion at the end of the year, constituting a growth of 156 percent – or about 90 percent after deducting the change of the effective rate for exports (as against 26 percent last year). The bulk of this credit's growth (in foreign currency terms as well) occurred at the end of the year. The rapid growth of foreign currency credit during this period derives from an expansion in exports, the speculative accumulation of diamond stocks and from the seasonal development of credit for exports in Israeli currency. This growth was apparently also affected by the freeze on free credit in Israeli currency, and by the lowered expectations of exchange rate increases in the initial period after the reform. It is also possible that demand for export credit in foreign currency was affected by the reduction of interest rates on this credit<sup>37</sup>.

In September, the Bank of Israel decided to reduce interest rates from 6 percent to 4 percent (in foreign currency) in the Export Shipments Fund, and subsequently in the Import for Export Production Fund as well. In the wake of this change, the banks were no longer able to finance credit for export shipments from their foreign currency means, and the financing of export shipments was gradually transferred to the Shipments Fund of the Bank of Israel<sup>38</sup>. The proportion of credit from the banks' means in total credit for export shipments decreased by the end of the year to 20 percent (\$54 million), as opposed to 85 percent prior to the change of interest rates (about \$180 million).

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<sup>37</sup> It seems that the reduction of the interest rate might have encouraged indirect use of this credit for financing local residents' foreign currency deposits. It is also possible that the increase of the effective rate of financing in the Export Shipments Fund (as a net result of the cancellation of the incentive and the reduction of the rate of financing from 100 percent to 85 percent of the official rate) contributed to an increased utilization of this fund as well.

<sup>38</sup> Since the participation of banks in credit for shipments had in the past enabled them to exploit their credit lines abroad, the Bank of Israel permitted banks wishing to do so to maintain at the Bank of Israel deposits against the exports shipments transferred by them. The banks deposited only \$ 72 million in these accounts.

TABLE XVIII-6  
MONEY SUPPLY AND UNLINKED ASSETS OF THE PUBLIC, 1975-1977

	Money supply		Other unlinked assets						Total money supply and other unlinked assets (1)+(9)= (10)	
	(1)	Change (2)	Time deposits		Short-term loans	Unlinked liquid assets		Deposits against liabilities		Total (6)+(8)= (9)
	(IL million)	(percent)	(IL million)	Change (4)	(5)	(3)+(5)= (6)	Change (7)	(8)	(IL million)	
Annual average										
1975	9,913	31.0	3,600	3.0	162	3,762	3.6	126	3,888	13,801
1976	11,665	17.7	3,646	1.3	116	3,762	0.0	164	3,926	15,591
1977	16,331	40.5	4,772	30.9	93	4,865	29.3	326	5,191	21,522
Balances at end of period										
1975	10,614	21.7	3,561	-1.1	83	3,644	-3.2	125	3,769	14,383
1976	13,486	27.1	4,064	14.1	67	4,131	13.4	174	4,305	17,791
1977	18,717	6.1	5,151	26.8	82	5,233	26.7	663	5,896	24,613
26 October 1977	17,680	31.1 <sup>a</sup>	5,363	32.0 <sup>a</sup>	106	5,469	32.4 <sup>a</sup>	354	5,823	23,503
December 1977	18,717	5.9 <sup>b</sup>	5,151	-3.9 <sup>b</sup>	82	5,233	-4.3 <sup>b</sup>	663	5,896	24,613
1977 <sup>c</sup> I	16,227	20.3	4,311	6.1	75	4,386	6.2	296	4,682	20,909
II	16,143	-0.5	4,617	7.1	110	4,727	7.8	282	5,009	21,152
III	17,642	9.3	5,214	12.9	98	5,312	12.4	343	5,655	23,297
IV	18,717	38.8	5,151	-1.2	82	5,233	-1.5	663	5,896	24,613

<sup>a</sup> Rate of change between end of December 1976 and 26 October 1977.

<sup>b</sup> Rate of change between 26 October 1977 and end of December 1977.

<sup>c</sup> Quarterly rates of change.

SOURCE: Table XVIII-VIII

At the beginning of 1978, the rapid growth of export credit in foreign currency continued (and particularly the Diamond Fund), and it increased by almost 30 percent in the first quarter of the year. In contrast, there was a slight decrease in Israeli currency export credit (towards the end of the financial year in March).

#### D. CREDIT IN FOREIGN CURRENCY EXCLUDING THE FUNDS <sup>39</sup>

Until the reform, credit in foreign currency from sources other than the Funds (approved credit from the banks' means in foreign currency) was granted within two frameworks: general approvals (for fuel imports, fodder, etc.) and special approvals. Later on, this division was cancelled and two new types of credit were created: free credit in foreign currency to the public (to which most of the credit from the general approvals was transferred) and credit from foreign currency deposits for loans (to which most of the credit from special approvals was transferred).

During the entire year, foreign currency credit from sources other than the Funds increased (after deducting the bank's share from their own means in the financing of export shipments) by 112 percent, and amounted to IL 16 billion (about \$ 1.1 billion). In foreign currency terms, this credit increased by 21 percent in the course of the year (and by about 5 percent between October and December). In the period preceding the reform, the rapid growth of credit in the framework of special approvals, which partly enjoys exchange rate guarantees, stood out, while credit in the framework of general approvals decreased in foreign currency terms. With the introduction of the reform, the volume of free credit in foreign currency was frozen, and this credit even decreased until the end of the year; however credit in foreign currency to local residents from earmarked deposits for loans rose. Hence, there was an increase of total credit from sources other than the Funds in foreign currency.

### 6. ASSETS IN THE HANDS OF THE PUBLIC

#### A. MONEY SUPPLY

In 1977, the growth rate of the money supply accelerated, and it reached 39 percent, as compared to 27 percent in the previous year. Its average annual level increased by 40.5, while in 1976 it had increased by only about 18 percent.

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<sup>39</sup> The discussion here does not include credit to foreign residents, financing of export shipments through the banks in foreign currency (discussed in the section on export credit) and rediscount of the Bank of Israel outside the funds in foreign currency (whose level is low and practically unchanging).

In the first part of the year, the upward trend in the real value of the money supply, which had commenced during the last months of 1976, continued. It increased by 8.7 percent in the first two quarters of the year, stabilized in the third quarter, and decreased by 11 percent in the last quarter. Thus, the real money supply decreased by 2.6 percent in the course of the year, as compared to a decrease of about 8 percent in 1976.

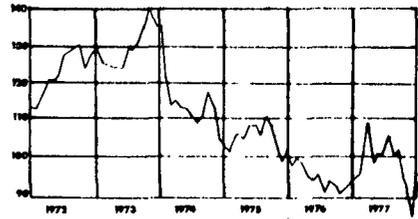


FIGURE XVIII-1

**REAL MONEY SUPPLY INDEX,  
1972-1977**

(Base: 1969=100)

The development of real demand for money in the period preceding the reform was influenced by two main factors:

- (a) developments in the inflation rate, which was very low at the beginning of the year and increased during the course of the year,
- (b) the boom on the stock market, and, in general, the increasing weight of components subject to risks in the portfolio of the public.

The price increases that accompanied the reform reduced the real value of the money supply. The money supply did not increase in November, and it increased by only 1 percent in December. Thus, the real money supply decreased between the introduction of the reform and the end of the year by 1 percent. This development is apparently due, on the one hand, to the general change in the structure of the assets portfolio that took place during this period (and which found expression mainly in a movement to local residents' foreign currency deposits), and on the other hand, apparently to an increase in the intensity of inflationary expectations.

In January 1978, the money supply decreased again, but it began to increase in February and March, so that by the end of the first quarter of 1978, its real level was similar to that of December 1977.

**B. OTHER UNLINKED FINANCIAL ASSETS**

Fixed deposits of the public increased in 1977 by 27 percent and amounted at the end of the year to IL 5.2 billion. Their increase was concentrated in the first ten months of the year, while in the last two months they decreased somewhat. Their real balance increased by about 5 percent prior to the introduction of the reform, and decreased afterwards by about 14 percent until the end of the year. Thus in the course of the year their real value decreased by about 10 percent.

TABLE XVIII-7

**LINKED ASSETS OF THE PUBLIC IN THE BANKING SYSTEM, 1975-1977**  
(IL million)

	Deposits linked to the Consumer Price Index				Deposits linked to foreign currency				
	Total	From this:			Balance	Devaluation & rates differentials	Increase or (-) decrease less devaluation & rates differentials		
		Total	In deposit terms	Monthly average of net deposits			Total	Patam	Restitution Patam
							(percent)		
1975	12,602	12,532	7,482	183	14,487	1,419			
1976	20,277	20,110	10,813	205	22,333	5,281	17.7	36.5	9.8
1977	37,479	36,790	18,401	468	49,681	22,956	19.7	47.0	6.8
26 October 1977	28,838	28,392	15,560	..	29,335	5,166	8.2 <sup>b</sup>	11.3 <sup>b</sup>	2.8 <sup>b</sup>
December 1977	37,479	36,790	18,401	..	49,681	17,790	8.7 <sup>c</sup>	26.6 <sup>c</sup>	3.1 <sup>c</sup>
1977 I	21,963	21,717	11,877		23,658	1,083	1.1	-0.9	2.0
II	24,520	24,167	13,187	267	25,922	839	6.0	17.2	0.9
III	28,220	27,800	15,018		28,555	2,841	-0.8	-5.1	1.6
IV	37,479	36,790	18,401	668	49,681	18,193	10.3	27.7	1.8

<sup>a</sup> The net value of deposits is not identical to the change in deposit terms because withdrawals include linkage differentials.

<sup>b</sup> Rate of change between end of 1976 and 26 October 1977.

<sup>c</sup> Rate of change between 26 October 1977 and end of December 1977.

SOURCE: Table XVIII-x.

Since the last months of 1976, a clear recovery of fixed-term deposits has become evident and they began to develop along a pattern similar to that of the money supply, after having been frozen at their level for a number of years (the ratio between fixed deposits and money supply reached 28 percent at the end of 1976, as opposed to 52 percent at the end of 1973). The change in the development of fixed-term deposits is apparently inherent in two factors :

(a) The deteriorating process in the terms of bond issues, accompanied by the decrease of the real rate of return to redemption and increased fluctuations on the secondary market.

(b) A certain improvement in the terms of fixed-term deposits: interest on these deposits in 1977 was raised by only 3 percent, although it is possible that holders of particularly large deposits were granted selective benefits beyond accepted interest rates, based on the assumption that holders of these deposits are more sensitive to rates of return offered to them<sup>40</sup>.

After the reform, fixed-term deposits were gradually reduced: they decreased by 4 percent until the end of the year, and at a similar rate in the first quarter of 1978, i.e. their real decrease was sharper than that of money supply.

The level of short-term loans held by the public remained low; it increased from about IL 70 million at the beginning of the year to IL 120 million in July (following an increase in the rate of net returns on these loans of about 1.5 percent in May) and decreased to about IL million at the end of the year. This decrease continued at the beginning of 1978, and in the month of April the public held short-term loans amounting to only about IL 50 million.

### C. DEPOSITS OF THE PUBLIC IN FOREIGN CURRENCY

Deposits of the public in foreign currency increased in the course of the year by 122 percent and amounted at the end of the year to about IL 50 billion (about \$3.2 billion). Most of this increase stemmed from a change in the exchange rate vis-à-vis the dollar, which reached 75 percent in the course of the year, and from the accumulation of exchange rate differentials following the 12 percent increase in the rate of the German Mark vis-à-vis the dollar (concentrated mainly in the last quarter of the year). After deduction of linkage and exchange rate differentials, the increase in the course of the year amounted to about 20 percent, as against 18 percent last year.

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<sup>40</sup> It is to be suspected that in a number of cases, certain banks made the granting of directed credit conditional upon the deposit of part of the amount in fixed-term deposits, or promised to grant free credit if necessary against these deposits.

TABLE XVIII-8

**ESTIMATED CONVERSION OF PAZAK RESTITUTION AND TAMAM FUNDS,  
1975-1977**

		Potential accumulation in Pazak restitution and Tamam		Total con- version to IL	Conversion rate A <sup>a</sup>	Conversion rate B <sup>a</sup>
		Total	w/o rate differentials & devaluation			
		(IL million)		(percent)		
1975		3,540	2,743	1,664	47	60
1976		7,274	3,261	2,266	31	69
1977		21,044	4,648	3,612	17	78
1976	I	1,576	748	462	29	62
	II	1,401	747	587	42	79
	III	2,032	783	609	30	78
	IV	2,265	983	608	27	62
1977	I	1,664	995	687	41	69
	II	1,704	1,021	880	51	86
	III	2,988	1,045	798	27	76
October		9,943	416	359	4	86
November		1,210	555	360	30	65
December		3,535	616	528	15	86

<sup>a</sup> Conversion rate A is the ratio between total conversion to IL and total potential accumulation in Pazak restitution and Tamam accounts. Conversion rate B is the ratio between total conversion and total potential accumulation in Pazak restitution and Tamam accounts discounting exchange rate differentials and devaluation.

SOURCE: Table XVIII-ix.

In the period preceding the reform, deposits increased by 8 percent (after deduction of linkage and exchange rate differentials). During this period, the rapid growth of deposits held by non-receivers of personal reparations in the second quarter of the year stood out, and it is possible that this was related to increased expectations of a devaluation.

The reform created substantial capital gains for holders of foreign currency deposits<sup>41</sup>. After the reform, a short-lived conversion flow of modest proportions (even compared to the past) took place, and altered course during November and December, and a quick accumulation ensued in these accounts, particularly in local residents' foreign currency accounts (Patam), a new type of deposit that combined the various accounts held by non-receivers of personal restitutions.

The rapid increase of local residents' foreign currency accounts after the reform was connected with the liberalization of foreign currency control, which made these accounts available to the public, while enhancing their liquidity considerably. Pursuant to these changes, there was a transition to maintaining liquidity in foreign currency, chiefly by firms dealing in these activities, but apparently also by the public at large. Since the introduction of the reform and until the end of the year, local residents' foreign currency accounts increased by about \$170 million, and amounted to about \$ 1.1 billion. In January and at the beginning of February 1978 additional accumulation took place in these deposits, amounting to about \$200 million (apparently influenced by rising expectations concerning the rate of change in the exchange rate), and afterwards their growth slowed down.

When the option to maintain foreign currency deposits was provided to the public at large, the uniqueness of the accounts of receivers of personal reparations lost some of their special status. Additionally, the unification of exchange rates also acted to remove an obstacle that had previously prevented larger conversions from these accounts. Despite the influence of these changes, and following a short transition period, accumulation in these accounts continued. This fact can apparently be attributed chiefly to the tax advantages conferred by these deposits, to the rapid increase that took place at that time in the exchange rate of the mark, and perhaps also to the conservative nature of holders of reparations deposits. The rate of conversion from current reparations revenue (conversion rate B – see Table XVIII-9) increased in October, but it decreased again afterwards, and during the entire last quarter it stood at a level similar to that of the first three quarters of the year. The rate of conversion from overall potential accumulation in reparations accounts (including effects of changes in the exchange rate) was particularly low at the end of the year.

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<sup>41</sup> After deduction of price increases that took place in November (and by evaluating the accounts preceding the reform at the Natad rate) these capital profits amounted to 24 percent, or IL 10 billion at prices prevalent in November.

#### D. SAVINGS SCHEMES AND LONG-TERM LINKED DEPOSITS

Total accumulation on the part of the public in approved savings schemes<sup>42</sup> (including linkage differentials, interest and grants) increased in the course of the year by IL 16.7 billion and amounted to about IL 31 billion – an increase of about 83 percent as opposed to 60 percent in 1976. Net accumulation in savings schemes, after deduction of the above-mentioned differentials, increased from IL 2.5 billion last year to IL 5.6 billion this year – a real growth of about 70 percent.

In the first half of the year there had been a somewhat higher average monthly accumulation in real terms than the last year – the accumulation doubled in real terms, during the second half of the year. In July and August, there was a rapid deposit growth in savings schemes<sup>43</sup>, stemming from improved terms offered for a determined period (increase of interest or linkage to the index of the previous month). After the reform, the possibility to deposit under improved terms was extended for a number of days. The public took advantage of the possibility to obtain an additional increase of revenue by advancing its deposits and linking them to an index that did not include the price increases accompanying the reform. In the first day after the reform, net deposits amounted to about IL 1.8 billion; afterwards, and in the first quarter of 1978, deposits returned to a level similar to that at the beginning of 1977.

In 1977, there was a rapid growth of long-term linked deposits, and they increased from about IL 170 million at the beginning of the year to about IL 690 million at the end of the year. These deposits, made in denominations of IL 500,000 and above, are mostly held by nonprofit institutions.

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<sup>42</sup> It should be noted that most of the benefits in savings schemes are granted gradually, in the course of the period of saving (which generally lasts six years). Accordingly, the estimated value of accumulation in savings schemes, based on the assumption that savers will persist in their saving until the end of the period, is significantly greater than its current realization value (“breaking value”).

<sup>43</sup> Since we have no monthly data on net accumulation, this discussion is based on the development of deposits at deposit values. The increase of the value of deposits at deposit values is greater than net accumulation, since it does not deduct withdrawals on account of linkage differentials, interest and grants.

## 7. DEVELOPMENT OF ASSETS AND LIABILITIES IN THE BANKING SYSTEM

### A. FOREIGN EXCHANGE ASSETS

Net claims of the banking system abroad increased by about \$ 30 million in 1977, as opposed to a growth of about \$ 170 million last year. Net assets of the Bank of Israel in foreign currency rose by \$ 180 million in 1971, and amounted to \$1,429 million. Net assets of banking institutions decreased in 1977 by \$ 150 million (about \$ 85 million last year), and stood at the end of the year at a negative balance of \$ 1.019 million.

The main source for the increase of net assets of the Bank of Israel in foreign currency were the transfers from the public sector, that amounted to \$ 715 million, an increase of \$ 65 million as compared to last year. The private sector purchased from the Bank of Israel foreign currency in the value of \$ 745 million. After deducting the influence of the financing of export shipments acquisitions of the private sector amounted to about \$ 620 million as against about \$ 740 million in 1976. In the course of the year, profits from interest and exchange rate differentials of the Bank of Israel amounted to about \$ 180 million, as against \$ 140 million last year.

In the course of the year, there was a considerable increase in the volume of activity of the private banking system in foreign currency, primarily after the introduction of the reform. Its claims abroad (including credit to foreign residents) increased by about \$ 500 million, and amounted to about \$ 2.5 billion; its liabilities abroad increased by about \$ 650 million, amounting to \$ 3.5 billion.

The approximately \$ 150 million increase in the net liabilities abroad of the banking institutions served to finance net loans to the government, which increased in the course of the year by \$ 140 million, after having decreased by about \$ 100 million last year. The changes that took place in the financing of shipments and in arrangements released about \$ 170 million of the banks' means in foreign currency. The components of other credit to Israeli residents from the bank's means in foreign currency increased by about \$ 180 million.

### B. DEVELOPMENT OF COMMERCIAL BANKING INSTITUTION BALANCE SHEET<sup>44</sup>

The consolidated balance sheet of the banking institutions increased in 1977 by 90 percent, as opposed to an increase of 45 percent in 1976, and amounted to IL 328 billion.

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<sup>44</sup> On the development of the balance sheet of the Bank of Israel, see Chapter XXI.

TABLE XVIII-9

**NET FOREIGN CURRENCY ASSETS IN THE BANKING SYSTEM, 1975-1977**  
(\$ million)

End of period	Net assets in Bank of Israel	Net assets in banking institutions			Net assets in banking system (4)+(1)
		Assets	Liabilities	Net (2)-(3)	
	(1)	(2)	(3)	(4)	(5)
1975	990	1,875	2,658	-783	207
1976	1,248	1,984	2,853	-869	379
1977	1,427	2,491	3,510	-1,019	408
1977 I	1,376	1,790	2,645	-855	521
II	1,269	1,932	2,757	-825	444
III	1,260	1,872	2,791	-917	343
IV	1,427	2,491	3,510	-1,019	408

SOURCE: Table XVIII-xi.

The portion expressed in Israeli currency increased by 66 percent (48 percent last year) and amounted to IL 177 billion at the end of the year; the portion expressed in foreign currency increased by 127 percent, as compared with an increase of 41 percent in 1976, and amounted to IL 150 billion.

After deducting the changes in the Consumer Price Index and in the exchange rate, the portions expressed in Israeli and foreign currency increased by 16 percent and 30 percent respectively (as against an increase of 7 percent and 14 percent last year). Owing to the quicker increase of the portion expressed in foreign currency, its weight in the balance sheet increased from 38 percent at the end of 1976 to 46 percent at the end of the year under review.

Prominent among the asset items in Israeli currency: a) loans to the government from approved deposits<sup>45</sup>, which increased by 83 percent reaching IL 50 billion, b) credit to the public from governmental and other deposits for loans, which increase by 48 percent to a level of IL 36 billion, and c) securities of local companies and institutions, which

**ASSETS AND LIABILITIES OF BANKING**  
(IL)

End of year balances	1976	
	Israeli currency (1)	Linkage differentials (2)
<b>ASSETS</b>		
Liquid IL assets at the Bank of Israel <sup>b</sup>	5,772	—
Foreign currency deposits with the Bank of Israel	—	—
Loans and deposits abroad	—	—
Nondirected credit	8,958	715
Participation in directed credit	2,485	187
Earmarked credit in foreign currency of local residents	—	—
Nondirected credit in foreign currency to local residents	—	—
Credit in foreign currency to local residents from earmarked deposits for loans	—	—
Credit to the public from earmarked deposits	11,112	8,180
Credit to the public from government deposits	5,144	141
Securities of Israeli companies and institutions	8,317	5,643
Premises and equipment	1,096	—
Loans to the government from the banks' own means	1,161	745
Government bonds <sup>c</sup>	1,293	1,177
Loans to the government from earmarked deposits	14,398	13,140
Balances in transit and deposits in banking institutions	1,042	449
Other accounts	4,707	235
Sundry accounts <sup>d</sup>	3,256 <sup>e</sup>	274 <sup>e</sup>
Contingent accounts <sup>g</sup>	6,744	299
Total assets <sup>h</sup>	75,485	31,185

<sup>a</sup> The balance sheet published by the Department of the Examiner of Banks has been adjusted to conform to the definition in this chapter.

<sup>b</sup> IL deposits with the Bank of Israel treated as liquid assets, treasury bills, and vault cash.

<sup>c</sup> Including the Short-Term Loan.

<sup>d</sup> Includes all adjustments mentioned in note (a).

<sup>e</sup> IL rediscounts for the public (before deducting deposits).

**INSTITUTIONS,<sup>a</sup> 1976-1977**  
 million)

1976		1977			
Foreign currency (3)		Israeli currency (4)	Linkage differentials (5)	Foreign currency (6)	
-		9,530 <sup>n</sup>	-	-	
19,870		-	-	45,649	
17,385		411	-	38,342	
-		13,268	1,323	-	
638		3,370	287	59	
9,175		-	-	-	
-		-	-	11,139	
-		-	-	5,794	
-		14,878	14,490	-	
-		6,875	192	-	
56		14,737	11,578	119	
-		1,452	-	-	
1,634		2,922	1,374	6,872	
-		1,716	1,924	-	
2,826		24,808	25,459	4,108	
1,800		1,129	923	3,329	
657		9,392	566	1,339	
5,588 <sup>f</sup>		4,160 <sup>e</sup>	467 <sup>e</sup>	16,418 <sup>f</sup>	
6,625		9,719	599	17,002	
66,254	172,924	118,368	59,182	150,170	327,720

<sup>f</sup> Foreign currency rediscounts for the public (before deducting deposits), rediscounts for the Jewish Agency and Patach funds deposited with the Bank of Israel (as reported by the banking institutions).

<sup>g</sup> Acceptances, documentary guarantees and credits.

<sup>h</sup> The breakdown of the total differs from that in the balance sheet published by the Department of the Examiner of Banks, since in this table rediscounts and credit to the public in the Exports Shipments Fund are treated as Israeli currency credit, and deposits in the Import for Export Production Fund are treated as foreign currency deposits.

TABLE

**ASSETS AND LIABILITIES OF BANKING**  
(IL)

End of year balances	1976	
	Israeli currency (1)	Linkage differentials (2)
<b>LIABILITIES</b>		
Equity capital and capital notes	4,046	37
Foreign deposits <sup>i</sup>	—	—
Rediscounts	581	—
Demand deposits	8,710	—
Time deposits	4,064	30
Approved saving schemes	11,498	8,612
Linked long-term deposits	132	33
Foreign currency deposits of the public	—	—
Approved earmarked deposits	24,357	21,917
Earmarked governmental deposits <sup>j</sup>	5,662	24
Government accounts <sup>k</sup>	212	0
Banking institution deposits and balances in transit	1,399	412
Other accounts	5,248	9
Sundry accounts <sup>d</sup>	3,430 <sup>l</sup>	275 <sup>l</sup>
Contingent accounts <sup>g</sup>	6,744	299
Total liabilities <sup>h</sup>	76,083	31,648

<sup>i</sup> Deposits of foreign banks and overseas branches of Israeli banks, nonresidents, new immigrants, and temporary residents, less deposits with the Bank of Israel.

<sup>j</sup> Utilized earmarked deposits.

<sup>k</sup> Demand, time, and unutilized earmarked government deposits.

<sup>l</sup> As in (e), plus deposits against liabilities, demand deposits of the public in the Agricultural Bank of Israel, and the difference between earmarked government and Jewish Agency deposits as recorded in the banks' liquidity report and in the monthly balance sheet.

## XVIII-10 (cont.)

INSTITUTIONS,<sup>a</sup> 1976-1977

million)

1976		1977			
Foreign currency (3)		Israeli currency (4)	Linkage differentials (5)	Foreign currency (6)	
771		7,891	47	2,103	
24,999		—	—	53,322	
—		305	—	—	
—		12,399	—	—	
—		5,154	12	—	
—		19,671	17,115	—	
—		523	166	—	
22,332		—	—	49,681	
167		38,227	41,038	1,859	
91		7,989	33	2,236	
2,142		39	0	1,857	
1,833		1,547	569	3,467	
585		10,093	17	1,232	
5,648 <sup>m</sup>		4,825 <sup>l</sup>	467 <sup>l</sup>	16,516 <sup>m</sup>	
6,625		9,719	599	17,002	
65,193	172,924	118,382	60,063	149,275	327,720

<sup>m</sup> As in (f), but with Patach funds according to Bank of Israel data.

<sup>n</sup> After Tables XVIII-1, XVIII-4, XVIII-i, and XVIII-iv, went to press, the liquid assets data were corrected to IL 144 million. Only the data in this Table are up-to-date. The change modifies the total narrow and broad money base and their changes in December 1977.

SOURCE: Monthly balance sheet of the banking institutions; rediscount and Patach in Bank of Israel – Bank of Israel balance sheet.

increased by 89 percent reaching IL 26 billion. Among the liabilities in Israeli currency, a high weight is attributed to loan deposits, which amounted to IL 81 billion, at the end of the year, following an increase of 75 percent in the course of the year, and to savings schemes, which increased by 83 percent, and amounted to IL 37 billion.

The portion of the balance sheet expressed in foreign currency stood at the end of the year at about \$9.7 billion, as compared to \$ 7.4 billion at the end of 1976. Among the assets, the most notable are deposits with the Bank of Israel amounting to about \$ 3 billion at the end of the year (\$ 2.3 billion at the end of 1976), and loans granted abroad as well as deposits abroad, which increased in foreign currency terms by 25 percent, amounting to \$ 2.5 billion. Among the foreign currency liabilities, a decisive weight is attributed to deposits from abroad, amounting to 3.5 billion after having increased by 23 percent in foreign currency terms during the course of the year, and to local resident's deposits in foreign currency, which stood at the end of the year at \$ 3.2 billion, as opposed to \$ 2.5 billion at the end of 1976.

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<sup>45</sup> These are depositions at the Treasury from the sale of linked securities by the banks.

TABLE XVIII-i

**THE MONEY BASE BY COMPONENT, 1975-1977**  
(IL million)

End of period	Currency in circulation (1)	Liquid assets of banking institutions (2)	Narrow money base (1)+(2)= (3)	Liquidity exemptions (4)	Recognized liquidity deficiencies (5)	Broad money base (3)+(4)+(5)= (6)	Growth of broad money base (7)
1975	3,970	3,254	7,224	1,310	35	8,569	6.3
1976	4,776	5,773	10,549	1,376	33	11,958	39.5
1977	6,319	9,674 <sup>b</sup>	15,993 <sup>b</sup>	1,360	187	17,540 <sup>b</sup>	43.6 <sup>b</sup>
1977 January	4,931	6,111	11,042	1,388	38	12,468	4.2
February	5,128	6,051	11,179	1,371	31	12,581	1.0
March	5,628	6,791	12,419	1,326	21	13,766	9.4
April	5,538	6,250	11,788	1,444	17	13,249	-3.8
May	5,621	7,448	13,069	1,414	15	14,498	6.6
June	5,803	7,155	12,958	1,365	54	14,377	-0.8
July	6,055	7,541	13,596	1,178	4	14,778	2.8
August	6,106	8,206	14,312	1,194	4	15,510	5.0
September	6,335	8,031	14,366	1,226	8	15,600	0.6
October	6,192	6,650	12,842	1,315	149	14,306	-8.4
November	6,329	7,736	14,065	1,341	199	15,605	9.1
December	6,319	9,674 <sup>b</sup>	15,993 <sup>b</sup>	1,360	187	17,540 <sup>b</sup>	12.4 <sup>b</sup>

<sup>a</sup> From May about IL 370 million of export financing deposits were transferred to the item "liquid assets" as a result of a change in reporting instructions. Growth ratios do not include this growth.

<sup>b</sup> See n in Table XVIII-10.

SOURCE: Liquid assets of the banking institution - monthly balance sheet of the banking institution; liquidity and exemptions and recognized liquidity deficiencies - monthly liquidity report of the banking institutions; currency in circulation - Department of the Examiner of Banks, statistics of the banking institutions.

TABLE

## INDICATORS OF THE LIQUIDITY POSITION

	Required liquidity on ordinary deposits <sup>a</sup>	Required liquidity on time deposits <sup>b</sup>	Required liquidity on free credit, in IL
			(IL mil-
1975	4,874	790	340
1976	6,219	760	422
1977	9,140	1,057	615
1977 January	6,248	802	429
February	6,329	836	439
March	7,627	817	485
April	6,850	827	489
May	7,244	875	473
June	7,435	877	494
July	8,037	912	538
August	7,963	936	553
September	8,155	984	561
October	7,848	1,019	621
November	8,046	1,037	597
December	9,140	1,057	615

<sup>a</sup> Required liquidity against demand deposits and deposits against liabilities in Israeli currency.

<sup>b</sup> Including required liquidity against time deposits which have been withdrawn.

<sup>c</sup> Including required liquidity on other factors, such as savings, directed credit, unutilized balances in earmarked deposits.

<sup>d</sup> Free reserves are the difference between liquid assets and required liquidity after reductions. The liquid assets on which this Table is based are taken from liquidity reports, and include certain adjustments not in the liquid assets data from the banking institutions' monthly balance which appear in Table XVIII-i.

## OF BANKING INSTITUTIONS, 1975-1977

Total required gross liquidity <sup>c</sup>	Total required liquidity less liquidity exemptions	End of month free reserves <sup>d</sup> (surplus+, deficit -)	Daily average free reserves over the month	Ratio of free reserves to gross liquidity <sup>e</sup> (daily average)	Ratio of free reserves to net required liquidity <sup>e</sup> (daily average)
lion)				(percent)	
6,116	4,770	-1,519	-1,052	-18.8	-24.3
7,542	6,133	-381	-537	-8.2	-10.3
11,022	9,475	-783	-1,033	-9.9	-11.6
7,598	6,175	-30	-239	-3.2	-3.9
7,691	6,294	-281	-8	-0.1	-0.1
9,082	7,743	-888	-267	-3.2	-3.9
8,464	7,008	-731	-322	-4.2	-4.6
9,062	7,637	-366	-463	-5.3	-6.4
8,984	7,590	-784	-363	-4.0	-4.7
8,775	7,367	-1,408	-582	-5.8	-7.2
9,809	8,604	-600	-381	-3.9	-4.4
10,007	8,774	-863	-701	-6.9	-7.8
9,877	8,412	-2,285	-563	-5.5	-6.3
10,081	8,541	-1,446	-1,114	-11.1	-13.2
11,022	9,475	-783	-1,033	-9.9	-11.6

<sup>e</sup> Gross required liquidity is the liquidity requirement without deducting liquidity exemptions, recognized liquidity deficiencies, and net liquidity requirement includes these factors.

SOURCE: Monthly liquidity reports of the banking institution; Department of the Examiner of Banks - statistics of the banking institutions.

TABLE

**THE BANKING INSTITUTIONS' FREELY  
(IL**

	Jan.- Dec. 1976	Jan.	Feb.	March
<b>USES</b>				
1. Credit from banks' own resources	2,517	108	381	1,142
2. Net credit to the government	-323	-312	139	88
3. Bond and share purchases in excess of required investment (including linkage differentials)	295	-111	-393	326
4. Surplus of foreign currency assets	181	-80	2	30
5. Premises and equipment	303	21	27	28
6. Inter-bank deposits and cash items in process of collection	-95	-30	-98	247
7. Total uses	2,878	-404	58	1,861
<b>SOURCES</b>				
8. Demand deposits, other deposits, and creditors	770 <sup>c</sup>	13	35	556
9. Time deposits	523 <sup>d</sup>	131	162	-92
10. Required liquid cover on credit	-83	-8	-10	-46
11. Approved savings schemes and long-term linked deposits <sup>e</sup>	1,193	-6	-217	256
12. Equity capital and capital notes	1,093	47	-14	232
13. Rediscounts and recognized liquidity deficiencies	297	-100	32	-43
14. Other accounts, net (including net linkage differentials other than on securities)	223	-130	-181	391
15. Total sources	4,016	-53	-193	1,254
16. Change in liquidity deficiencies	-1,138	-351	251	607

a In May about IL 370 million was transferred from export financing deposits to liquid assets. The effect of the transfer was deducted in this Table.

**LOANABLE RESOURCES, 1976 and 1977**  
million)

April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.- Dec. 1977
-114	-6	1,320	216	474	1,238	977	-1,033	405	5,108
-118	-29	-32	-46	1	-26	-36	1,531	294	1,454
-97	57	228	690	-191	544	692	-1,134	2,788	3,593
19	124	107	-12	42	-13	37	-140	-18	98
21	25	54	39	32	16	35	57	1	356
4	-112	-145	455	-298	28	78	40	-217	-48
-91	59	1,532	1,342	60	1,787	1,783	-679	3,253	10,561
-333	169	82	258	-32	82	-117	70	470	1,253
41	127	75	106	154	232	105	-140	-99	802
-4	16	-21	-44	-15	12	-111	55	-18	-194
190	210	137	405	252	266	217	521	526	2,757
704	-3	637	50	368	429	-25	125	1,313	3,863
-200	-96	17	172	38	-31	139	59	-10	-23
-332	1	187	-229	103	535	153	-530	1,734	1,702
66	424	1,114	718	868	1,525	361	160	3,916	10,160
-157	-365	418	624	-808	262	1,422	-839	-663	401

SOURCE: The monthly balance sheet of the banking institutions and monthly liquidity report.

TABLE

**INFLUENCE OF PUBLIC AND PRIVATE**  
(IL)

	1975	1976	1977	Jan.	Feb.
1. Public sector operations, net	5,460	8,142	11,098	1,273	126
Thereof: Government <sup>b</sup>	(4,255)	(6,009)	(8,629)	(988)	(-54)
2. Foreign currency sales by the private sector <sup>b,c</sup>	-5,083	-4,349	-7,433	-496	-388
3. Change in foreign currency deposits of the public	-1,431	-2,085	-5,064	-125	-349
4. Foreign currency credit to the private sector <sup>b,d</sup>	38	923	5,089	347	572
5. IL credit to the private sector <sup>b,d</sup>	757	271	983	-225	-87
6. Open-market operations	140	647	117	2	-43
7. Other factors	454	-225	281 <sup>e</sup>	-283	306
8. Total increase in narrow money base	335	3,325	5,071 <sup>e</sup>	493	137
9. Liquidity exemptions, recognized liquidity deficiencies <sup>b</sup>	171	63	138	16	-24
10. Total increase in broad money base <sup>b</sup>	506	3,388	5,209 <sup>e</sup>	509	113

<sup>a</sup> In May a technical transfer of about IL 370 million was made from the item "export financing deposits" to the item "liquid assets": this sum was deducted from the injection in the money base.

<sup>b</sup> In September 1977 the agreement in use since May 1976, to finance export shipments from the banks' own means in foreign currency, was cancelled. The operations connected with this agreement (and with its cancellation) had the following effect:

1. Rise in foreign currency sales by IL 1,400 million in 1976 and their decline by IL 1,861 million in 1977.
2. Reduction of credit to the public by IL 910 million in 1976 and its rise to IL 1,806 million in 1977.
3. Decline of liquidity exemptions by IL 315 million in 1976 and by IL 35 million in 1977 and rise of broad money base by IL 175 million in 1976 and by IL 20 million in 1977.
4. The change in the agreement had no influence in 1977 on the money base but increased the liquidity requirements of the banking institutions, which are forced to hold liquid assets of 15 percent of Shipments Fund balance. Most of the influence in 1977 centered on the last quarter of the year.

<sup>e</sup> See Note n in Table XVIII-10.

SECTORS ON THE MONEY BASE<sup>a</sup>, 1975-1977

million)

1977									
March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1,882	-158	2,131	1,182	872	1,473	1,442	-1,043	182	1,736
(1,532)	(-278)	(1,941)	(987)	(552)	(1,243)	(1,227)	(-1,168)	(122)	(1,536)
126	-560	-844	-1,083	-258	-1,223	-954	-952	-381	-420
-218	-338	-343	-280	-268	-86	-310	-687	-499	-1,561
4	-204	2	123	303	229	228	976	1,105	1,404
-123	367	72	180	197	25	122	109	205	141
-24	-71	-41	-8	-52	6	64	112	212	-40
-407	333	-69	-225	-156	291	-537	-39	399	668 <sup>e</sup>
1,240	-631	908	-111	638	715	55	-1,524	1,223	1,928 <sup>e</sup>
-55	114	-31	-10	-237	16	36	230	76	7
1,185	-517	877	-121	401	731	91	-1,294	1,299	1,935

<sup>c</sup> At the beginning of 1977 the accounts of deposits in foreign currency as against export funds in foreign currency were finally liquidated. The operations connected with this liquidation resulted in a rise in foreign currency credit to the public of IL 134 million in 1976, of IL 360 million in the first quarter of 1977 and to a decline of the same respective sums in foreign currency sales by the public.

<sup>d</sup> From the beginning of 1977 rediscount in shipments fund was transferred from Israeli currency credit to foreign currency credit.

<sup>e</sup> See Note n in Table XVIII-10.

SOURCE: Bank of Israel balance sheet; monthly liquidity report of the banking institutions.

TABLE

**OUTSTANDING CREDIT GRANTED TO**  
**(Excl. linkage differentials**  
**(IL**

	Nondirected credit, in IL <sup>b</sup>	Directed credit, in IL		Foreign currency credit through funds		
		Total	Rediscounts & liquidity exemptions	Total	Shipments Fund	Rediscounts & liquidity exemptions
1974	5,434	3,192	(2,441)	2,211	(800)	(2,075)
1975	7,072	4,279	(3,177)	3,405	(1,280)	(2,779)
1976	8,958	5,386	(4,146)	3,891	(332)	(3,384)
1977	13,268	7,647	(5,179)	13,167	(3,509)	(9,806)
1977	January	8,808	(4,107)	4,285	(358)	(3,839)
	February	9,116	(3,944)	4,677	(344)	(4,430)
	March	10,349	(3,869)	4,704	(322)	(4,528)
	April	9,969	(4,517)	4,482	(277)	(4,309)
	May	9,959	(4,660)	4,597	(258)	(4,820)
	June	10,868	(4,898)	4,673	(256)	(4,842)
	July	10,885	(5,066)	5,099	(263)	(5,109)
	August	11,064	(4,864)	5,574	(240)	(5,782)
	September	12,318	(4,791)	5,953	(330)	(6,222)
	October	13,054	(4,833)	10,572	(1,623)	(7,199)
	November	12,421	(5,038)	11,638	(2,575)	(8,304)
	December	13,268	(5,179)	13,167	(3,509)	(9,806)

<sup>a</sup> Excluding credit to the government and National Institutions.

<sup>b</sup> In December 1976 linkage differentials in nondirected credit totalled IL 830 million, and at the end of 1977 – IL 1,320 million; those linkage differentials are not included in the nondirected credit balances in this Table.

## THE PUBLIC<sup>a</sup> BY THE BANKING SYSTEM

to price index) 1974--1977  
million)

Foreign currency credit outside funds						
Total	Shipments from credit lines	Rediscounts	Total bank credit to the public	Credit from earmarked nongovernment deposits	Credit from government deposits (to tax debtors etc.)	Other credit from earmarked government deposits
3,608	(-)	(243)	14,445	5,431	606	2,128
5,200	(-)	(267)	19,956	8,006	1,489	2,761
9,444	(1,573)	(269)	27,679	11,112	1,500	3,644
17,232	(831)	(300)	51,314	14,876	1,816	5,051
9,757	(1,688)	(281)	28,184	10,770	1,470	4,282
9,945	(1,707)	(268)	28,842	11,000	1,471	4,376
9,936	(1,796)	(271)	29,991	11,446	1,812	4,464
9,642	(1,662)	(259)	29,897	11,782	1,771	4,625
10,247	(1,709)	(248)	30,818	12,143	1,677	4,643
10,080	(1,752)	(248)	32,044	12,755	1,715	4,774
10,358	(1,921)	(247)	32,919	12,999	1,646	4,916
10,746	(1,832)	(276)	34,071	14,386	1,633	4,157
11,498	(1,769)	(240)	36,696	14,513	1,679	4,240
17,213	(1,717)	(358)	47,841	16,125	1,605	4,592
15,880	(1,083)	(332)	47,334	14,845	1,630	4,658
17,232	(831)	(300)	51,314	14,876	1,816	5,051

<sup>c</sup> In December 1976 linkage differentials on credit in the Employers' Loan Fund totalled IL 275 million and at the end of 1977 - IL 470 million. Those linkage differentials are not included in the credit balances in this Table.

SOURCE: Monthly balance sheet of the banking institutions, monthly liquidity report of the banking institutions.

TABLE XVIII-vi

## BANK CREDIT TO THE PUBLIC, 1976-1977

	Balance at end of year				Annual average			
	1976	1977	Change		1976	1977	Change	
			1976	1977			1976	1977
	(IL million)		(percent)	(IL million)		(percent)		
1. Free credit	8,958	13,268	24	48	7,913	11,006	29	39
2. Directed IL credit for domestic activity	2,308	3,068	24	33	2,145	2,741	18	28
A. Working capital funds	1,517	2,075	34	37	1,387	1,878	33	35
For industry	(475)	(880)	(33)	(85)	(423)	(715)	(49)	(69)
For agriculture	(455)	(386)	(43)	(-15)	(395)	(464)	(23)	(17)
General fund	(57)	(79)	(-25)	(39)	(67)	(66)	(-14)	(-1)
Employers' loan fund	(530)	(730)	(38)	(38)	(502)	(632)	(39)	(26)
B. Other	791	993	9	-	758	863	-2	14
3. Directed IL credit for export	3,078	4,579	27	49	2,474	3,586	31	45
Export production fund	(2,171)	(3,489)	(33)	(61)	(1,819)	(2,770)	(32)	(52)
Citrus and cotton fund	(615)	(695)	(6)	(13)	(417)	(500)	(16)	(20)
Indirect exports fund	(292)	(395)	(38)	(35)	(238)	(317)	(60)	(33)
4. Export credit in foreign currency or linked to it	5,464	13,998	60	156	4,272	8,229	54	93
A. Shipment credit in IL linked to foreign currency	1,905	4,340	49	128	1,512	2,494	51	65
Shipments fund	(332)	(3,509)	(-74)	(957)	(669)	(864)	(-33)	(29)
Shipments from credit lines	(1,573)	(831)	(..)	(-47)	(843)	(1,622)	(..)	(92)
B. Diamond fund (foreign currency)	2,810	7,630	56	172	2,278	4,598	53	102
C. Import for export production (foreign currency)	749	2,028	132	171	482	1,156	75	140
5. Foreign currency rediscount outside funds	269	300	1	12	274	277	3	-1
6. Approved foreign currency credit from the banks' own means <sup>a</sup>	7,602	16,101	54	112	5,951	9,978	38	68
A. General approvals <sup>b</sup>	4,921	11,262	34	129	4,139	6,358	33	54
Imports on consignment	(650)		-32		713			
Fuel imports	(2,661)		37		2,059			
Fodder	(846)		132		615			
Other	(764)		90		752			
B. Specific approvals	2,681	4,839	111	80	1,812	3,620	51	100

<sup>a</sup> Excluding export shipments credit financed from credit lines abroad, which is included in export credit in foreign currency or in IL linked to foreign currency. The liquidation of this item in 1977 is based on the balance on 26 October.

<sup>b</sup> The agreement for credit granted under general approvals went into effect in August 1976.

SOURCE: Monthly balance sheet of the banking institutions; weekly balance sheet of the banking institutions; liquidity report of the banking institutions.

TABLE XVIII-vii  
**OUTSTANDING IL CREDIT GRANTED TO THE GOVERNMENT BY THE BANKING SYSTEM, 1975-1977**  
 (IL million)

	From the Bank of Israel			From banking institutions			
	Credit granted to govt. <sup>a</sup> (1)	Govt. & National Institution deposits <sup>b</sup> (2)	Net credit (1)-(2)= (3)	Credit granted to govt. (4)	Government securities <sup>c</sup> (5)	Less government deposits <sup>d</sup> (6)	Net credit <sup>e</sup> (4)+(5)-(6)= (7)
1975	7,831	474	7,357	1,135	1,367	148	2,354
1976	11,313	291	11,022	1,110	1,292	190	2,212
1977	23,031	3,704	19,327	2,923	1,704	219	4,408
1977 January	11,806	529	11,277	821	1,284	195	1,910
February	11,312	414	10,898	866	1,289	72	2,083
March	12,926	202	12,724	985	1,393	79	2,299
April	12,958	713	12,245	911	1,263	117	2,057
May	15,010	1,125	13,885	932	1,275	128	2,079
June	15,648	1,069	14,579	961	1,351	171	2,141
July	16,067	840	15,227	961	1,389	185	2,165
August	16,716	886	15,830	978	1,444	157	2,265
September	17,537	813	16,724	1,000	1,499	166	2,333
October	15,404	-1,913	17,317	1,005	1,754	234	2,525
November	15,360	-1,813	17,173	2,613 <sup>f</sup>	2,009	283	4,339
December	23,031	3,704	19,327	2,923 <sup>f</sup>	1,704	219	4,408

<sup>a</sup> Includes the monthly credits to the government's account for Bank of Israel profits.

<sup>b</sup> Includes the Bank of Israel's capital and the "other accounts" item in its balance sheet.

<sup>c</sup> Excludes treasury bills and the banks' Short-Term Loan holdings.

<sup>d</sup> Israeli currency deposits, the government's deposits earmarked for loans to the public and the loans actually extended.

<sup>e</sup> Credit to the government, as shown in Table XVIII-iii. This is the net change in the government debt as it appears in this table less government securities and deposits in the Treasury against savings for housing.

<sup>f</sup> The growth of the government debt to the banks stems from deposits in the Treasury against programs which will be converted into linked bonds. This deposit was reduced in December, but credit rose by an additional sum, due to payment of salaries to government employees on 31 December.

SOURCE: Bank of Israel balance sheet; monthly balance sheet of the banking institutions.

TABLE XVIII-viii

**ESTIMATED CONVERSION OF PAZAK RESTITUTION AND TAMAM FUNDS<sup>a</sup>, 1975-1977**  
(IL million)

	Personal restitution (1)	Interest (2)	Exchange rate & linkage differentials (3)	Total poten- tial increase (1)+(2)+(3)= (4)	Actual increase (5)	Amount con- verted to IL (4)-(5)= (6)	Conversion rate A <sup>b</sup> (6)/(4)= (7)	Conversion rate B <sup>c</sup> (6)/(1+2)= (8)
	(percent)							
1975	2,283	460	797	3,540	1,876	1,664	47	61
1976	2,560	701	4,013	7,274	5,008	2,266	31	69
1977	3,616	1,032	16,396	21,044	17,432	3,612	17	78
1977								
January	263	58	-83	238	-103	341	143	106
February	240	85	130	455	363	92	20	28
March	243	106	622	971	717	254	26	73
April	256	64	208	528	236	292	55	91
May	302	58	337	697	327	370	53	103
June	260	81	138	479	261	218	46	64
July	262	84	1,067	1,413	888	525	37	152
August	287	58	418	763	562	201	26	58
September	264	90	458	812	740	72	9	20
October	337	79	9,527	9,943	9,584	359	4	86
November	452	103	655	1,210	850	360	30	65
December	450	166	2,919	3,535	3,007	528	15	86

<sup>a</sup> The data relate only to Pazak restitution and Tamam funds, and do not show the change in other deposits not belonging to recipients of personal restitution.

<sup>b</sup> This calculation assumes that the recipients treat exchange rate differentials in the same manner as restitution and interest receipts.

<sup>c</sup> This calculation assumes that the recipients treat exchange rate differentials as capital gains in the deposits.

SOURCE: Personal restitution receipts and exchange rate differentials - Foreign Exchange Department, Ministry of Finance; interest on Pazak and Tamam - Bank of Israel balance sheet; actual increase - monthly balance sheet of banking institutions.

TABLE

## MONEY SUPPLY, THE PUBLIC'S UNLINKED DEPOSIT

End of period	Money supply				Money supply seasonally adjusted	
	Cash	Demand deposits	Total (1)+(2) =	Change from previous month	Total	Change compared to previous month
	(1)	(2)	(3)	(4)	(5)	(6)
		(IL million)		(percent)	(IL million)	(percent)
1975	3,970	6,644	10,614	21.7	10,355	18.5
1976	4,776	8,710	13,486	27.1	13,171	27.2
1977	6,319	12,398	18,717	38.8	18,332	39.2
1977 January	4,931	8,714	13,645	1.2	13,769	4.5
February	5,128	8,837	13,965	2.3	14,078	2.2
March	5,628	10,599	16,227	16.2	16,066	14.1
April	5,538	9,516	15,054	-7.2	14,994	-6.7
May	5,621	10,070	15,691	4.2	15,772	5.2
June	5,803	10,340	16,143	2.9	16,031	1.6
July	6,055	11,166	17,221	6.7	17,430	8.7
August	6,106	10,971	17,077	-0.8	17,146	-1.6
September	6,335	11,307	17,642	3.3	17,642	2.9
October	6,192	10,944	17,136	-2.9	17,153	-2.8
November	6,329	11,123	17,452	1.8	17,435	1.6
December	6,319	12,398	18,171	6.8	18,332	4.7

SOURCE: The Examiner of Banks, statistics of the banking institutions; monthly balance sheet of the banking institutions; Government Loan Administration weekly review of the money and capital markets.

## AND SHORT-TERM LOAN BALANCE, 1975-1977

Weight of cash in money supply (original data) (7)	IL time deposits (8)	Short- term loan balance of public (9)	Deposits against liabil- ities, in IL (10)	Total	
				(3)+(8)+ (9)+(10) = (11)	Change from previous month
(percent)		(IL million)			(percent)
37.4	3,561	83	25	14,383	14.2
35.4	4,064	67	174	17,791	23.7
33.8	5,151	82	663	24,613	38.3
36.1	4,227	74	212	18,158	2.1
36.7	4,423	77	204	18,669	2.8
34.7	4,311	75	296	20,909	11.9
36.8	4,363	74	269	19,760	-5.5
35.8	4,538	88	278	20,595	4.2
35.9	4,616	110	282	21,151	2.7
35.2	4,755	120	316	22,412	6.0
35.8	4,934	111	405	22,527	0.5
35.9	5,214	98	343	23,297	3.4
36.1	5,346	106	267	22,855	-1.9
36.3	5,232	105	372	23,161	1.3
33.8	5,151	82	663	24,613	6.3

TABLE XVIII-x  
 LINKED ASSETS OF THE PUBLIC IN THE BANKING SYSTEM, 1975-1977  
 (IL million)

	Approved savings scheme deposits		Long-term linked deposits <sup>a</sup>	Marked and limited deposits <sup>b</sup>			Free and tied deposits <sup>b,d</sup>	Total
	Total	Actual deposits		Pazak restitutions	Tamam	Other deposits <sup>c</sup>		
1975	12,532	7,482	70	6,312	3,879	2,646	1,650	27,089
(devaluation differentials)				(918)	(582)	(407)	(215)	(2,122)
1976	20,110	10,813	167	9,326	5,873	4,755	2,379	42,610
(devaluation differentials)				(1,693)	(1,063)	(867)	(401)	(4,024)
1977	36,790	18,401	689	19,827	12,804	17,050		87,160
(devaluation differentials)				(8,147)	(5,282)	(6,560)		(19,989)
1977 January	20,815	11,146	209	9,240	5,856	4,938	2,107	43,165
(devaluation differentials)				(173)	(110)	(93)	(39)	(415)
February	21,123	11,472	221	9,467	5,992	4,823	2,161	43,790
March	21,717	11,877	246	9,916	6,260	5,218	2,263	45,620
(devaluation differentials)				(366)	(231)	(197)	(85)	(879)
April	22,402	12,312	261	10,042	6,370	5,774	2,447	47,296

May	23,264	12,741	314	10,198	6,541	5,952	2,576	48,845
(devaluation differentials)				(189)	(122)	(109)	(47)	(467)
June	24,167	13,187	353	10,361	6,639	6,167	2,755	50,442
July	25,441	13,901	367	10,914	6,974	6,634	2,631	52,961
(devaluation differentials)				(408)	(260)	(250)	(98)	(1,016)
August	26,529	14,653	385	11,287	7,163	6,915	2,403	54,682
(devaluation differentials)				(439)	(279)	(268)	(100)	(1,086)
September	27,800	15,018	420	11,709	7,481	7,002	2,364	56,776
(devaluation differentials)				(228)	(145)	(136)	(46)	(555)
October	29,893	16,155	436	17,495	11,279	15,251		74,354
(devaluation differentials)				(5,512)	(3,612)	(4,476)		(13,600)
November	32,574	17,803	499	18,000	11,624	14,550		77,247
(devaluation differentials)				(52)		(60)		(195)
December	36,790	18,401	689	19,827	12,804	17,050		87,160
(devaluation differentials)				(749)	(471)	(556)		(1,776)

- a The deposit values of these deposits reached IL 56 million at the end of 1975, IL 132 million at the end of 1976 and IL 523 million at the end of 1977.
- b Including rate differentials for changes in relative prices of foreign currencies. After the reform, Pazak restitution and Tamam accounts became "Patam restitutions", and other foreign currency deposits became "Patam".
- c Including other Pazak accounts, Natad, Hani, foreign currency deposits of mortgage banks, as well as other investments and sums which have not yet been categorized.
- d Including temporary Pazam deposits, Hai, and tied deposits.
- SOURCE: Monthly balance sheet of the banking institutions.

TABLE

## FOREIGN CURRENCY ASSETS AND LIABILITIES

(\$)

End of period	Bank of		
	Foreign currency assets  (1)	Non- residents' deposits <sup>a</sup> (Patach) (2)	Other liabilities <sup>b</sup>  (3)
1975	1,304	142	172
1976	1,645	207	190
1977	1,827	201	199
1977 January	1,674	206	190
February	1,713	204	188
March	1,764	199	189
April	1,747	206	189
May	1,727	201	189
June	1,665	207	189
July	1,764	212	192
August	1,701	208	190
September	1,671	206	205
October	1,757	212	193
November	1,791	208	193
December	1,827	201	199

a Nonresidents' deposits redeposited by the banking institutions with the Bank of Israel.

b Includes deposits of foreign banks and Israeli currency deposits of the International Monetary Fund.

c Loans to and deposits with foreign banks and overseas branches of Israeli banks, loans to nonresidents, foreign securities, and currency.

## OF THE BANKING SYSTEM, 1975-1977

(million)

Israel	Banking institutions				
Net foreign currency assets (1)-(2)-(3)= (4)	Foreign currency assets <sup>c</sup> (5)	Non- residents' deposits <sup>d</sup> (Patach) (6)	Other liabilities <sup>e</sup> (7)	Net foreign currency assets (5)-(6)-(7)= (8)	Net foreign currency assets in the banking system (8)+(4)= (9)
990	1,875	1,007	1,651	-783	207
1,248	1,984	1,191	1,662	-869	379
1,427	2,491	1,543	1,967	-1,019	408
1,278	1,790	1,183	1,533	-926	352
1,321	1,780	1,221	1,474	-915	406
1,376	1,790	1,172	1,473	-855	521
1,352	1,857	1,188	1,477	-808	544
1,337	1,838	1,237	1,447	-846	491
1,269	1,932	1,232	1,525	-825	444
1,360	1,861	1,256	1,493	-888	472
1,303	1,868	1,240	1,476	-848	455
1,260	1,872	1,278	1,513	-917	343
1,352	1,917	1,311	1,618	-1,012	340
1,390	2,232	1,444	1,740	-952	438
1,427	2,491	1,543	1,967	-1,019	408

<sup>d</sup> Deposits of new immigrants and temporary residents, less Patach deposits redeposited with the Bank of Israel.

<sup>e</sup> Deposits of foreign banks and overseas branches of Israeli banks.

SOURCES: Balance sheet of the Bank of Israel; monthly balance sheet of the banking institutions.