

NOTES TO THE 2005 FINANCIAL STATEMENTS

1. Accounting policies

a. General

The financial statements are presented in accordance with generally accepted accounting principles adapted for the special activity of a central bank, and in line with the practice in other central banks.

Income and expenses are entered on an accrual basis and are included in the balance-sheet items on which they accrued, except for income from securities in local currency (see note 1.d).

b. Foreign currency

Assets and liabilities denominated in or indexed to foreign currency are translated into NIS at the representative exchange rates published by the Bank of Israel for the balance-sheet date.

Income and expenses in foreign currency are recorded in the profit and loss account at the representative exchange rates prevailing on the value dates of the transactions.

Unrealized exchange-rate differentials are included separately for each currency in the 'Revaluation accounts' item in the balance sheet. Realized exchange-rate differentials are transferred to the profit and loss account, and are calculated on the basis of the average cost of the balances of that currency. Realization is calculated separately for each calendar month for all foreign-currency assets and liabilities and for each currency. A balance of loss in the revaluation accounts at the end of the year is transferred to the profit and loss account, and is not offset in the future against unrealized profits. Unrealized losses in one currency are not offset against unrealized profits in other currencies.

Details of the exchange rates are as follows:

	31 December			Change	
	2005	2004	2003	2005	2004
	(NIS)			(percent)	
US\$	4.603	4.308	4.379	6.8	(1.6)
Euro	5.447	5.877	5.533	(7.3)	6.2
Special drawing rights (SDR) ^a	6.578	6.668	6.484	(1.3)	2.8
First currency basket ^b	5.181	5.326	5.131	(2.7)	3.8
Currency basket ^c	5.089	5.006	4.965	1.7	0.8

^a Based on a weighted 4-currency basket consisting of US\$, €, ¥, and £.
^b In effect until July 31, 1986, and consisting of: US\$ 0.3500; £ 0.1295; and € 0.4667.
^c In effect since May 2, 2000, and consisting of: US\$ 0.6698; £ 0.0453; € 0.2493; and ¥ 7.2411.

c. Indexation

Assets and liabilities indexed to the Consumer Price Index (CPI) are shown according to the latest known index on the balance-sheet date, i.e., the November index.

Details of the CPI are as follows:

	31 December			Change	
	2005	2004	2003	2005	2004
	(CPI) ^a			(percent)	
November	103.2	100.5	99.6	2.7	0.9
December	103.0	100.6	99.4	2.4	1.2

^a 2002 average = 100.

d. Securities*Foreign-currency securities*

Tradable foreign-currency securities are shown at market value on the balance-sheet date.

Unrealized profits arising from the difference between the adjusted cost of securities and their market value are included in the 'Revaluation accounts' item in the balance sheet.

Unrealized losses at the end of the year due to a fall in the market price of securities to below their adjusted cost are transferred to the profit and loss account and are shown under 'Other financial income from (expenses on) securities and derivatives'. The adjusted cost of securities is their nominal value *plus* interest, indexation differentials and the balance of the premium or discount not yet amortized. The premium or discount is amortized over the period from the date of purchase until the date of redemption.

Interest and indexation income on foreign-currency securities are shown under 'Interest income from foreign exchange reserves.' Income from the realization of securities is shown under 'Other financial income from (expenses on) securities and derivatives.'

Local-currency securities

Tradable local-currency government securities are shown on the balance sheet at market value on the balance-sheet date. The difference between the market value of securities and their original cost is recorded in the 'Revaluation accounts' item in the balance sheet.

Income from tradable government securities is included in the profit and loss account on a cash basis in line with the matched timing principle according to which accrued profits from government securities not yet received in cash from the government are not included in the Bank's income.

Interest and indexation income on local-currency securities are shown under 'Interest income from the government.'

e. International financial institutions

The International Monetary Fund (IMF)

The Bank of Israel's participation in the IMF less its liability for participation is shown under assets in the item 'International financial institutions.'

Special drawing rights (SDR) allocated by the IMF are shown under liabilities in the item 'International financial institutions.'

Other international financial institutions and investment in shares of the Bank for International Settlements (BIS)

The Bank of Israel's participation in other international financial institutions includes initial participation in their capital and additional participation payments for increases in the capital of those institutions. The Bank of Israel's participation in other international financial institutions is shown under 'International financial institutions' according to the cost in the currency in which the participation was paid, translated at the exchange rate on the date the transaction took place. Liabilities to international financial institutions are shown under liabilities in the item 'International financial institutions.'

f. Buildings and equipment

Buildings and equipment are shown at cost, less accumulated depreciation. Depreciation is calculated by the straight-line method for the estimated useful life:

Buildings — fifty to sixty-seven years;

Vehicles — six and a half years;

Computers — four years;

Equipment — ten years.

Purchases of fixed property for non-significant amounts are recorded in the profit and loss account.

g. *Makam* (short-term bills issued by the Bank of Israel)

The balance of *makam* in the balance sheet reflects the par value (the redemption price) of *makam* held by the public less the balance of the discount that has not yet been amortized. *Makam* sold by the government to the Bank of Israel but not yet sold to the public are not included in this balance.

The discount is the difference between the par value of the *makam* and the proceeds of their sale to the public. The discount is amortized by the straight-line method.

Interest expenses on the balance of *makam* held by the public are shown in the profit and loss account in the item 'Interest paid to the banks and the public.'

h. Employee pensions, severance pay, and vacation pay

The liability for employee pensions and severance pay is actuarially computed on

an accrual basis which reflects the liability for pensions and severance payments to employees accrued to the balance-sheet date.

Provision for vacation pay is computed on the basis of vacation days due, accrued to the balance-sheet date.

i. Revaluation accounts

The revaluation accounts include unrealized profits from exchange-rate differentials on foreign-currency assets and unrealized profits from the revaluation of tradable local-currency and foreign-currency assets to market value.

There are separate revaluation accounts for each item (currency, security), which are transferred to the profit and loss account when the item is realized in whole or in part.

The balance of the loss in the revaluation accounts arising from price differentials in foreign-currency securities and from exchange-rate differentials on balances in foreign currency is transferred to the profit and loss account at the end of the year.

j. Derivative financial instruments

The Bank of Israel uses derivative financial instruments in its monetary and foreign exchange activities.

1. Activity in derivative financial instruments in Israel

a) NIS/US\$ swaps

NIS/US\$ swaps implemented by the Bank of Israel with domestic banks are shown net, i.e., the balance of dollars to be received from the banks (translated according to the exchange rate on the balance-sheet date) less the balance of NIS to be transferred to the banks. The way the balance is shown in the balance sheet depends on whether it is a net debit or net credit balance. A net debit balance is shown under the item 'Other assets' and a net credit balance under 'Other liabilities.'

Interest expenses on these transactions is shown in the profit and loss account under the item 'Interest paid to the banking corporations and the public' (Note 23).

b) Purchase and sale options on the US\$/NIS exchange rate

The Bank of Israel sells NIS/US\$ exchange-rate options to the banks. The balance of options on the date of the financial statement is shown in Note 18, 'Contingent liabilities and special commitments.' Expenses arising from the exercise of options during the period of the statement, and expenses expected from their exercise in accordance with the representative exchange rate of the dollar on the balance-sheet date, less income from the premium on the options,

are shown in the item ‘Other financial income from (expenses on) securities and derivatives.’ The income from the premium on options is spread evenly over the duration of the options using the straight-line method. Advance income on the premium plus expenses accrued due to the difference between the exercise rate and the representative dollar exchange rate on the balance-sheet date is included in the ‘Other liabilities’ item.

c) Future remittances of makam

The balance of the liability for future remittance of makam up to the date of the financial statement is given at par (redemption price) in Note 18, ‘Contingent liabilities and special commitments.’

Receipts on account of future issues of makam are included in the balance sheet under ‘Other liabilities.’

2. Derivative financial instruments in activities abroad

a) Repurchase agreements (repo), and reverse repurchase agreements (reverse repo)

The balances of repo and reverse repo agreements are shown in the balance sheet as ‘Foreign exchange reserves.’ In the profit and loss account the results of the transactions are shown as ‘Interest income from foreign exchange reserves.’

b) Foreign-currency swaps

The transactions are included in the balance sheet at net value in ‘Foreign exchange reserves,’ i.e., the balance of future foreign-currency receipts (in one of the currencies) less future foreign-currency remittances (in the other currency).

In the profit and loss account the results of these transactions are included in ‘Interest income from foreign exchange reserves.’

c) Futures

The balance of futures contracts at market prices on the date of the financial statement are given in Note 18, ‘Contingent liabilities and special commitments.’

In the profit and loss account the change in the value of the contracts is recorded under ‘Other financial income from (expenses on) securities and derivatives.’

k. Transfer of profits

In accordance with the Bank of Israel Law, 5714–1954, the Bank must transfer its net profits to the government within sixty days of the end of each business year. Since the Bank has a balance of accrued losses, the profits are offset against them and are not transferred to the government.

1. Accounting Standard 12 of the Israel Accounting Standards Board

The Bank of Israel's financial statements for 2005 implement, for the first time, the directives of Accounting Standard 12 of the Israel Accounting Standards Board. In accordance with section 18 in the Standard certain balances in the balance sheet—fixed assets, balance of international financial institutions, capital and general reserve—were adjusted according to the rise in the CPI from the date the balances were created to 31 December 2003. The balances of fixed assets and of international financial institutions on 31 December 2003 were shown on the balance sheet on that date at their adjusted values whereas balances arising after that date were shown at their nominal values. The amount required for the adjustment of the Bank's capital and general reserve is shown under the item 'Difference arising from switch to reporting according to Accounting Standard No. 12' (see Note 15). The differences from the adjustment of the above balances are recorded against the balance of losses.

In accordance with the above Standard, the relevant balance-sheet balances on 31 December 2004 are shown as follows:

	As stated in the past	Effect of adjustment	As restated
		NIS million	
Other assets (including fixed assets)	443	182	625
International financial institutions	2,520	282	2,802
Difference arising from switch to reporting according to Accounting Standard No. 12	-	3,665	(3,665)
Loss	(13,852)	(3,201)	(17,053)

2. Foreign exchange reserves

The currency composition of this item matches their possible uses. These uses, which also provide a basis for the determination of the desired level of the reserves, consist

	31 December		31 December	
	2005	2004	2005	2004
	(NIS million)		(\$ million)	
Tradable securities	119,760	99,717	26,018	23,147
Short-term deposits	16,364	11,906	3,555	2,764
Demand deposits	1,250	3,103	272	720
Derivative financial instruments ^a	(9,145)	2	(1,987)	1
Total	128,229	114,728	27,858	26,632

^a Derivative financial instruments are shown net, i.e., future foreign-currency liabilities minus future foreign-currency assets (see note 1.j.2).

of selling them (foreign currency) to the government to service its debts and to finance imports in an emergency; using them to implement the Bank of Israel's policy on the stability of the banking system and the foreign-currency market; and using them as an instrument for implementing monetary policy. (The yields on the foreign exchange reserves are shown in Table 4 in the Explanatory Remarks to the Financial Statements below.)

3. International financial institutions (assets)

	31 December	
	2005	2004
	(NIS million)	
The IMF (see section a below)	933	1,995
Investment in BIS shares	282	264*
Balances related to other international financial institutions (see section b below)	554	543*
Total	1,769	2,802

* Restated (see Note 1.1).

a. The International Monetary Fund (IMF)

The balance with the IMF (the reserve tranche) constitutes part of the quota allocated to Israel for which Israel paid the Fund in foreign currency.

The quota in the IMF

Each member country has a quota allowing it to participate in the capital of the Fund. The quota is determined according to the country's economic situation (national income, exports, balance of payments, level of the reserves) and it also determines the country's voting rights. Part of the quota (called the reserve tranche) is transferred to the Fund in foreign currency, and can be withdrawn, and the rest is deposited in the country's central bank in deposits and notes indexed to Special Drawing Rights.

Up to 1998 Israel drew down its reserve tranche, putting up against this withdrawal a non-interest-bearing deposit in favor of the Fund. In the latest increase in members' participation, in 1999, Israel's quota rose by SDR 262 million. The foreign-currency payment for this increase, about SDR 66 million, was deposited in the Fund, and has not been withdrawn.

The IMF Financial Transactions Plan

Since 1999 Israel has been part of the IMF's financial transaction plan. The plan is a mechanism through which a member country can exchange SDR or foreign currency

against its local currency, and another country is asked to execute a counter-exchange. The request to exchange foreign currency is passed on by the Fund at short notice. The IMF manages the sums transferred and received in these transactions in such a way that the share of the reserve tranche in the quota of each member country participating in the plan remains similar. Up to 2004, Israel's reserve tranche balance grew gradually due to Israel's transfer of foreign currency to other countries. In 2004 and 2005 the Fund transferred foreign currency to Israel. In 2005 Israel's reserve tranche was reduced by about SDR 157 million.

	31 December		31 December	
	2005	2004	2005	2004
	(NIS million)		(SDR million)	
International Monetary Fund (IMF) quota	6,110	6,195	928	928
Minus liability for the quota ^a	5,177	4,200	787	630
Total^b	933	1,995	141	298
^a The balance of the liability to the IMF is in notes and deposits				
^b The surplus of the reserve tranche over the 'basic sum' of SDR 33 million bears interest at a rate set by IMF from time to time.				
The annual rate of interest on 31 December 2005, was 1.6 percent (on 31 December 2004, it was 1.6 percent).				

b. Balances related to other international financial institutions

The balances relate to the following institutions:

- IBRD – The International Bank for Reconstruction and Development
- IDA – The International Development Association
- IFC – The International Finance Corporation
- EBRD – The European Bank for Reconstruction and Development
- MIGA – The Multilateral Investment Guarantee Agency
- IDB – The Inter-American Development Bank
- IIC – The Inter-American Investment Corporation

4. Credit to the government

Credit to the government consists mainly of long-term advances. These advances were made until 1988.

	31 December	
	2005	2004
	(NIS million)	
Long-term advances ^{a,e}		
Indexed ^b	2,698	3,189
Unindexed ^c	581	664
Credit for binational funds ^d	152	142
Total	3,431	3,995

^a The interest and indexation differentials for each year are due for payment on 31 December of that year. The principal is due to be paid in annual payments, the last of which will be in the year 2012.

^b This credit is indexed to the first currency basket. It bears an interest rate of 8 percent, also indexed to that basket.

^c This credit bears interest at prime rate plus 2 percentage points. The average rate of interest during 2005 was 7.3 percent (7.9 percent in 2004).

^d This credit was given to the government for it to invest in the Binational (US–Israel) Industrial Research and Development Fund and the Binational (US–Israel) Science Fund, established in cooperation with the US government. The Funds deposited their money in deposits in the Bank of Israel, and it is shown in the balance sheet under “Other Liabilities” (see Note 13). The credit and the deposits bear interest.

^e i. Correspondence in September 2003 between the Minister of Finance and the Governor of the Bank of Israel included several agreements regarding “Proposals in the Economic Program for 2004 Relating to the Bank of Israel.” One of the items in that correspondence was “the repayment of the government’s debt to the Bank of Israel due to be repaid on 31 December 2003,” and it was determined that “the Bank of Israel will grant a loan to the government to finance the balance of the debt, principal and interest due for repayment on 31 December 2003.” The same section also specified the repayment dates of the loan, the fact that the Bank and the Ministry of Finance should reach an agreement on the interest payable, and that “if the Attorney General is of the opinion that the debt can be cancelled, then it shall be cancelled.

The amount of the debt, principal and interest, due for repayment on 31 December 2003 was NIS 1,070 million (the total balance of the government debt, principal plus interest, prior to the above repayment was NIS 5,460 million). The debt due to be repaid on 31 December 2003 was duly repaid, as at that time the views of the Attorney General regarding the debt had not been received. Furthermore, as the Bank and the Ministry of Finance had not reached an agreement with regard to the rate of interest on the loan to finance the repayment of that debt, no such loan was granted to the government.

ii. In February 2005 the opinion of the Deputy Attorney General, on behalf of the Attorney General, was received, according to which “there are no legal grounds preventing the Bank of Israel from cancelling the government’s debt to the Bank as agreed between the outgoing Governor and the Minister of Finance.” In the summary giving the basis for this opinion it was written that “it appears that from a legal standpoint the Bank of Israel has the authority to cancel a government debt to the Bank that dates back to a time prior to the prohibition on granting loans to the government under section 45 of the Bank of Israel Law.” With regard to the reasonableness of a Bank of Israel decision to cancel a government debt to the Bank, it noted that “if there are macroeconomic reasons supporting such a decision that are consistent with the Bank’s objectives and policies, such a decision would not be unreasonable.” Summarizing the position, it stated that “we stress that our conclusion that there are no legal grounds preventing the Bank of Israel from canceling a government debt to the Bank applies in the light of the special circumstances in this case, which is about a debt created in essence prior to the amendment of section 45 of the Bank of Israel Law, and it does not create a precedent for other issues, including any other government debts to the Bank of Israel.”

iii. In effect, most of the government debt (about two-thirds of the principal) to the Bank of Israel was created after the passing of the amendment to section 45 of the Bank of Israel Law (the section relevant to the question of the possibility of canceling such a debt).

iv. Cancellation of a government debt by the Bank of Israel is a capital transaction whose accounting-economic essence is equivalent to transferring profit from the Bank of Israel to the government, which must be shown in the Bank’s financial statements in accordance with that essence. The Bank of Israel Law does not allow the transfer of profit to the government in the absence of an appropriate balance of profit (on 31 December 2004 and 31 December 2005 the Bank of Israel had loss balances of NIS 17,053 million and NIS 15,639 million respectively).

In the light of the above, the Bank of Israel’s financial statements do not take into account a cancellation of government debt to the Bank. The Bank considers that this subject must be examined from all relevant aspects—economic, accounting and legal. A comprehensive study of this issue can only be performed after the government has reconsidered and updated its views, and if necessary after the an updated legal view has been obtained relating also to the points made in subsections iii and iv above.

5. Loans

	31 December	
	2005	2004
	(NIS million)	
Monetary loans ^a	30	787
Other loans ^b	1,034	1,404
Total	1,064	2,191

^a The average rate of interest on the monetary loans in 2005 was 3.2 percent (in 2004, 3.8 percent). The average rate of interest on the monetary loans on 31 December 2004 was 3.3 percent.

The balance in 2004 consisted of monetary loans granted under a quota system. In September 2005 the Bank of Israel stopped granting loans under the quota system, and instead loans were granted over night at an interest rate 1 percent above the Bank of Israel rate. These loans are not limited by quotas, and are granted against appropriate collateral. On 31 December 2005 the balance of these loans was NIS 30 million. The average rate of interest on these loans in 2005 was 5.4 percent. In addition to these loans, in 2005, for the first time since February 1998, the Bank of Israel offered the banking corporations daily auctions for monetary loans, against appropriate collateral. These auctions were held from 23 to 29 May 2005. The average rate of interest on these loans was 3.6 percent.

^b Including, on 31 December 2005, credit to the Industrial Development Bank of NIS 1,023 million (on 31 December 2004 it was NIS 1,389 million). In August 2002 the Industrial Development Bank encountered liquidity problems and could not meet its liabilities. The Bank of Israel responded to a request from the bank and made available to it a special credit line to enable it to continue operating regularly. The credit line was originally NIS 2,200 million; this was reduced from time to time, and was supposed to end at the end of July 2006. On 30 October 2005 the Bank of Israel agreed to a request from the bank to extend the period of the loan by two years, to 31 July 2008. The Industrial Development Bank pays interest on the utilized part of the credit at the Bank of Israel interest rate. In accordance with the decision of the economic-social cabinet, since 1 July 2005 responsibility for repayment of the credit lies with the government. If at the end of the period there remains a balance of credit to be repaid on this credit line, it will be repaid by the government. This credit is therefore not expected to result in a loss to the Bank of Israel.

6. Local-currency securities

This item consists of tradable government securities indexed to the last CPI known on the balance-sheet date. They are shown at market value.

The yield to maturity on the local-currency securities portfolio on 31 December 2005 was 3.3 percent, and the portfolio's average period to maturity was 4.2 years (on 31 December 2004 the yield to maturity was 2.6 percent, and the average period to maturity was 4.3 years).

	31 December	
	2005	2004
	(NIS million)	
Time to redemption from balance-sheet date		
Less than one year	240	1,428
Between one and two years	409	237
Between two and three years	504	405
Between three and four years	689	499
Between four and five years	884	678
Between five and seven years	364	937
Seven years or longer	311	579
Total	3,401	4,763

7. Other assets

This item consists mainly of:

- a. Amounts receivable from the official receiver of the Trade Bank (In Liquidation) Ltd., constituting reimbursement of payments made by the Bank of Israel on the strength of guarantees given, with government authorization, to depositors in the Trade Bank following the discovery in April 2002 of the embezzlement in the bank.
- b. Loans to employees;
- c. Buildings and equipment net of cumulative depreciation (see Note 1.f). This item has been restated (see Note 1.l).

8. Banknotes and coins in circulation

This item includes all the banknotes and coins in circulation, and also banknotes of the 'new sheqel' series that are no longer legal tender and that can be exchanged at the Bank of Israel until 31 December 2010. This item does not include commemorative coins, although they are legal tender. The balance of these coins is included in the balance sheet in the item 'Other liabilities.' The balance of commemorative coins on 31 December 2005 was NIS 5 million (the same as on 31 December 2004).

	31 December 2005		31 December 2004*	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
Banknotes in circulation				
NIS 20	23	457	22	436
NIS 50	48	2,389	44	2,181
NIS 100	125	12,460	105	10,480
NIS 200	40	8,033	33	6,689
Coins in circulation	-	1,038	-	983
Other	-	33	-	9
Total		24,410		20,778*

* Reclassified.

9. International financial institutions (liabilities)

	31 December	
	2005	2004
	(NIS million)	
Special Drawing Rights allocated ^a	703	712
Liabilities to international financial institutions ^b	64	64
Total	767	776

^a Special drawing rights (SDR) are money which member countries of the International Monetary Fund (IMF) have undertaken to buy from it. The Fund allocates SDRs to member countries relative to the size of their quotas. To date Israel has been allocated SDR 106.4 million.

^b Liabilities in bills or deposits to the following institutions: IDB, MIGA, EBRD, IDA, IBRD (see Note 3.b).

10. Deposits of the government

Government deposits comprise deposits for financing its budgetary activity and other deposits.

Government deposits for financing the budget

These are defined as deposits that the government may use to finance its budgetary and extra-budgetary activity and, accordingly, to which section 45(b) of the Bank of Israel Law (the “Non-Printing Law”), 5714-1954, applies. Financial movements arising from government budgetary and extra-budgetary activity in Israel and abroad and financial movements with the Bank of Israel are recorded in this item.

Other deposits

Other deposits include a local-currency deposit for stabilizing bond prices, and various foreign-currency deposits. The bond-price stabilization deposit represents the proceeds from the purchase at source of government securities by the Bank of Israel in order to stabilize prices on the Tel Aviv Stock Exchange (TASE). In accordance with an agreement with the Ministry of Finance, the proceeds are placed in a special deposit on behalf of the government, but may not be used to finance government expenses. At the request of the Ministry of Finance the bond-price stabilization arrangement was discontinued in January 1993, and the deposit is gradually being reduced against the redemption of such bonds purchased in the past. The redemption of these bonds will end in 2009.

	31 December			
	2005	2004	2005	2004
	(NIS million)		(\$ million)	
Deposits for budget financing				
Local currency ^a	(48)	(7,407)*		
Foreign currency				
Borrowing under US government guarantee ^b	5,196	12,682*	1,129	2,944*
US government economic aid ^b	1,105	-	240	-
Current deposit	379	533	82	124
Total	6,680	13,215	1,451	3,068
Total deposits for budget financing	6,632	5,808		
Other deposits				
Bond-price stabilization local-currency deposit ^a	55	90		
Other foreign-currency deposits ^b	240	616	52	143
Total other deposits	295	706		
Total	6,927	6,514		

* Reclassified.

^a Local-currency government deposits bear (when in debt) or pay (when in credit) interest at prime. The average prime rate in 2005 was 5.2 percent (in 2004 it was 5.7 percent).

^b Government foreign-currency deposits derived from borrowing under US government guarantee or from US government economic aid and some of other deposits earn interest at the rate paid on US Treasury bills with an average of 6 months to maturity. The rate of interest on 31 December 2005 was 4.3 percent (on 31 December 2004 it was 2.4 percent).

11. *Makam* (short-term bills issued by the Bank of Israel)

The Short-Term Loan Law, 5744–1984, authorizes the government to issue bonds to be sold only to the Bank of Israel; The Bank would sell them to and buy them from the public to regulate the money supply and to carry out its functions. The government must deposit the entire proceeds of sales of these bonds in the Bank of Israel and may not use the proceeds for anything apart from repaying the loan in accordance with this Law or paying the interest on it. The purchase of bonds from the government by the Bank of Israel and the deposit of the proceeds of this sale in the Bank of Israel are not reflected in the Bank's balance sheet.

The balance of *makam* shown in the balance sheet reflects the redemption value of bills held by the public *less* the balance of the discount not yet amortized.

The following is the composition of the balance of *makam*:

	31 December	
	2005	2004
	(NIS million)	
Redemption value of <i>makam</i> sold to the public	85,491	73,506
Less discount at time of sale to public	3,459	3,254
Proceeds of sale of <i>makam</i> to the public	82,032	70,252
Plus reduction in discount for period to balance-sheet date	1,700	1,652
Total balance of <i>makam</i>	83,732	71,904

12. Deposits of banking corporations

	31 December	
	2005	2004
	(NIS million)	
Local-currency time deposits (see section a below)	3,561	16,003
Demand and other deposits (see section b below)	15,255	12,017
Total	18,816	28,020

a. Local-currency time deposit

The Bank of Israel receives local-currency time deposits from the banking corporations. The deposits are allocated by auction for periods of a day or a week. The deposits are not considered as liquid assets for the purpose of fulfilling the banking corporations' reserve requirements.

In September 2005 the Bank of Israel began receiving overnight deposits from the banks at a rate of interest 1 percentage point below the Bank's policy rate. This replaced the previous system in which the Bank of Israel paid a rate of interest on surplus liquidity that was 3.2 percentage points below the Bank's policy rate. The balance of these deposits was zeroed on 31 December 2005.

	31 December	
	2005	2004
	(NIS million)	
Daily deposits	3,560	8,000
Weekly deposits	-	8,000
Total	3,560	16,000
Accrued interest on deposits	1	3
Total	3,561	16,003
The average rate of interest on time deposits in 2005 was 3.7 percent (in 2004 it was 4.3 percent).		
The average rate of interest on the balance of deposits on 31 December 2005 was 4.5 percent (on 31 December 2004 it was 3.8 percent).		
The average rate of interest on overnight deposits in 2005 was 3.1 percent.		

b. Demand and other deposits

The banking corporations' other local-currency deposits in the Bank of Israel serve as liquid assets against residents' local-currency and foreign-currency deposits.

Foreign-currency demand deposits (*Pamach*) serve as a liquid asset against nonresidents' foreign-currency deposits.

The reserve requirement ranges from 0 percent to 6 percent, according to the term of the deposit.

	31 December		31 December	
	2005	2004	2005	2004
	(NIS million)		(\$ million)	
Local-currency demand deposits	14,151	10,426		
Foreign-currency deposits				
Foreign-currency demand deposits	1,066	1,103	232	256
Unrestricted deposits	38	488	8	113
Total foreign-currency deposits	1,104	1,591	240	369
Total	15,255	12,017		

13. Other liabilities

This item consists mainly of:

- a. Provision for employee pensions and severance and vacation pay;
- b. Deposits of the US–Israel Binational Industrial Research and Development Foundation and a deposit of the US–Israel Binational Science Foundation;
- c. In 2004, this item included expected expenses against the exercise of options on the US\$/NIS exchange rate *plus* income received in advance;
- d. In 2004, this item included the net balance of NIS/US\$ swaps. (See Notes 1.j.1(a) and 18). In September 2005 the Bank of Israel stopped holding these auctions;
- e. Commemorative coins (reclassified from the item ‘Banknotes and coins in circulation’) (see Note 8).
- f. Various creditors.

14. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see also Notes 1.b, 1.d, and 1.i):

	31 December	
	2005	2004
	(NIS million)	
Foreign-currency balances	11,252	9,390
Tradable foreign-currency securities	16	107
Tradable local-currency securities	816	1,198
Total	12,084	10,695

15. Bank of Israel's capital and general reserve

	31 December	
	2005	2004
	(NIS million)	
Share capital	60	60
General reserve	260	260
Difference arising from switch to reporting according to Accounting Standard No. 12.	3,665	3,665*
Total	3,985	3,985

* Restated (see Note 1.1).

16. Losses

In accordance with the Bank of Israel Law, 5714–1954, the Bank must transfer its net profits to the government within sixty days of the end of each business year. Losses incurred by the Bank accrue in this item, and will be offset against future profits.

	31 December	
	2005	2004
	(NIS million)	
Loss brought forward from previous year	(17,053)	(16,256)*
(Loss) Profit in current year	1,414	(797)
Total loss	(15,639)	(17,053)

* Restated (see Note 1.1).

17. Assets and liabilities, by indexation bases

	31 December 2005				31 December 2004			
	In local currency	In foreign currency	Non- financial items	Total	In local currency	In foreign currency	Non- financial items	Total
(NIS million)								
Assets								
Foreign exchange reserves	-	128,229	-	128,229	-	114,728	-	114,728
Balance in international financial institutions	-	947	822	1,769	-	2,009	793	2,802**
Credit to the government ^a	581	2,850	-	3,431	664	3,331	-	3,995
Loans	1,064	-	-	1,064	2,191	-	-	2,191
Local-currency securities ^b	3,401	-	-	3,401	4,763	-	-	4,763
Other assets	414	-	212	626	407	-	218	625**
Total assets	5,460	132,026	1,034	138,520	8,025	120,068	1,011	129,104
Liabilities								
Banknotes and coins in circulation	24,410	-	-	24,410	20,778	-	-	20,778*
International financial institutions	-	767	-	767	-	776	-	776
Deposits of the government	7	6,920	-	6,927	(7,317)	13,831	-	6,514
<i>Makam</i>	83,732	-	-	83,732	71,904	-	-	71,904
Deposits of banking corporations	17,712	1,104	-	18,816	26,428	1,592	-	28,020
Other liabilities ^{c,d}	3,244	194	-	3,438	9,328	(5,843)	-	3,485*
Revaluation accounts	12,068	16	-	12,084	10,588	107	-	10,695
Bank of Israel capital	-	-	(11,654)	(11,654)	-	-	(13,068)	(13,068)**
Total liabilities	141,173	9,001	(11,654)	138,520	131,709	10,463	(13,068)	129,104
Surplus assets (liabilities)	(135,713)	123,025	12,688	-	(123,684)	109,605	14,079	-

* Reclassified.

** Restated (see Note 1.1).

^a Foreign-currency credit to the government includes long-term advances totalling NIS 2,698 million denominated in NIS and indexed to the exchange rate against the first currency basket (NIS 3,189 million on 31 December 2004).^b Local-currency securities indexed to the Consumer Price Index.^c On 31 December 2004, other foreign-currency liabilities include NIS 28 million deriving from expenses expected on exercising US\$/NIS exchange-rate options.^d NIS/\$ swaps are shown in the balance sheet net, in accordance with the balance (see Note 1.j.1(a)). In 2004 this net balance was in credit, and is therefore shown in this ('Other liabilities') item. (In 2005 the balance of swaps was zero.) In this table dollars to be received are shown in the foreign-currency column (NIS 6,031 million on 31 December 2004), and NIS to be paid are shown in the local-currency column (NIS 6,239 million on 31 December 2004), so that the balances of these items are negative.

18. Contingent liabilities and special commitments

	31 December	
	2005	2004
	(NIS million)	
1 Contingent liabilities ^a		
Documentary credits and guarantees for government imports and exports		
Documentary credits	29	26
Guarantees	241	442
Other contingent liabilities		
Liabilities to pay international financial institutions on demand	3,800	3,593
2 Special commitments		
Derivative financial instruments in activity in Israel		
Currency swaps with domestic banks		
Future receipts of dollars ^b	-	6,031
Future payments of NIS	-	6,239
\$/NIS purchase options	1,436	844
\$/NIS sales options	1,436	810
Future remittances of <i>makam</i> (at par)	640	640
Derivative financial instruments in activity abroad		
Currency swaps and forward transactions		
Future receipts of foreign currency	9,484	1,873
Future payments of foreign currency	10,327	2,055
Repurchase agreements (Repo) and Reverse Repo (RRepo)		
Repo	14,283	-
Reverse Repo	4,879	-
Futures		
Sales commitments	363	2,805
Purchase commitments	-	1,607
Participation in international financial institutions not yet due for payment	-	10

^a Several claims were made on the Bank of Israel. The Bank of Israel does not consider it necessary to make a special provision for these claims, as the chances that they will be upheld are slight.

^b The balance of swaps on 31 December 2004 was \$1,400 million.

19. Interest income from the foreign exchange reserves

	Year to 31 December	
	2005	2004
	(NIS million)	
Tradable securities	2,644	2,236
Short-term deposits	743	331
Demand deposits	58	13
Derivative financial instruments ^a	(70)	(20)
Total	3,375	2,560

^a Expenses on interest on derivatives is shown net.

20. Interest income from loans

	Year to 31 December	
	2005	2004
	(NIS million)	
From monetary loans	20	30
From other loans ^a	43	73
Total	63	103

^a Mostly deriving from interest on credit advanced to the Industrial Development Bank (see Note 5).

21. Interest income from the government

	Year to 31 December	
	2005	2004
	(NIS million)	
Long-term advances		
Indexed	255	441
Unindexed	49	59
From binational funds	67	65
From government deposits	56	348
From local-currency securities	615	474
Total	1,042	1,387

22. Other interest income

This item consists of interest income from the IMF.

23. Interest paid to the banks and the public

	Year to 31 December	
	2005	2004
	(NIS million)	
Interest paid		
In local currency		
On local-currency time deposits	342	906
On swaps	65	192
On <i>makam</i>	3,358	3,472
On banks' deposits	2	4
Total in local currency	3,767	4,574
In foreign currency		
On banks' deposits	14	9
Total	3,781	4,583

24. Interest paid to the government

	Year to 31 December	
	2005	2004
	(NIS million)	
On local-currency deposits ^a	4	6
On foreign-currency deposits	352	251
Total	356	257

^a On the bond-price stabilization deposit (see Note 10).

25. Other interest paid

This item consists mainly of interest paid:

- a. To international financial institutions;
- b. On deposits of the US–Israel Binational Industrial Research and Development (BIRD) Foundation and a deposit of the US–Israel Binational Science Foundation.

26. Other financial income from (expenses on) securities and derivatives

	Year to 31 December	
	2005	2004
	(NIS million)	
Securities^a	(234)	(273)
Derivative financial instruments^b		
In foreign currency	23	(183)
In local currency	7	12
Total derivative financial instruments	30	(171)
Total	(204)	(444)

^a Including income from (expenses on) the realization of securities and from decline in their value at the end of the year.

^b Consisting mainly of financial income from (expenses on) the realization of derivatives.

27. Other financial income—miscellaneous^a

	Year to 31 December	
	2005	2004
	(NIS million)	
In local currency	3	5
In foreign currency	29	37
Total	32	42

^a Consisting mainly of income from fees and fines deriving from the Bank of Israel's financial activities.

28. Administrative and general expenses

	Year to 31 December	
	2005	2004
	(NIS million)	
Staff wages and general expenses	337	324*
Provision for employees' entitlements ^a	273	190*
Total	610	514

* Reclassified..

^a In 2005 this item includes the effect of the legal changes regarding pensions resulting from the Retirement Age Law 5764—2004, and the application of updated mortality tables.

29. Other income

	Year to 31 December	
	2005	2004
	(NIS million)	
Doubtful debts ^a	-	23
Income from dividend from the BIS	5	2
Total	5	25

^a In 2004 includes update of the loan-loss provision for the North American Bank.