CHAPTER VIII

MONEY AND CAPITAL MARKETS

I. GENERAL ANALYSIS

1. MAIN DEVELOPMENTS

In 1980 liquid and other financial assets of the public expanded rapidly in nominal terms and even rose in real terms, after declining in the previous year.[1] This occurred against the background of a tight credit policy, which was reflected by a further drop in the volume of bank credit and high interest rates on non-directed credit. This policy was one of the factors responsible for the shifting of the public's demand from real (i.e. nonfinancial) to financial assets and for the slowing of economic activity, thereby indirectly contributing to the reduced absorption of liquidity through taxes and the balance of payments. As to the growth of the public's assets portfolio, there was a sizable increase in securities in general and bonds in particular. However, this real expansion did not fully offset the previous year's decline in liquid financial assets. These developments, together with the continued erosion of medium- and long-term liabilities, resulted in the swelling of the public's net real financial wealth. The flow of medium- and long-term credit contracted a bit in real terms during the year.

The monetary developments in 1980 were a result of the tight policy followed by the Bank of Israel in the last two years, the fiscal steps taken at the end of 1979, and the expectations of a comprehensive stringent policy. In view of the sizable monetary expansion in 1977–78 and the dramatic acceleration of inflation, the Bank of Israel imposed restrictions on nondirected credit in April 1979. This reduced the total volume of bank credit and pushed up real interest rates. These measures, together with the adjustment to the earlier expansion and the deterioration in the balance of payments, depressed the public's financial asset holdings in real terms during 1979 and dampened real demands and economic activity. These changes, however, had no immediate effect on the inflation rate, which continued to rise during 1979.

Real demands subsided further in 1980 in response to the abolition of subsidies, a further squeeze on credit at the end of 1979, and the expectation of a

[1] In this chapter real values are calculated using the consumer price index as a deflator (unless otherwise indicated).

Table VIII-1

MAIN MONEY AND CAPITAL MARKET DEVELOPMENTS, 1979-80

(IS billion)

	Balances/flows		Percent annual increase: Nominal[a]		Percent annual increase: Real[b]	
	1979	1980	1979	1980	1979	1980
A. **End-year balances**						
1. Money supply[c]	3.5	7.0	31	98	-38	-15
2. Liquid financial assets of the public[d]	22.1	54.9	81	148	-14	6
3. Shares held by the public[e]	7.7	34.9	75	353	-18	95
4. Total financial assets of the public[f]	81.0	223.6	103	176	-4	18
5. Estimated net financial wealth of the private nonfinancial sector[g]	51.9	147.7	104	185	-3	22
5. Total bank credit to the public[h]	18.0	37.9	101	110	-5	-10
B. **Annual average balances**						
1. Money supply	3.0	5.1	34	70	-23	-28
2. Liquid financial assets of the public	16.2	36.3	67	124	-4	-6
3. Total financial assets of the public	60.8	151.3	89	149	1	7
4. Total bank credit to the public	12.2	25.8	—	107	—	-7
C. **Fund flows during the year**						
1. Net long- and medium-term credit[i]	2.9	6.5	128	122	28	-3
2. Liquidity injection generated by public sector demand surplus[j]	2.0	6.0	45	197	-18	28
3. Liquidity injection generated by Bank of Israel credit[k]	1.8	3.7	59	100	-21	0
4. Liquidity absorbed through purchases of foreign currency[l]	2.7	5.1	418	86	83	-3
D. **Annual nominal cost of credit (%)**						
1. Overdraft accounts[m]	89	177				
2. Total short-term credit[n]	90	135				

[a] Calculated from unrounded data.

[b] Calculated for most items by deflating each month by the consumer price index.

[c] As defined in Table VIII-10, line A-1.

[d] As defined in Table VIII-10, section A.

[e] As defined in Table VIII-10, section B.

[f] As defined in Table VIII-10, section F.

[g] Total assets less liabilities, as defined in Table VIII-6, section C.

[h] As defined in Table VIII-14.

[i] As defined in Table VIII-13, line 3.

[j] As defined in Table VIII-7, line 1.

[k] As defined in Table VIII-8, line 2.

[l] As defined in Table VIII-8, line 3.

[m] As defined in Table VIII-4, column 1.

[n] As defined in Table VIII-12, line 3.

general policy of restraint, which presumably would affect economic activity and employment. This induced the public to switch from real to financial assets, with heavily taxed import-intensive goods contracting most noticeably. The public sector did not cut its expenditures commensurately, and the liquidity injection engendered by its demand surplus rose from IS2 billion to IS6 billion. At the same time the absorption through the private sector's current account declined, so that the net amount of money pumped into the economy from these two sources came to IS3 billion, compared with IS1.4 billion in 1979. The expansionary effect of this injection outweighed the dampening effect of the real decline in credit, with the shifting of demands to financial assets generating the desired liquidity.

Financial demands remained lively throughout the year, with only a small portion going to enlarge the balances required for conducting real transactions and economic activity. Since the monetary expansion reflected the public's preferences and not an exogenous growth in liquidity supply, it did not further aggravate inflation. However, the availability of a large potential supply of liquidity was one of the reasons why inflation did not cool during the year. It thus appears that the monetary expansion was not one of the prime factors in the reflating of demands and activity in 1980. The recovery was related to the ending of the destocking process and the waning of fears regarding the degree of fiscal restraint. A striking feature was that the rebounding of economic activity coincided with a high level of real interest on nondirected credit, which apparently limited the extent of the recovery.

The continued high real interest rates on nondirected credit in a year of financial asset expansion reflected short-term imperfections in the money market. As a result, the credit restrictions hurt the business sector in particular, as it is heavily dependent on bank credit, and so it had to cut back its demands and activity. Given this situation and the steady rise in the real interest rate in the second half of the year, the Bank of Israel refrained from any further tightening of nondirected credit.

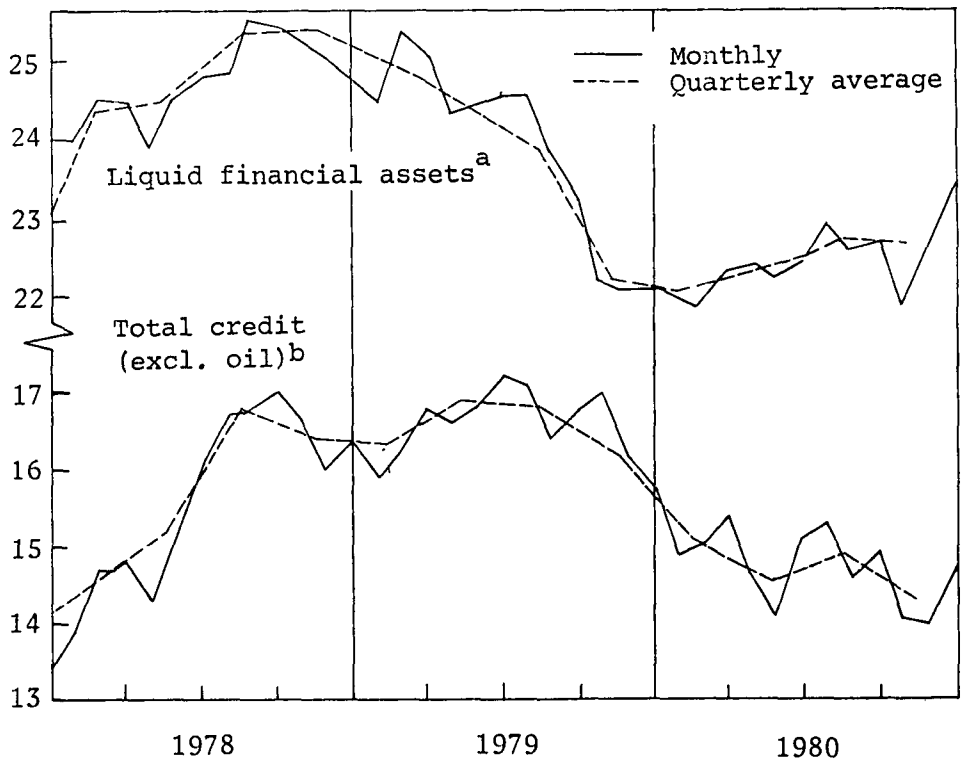
It should be emphasized that the concentration of monetary policy on the curbing of nondirected credit is not an optimal solution but a consequence of the constraints faced by the Bank of Israel. A consistent, effective anti-inflationary policy requires the reduction of the public sector's demand surplus and the liquidity injection engendered by directed credit. During the year reviewed, particularly in the final part, the Bank of Israel began to gradually curtail such credit, after it concluded that it was not only a major source of monetary expansion but also an ineffective tool for improving the balance of payments.

Liquid financial assets of the public rose 6 percent in real terms during 1980 (i.e. in December levels), after shrinking 14 percent the year before. On an annual average, however, they declined. The most striking developments here were the sharp appreciation of tradable bonds, whose prices had been depressed

Figure VIII-1

BANK CREDIT AND LIQUID FINANCIAL ASSETS OF THE PUBLIC, 1978–80

(IS billion, at Dec. 1979 prices)



[a] Money supply, time deposits in Israeli currency, certificates of deposit, Patam local residents' deposits, and tradable bonds held by the public.

[b] Credit from the domestic banking system, excluding that for oil imports and credit from Israeli bank branches abroad.

at the end of 1979, and the slackening of the real drop in nonindexed financial assets, as reflected by the rapid growth of negotiable certificates of deposit and the retarding of the real decline in the money supply. The uptrend in the real value of Patam local residents' foreign currency deposits slowed compared with the two preceding years.

Total asset holdings of the public grew 18 percent in 1980, following a 4 percent decrease the year before. Half of this real gain was accounted for by shares, whose total market value almost doubled, with prices mounting steeply and new issues increasing. This was one aspect of the sharp real stock market fluctuations, which are mainly triggered by self-fulfilling expectations whose timing and strength are difficult to foresee.

Along with the real expansion of liquid financial assets, the value of bank shares, which are highly liquid, swelled noticeably. The public also revealed a lively interest in newly established mutual funds and continued to enjoy the more

attractive terms (the shortening of the maturity period and increased flexibility) offered by the long- and medium-term savings schemes. At the same time the rates of return on most of the assets were more volatile this year, so that it cannot be determined if the portfolio as a whole became more liquid.

Total short-term bank credit was down 10 percent in real terms, after a 5 percent drop in 1979—a development attributable to the policy of restricting nondirected credit. By contrast, directed export credit continued to expand, although proportionally less than exports themselves. Medium- and long-term credit inched down 1 percent relative to the uses which it financed, which suggests that some of the credit may have indirectly financed short-term activities. A large proportion of the medium- and long-term credit granted this year was fully or partially indexed.

The public's net financial wealth expanded at an impressive 22 percent real rate in 1980.[2] This was a combined result of the sizable growth of assets, the curbing of bank credit, and a further erosion of outstanding medium- and long-term liabilities.

Given the high inflation this year, the nominal expansion of the various monetary aggregates reached extremely high levels. The automatic appreciation of most of the assets held by the public and some of its liabilities goes a long way to explain this development. The high rate of indexation creates a situation in which inflation is largely self-feeding, as it automatically leads to the monetary expansion necessary for its perpetuation. At the same time indexation fulfills an important role by ensuring the normal functioning of the money and capital markets under conditions of high, irregular inflation. However, indexation is not all-embracing, and so there is undoubtedly room for controlling the rate of monetary expansion. This, as stated, depends on the reduction of the liquidity injection engendered by the public sector's demand surplus and the granting of directed credit.

2. INFLATION, ECONOMIC ACTIVITY, AND MONETARY DEVELOPMENTS

During the 1970s the Israeli economy was beset with high inflation, which worsened steadily. This was closely but not always consistently related to monetary developments. On the one hand, inflation could not have persisted for such a long time and at such a rapid rate had it not been fueled by the provision of ample liquidity through the nominal growth of the monetary aggregates. During certain periods the monetary developments permitted the pressures generated by the adjustment of relative prices and taxes to drive up the general price level; at other times monetary developments were themselves the major cause of the acceleration of inflation.

[2] Estimates of the net financial wealth, which are presented here for the first time, are preliminary and quite rough. However, it is clear that the public's total net wealth increased much more slowly than its net financial wealth.

On the other hand, inflation influenced monetary developments in two ways: First, the intensification of inflationary expectations induced the public to reshuffle its assets and liabilities portfolios—in particular, to reduce the proportion of unlinked[3] assets and to resort more heavily to unlinked credit as long as the nominal interest rates thereon were not adjusted for the inflationary expectations. Secondly, the price increases caused an almost automatic revaluation of the linked components in the public's financial portfolio, as well as a nominal adjustment of a significant portion of the injections generated by various government activities and by the granting of cheap credit for export, investment, etc. The nature of these portfolio shifts tended to result in an increasingly higher revaluation of these portfolios.

The growing weight of the linked components in the public's assets portfolio must be viewed as part of a wider process of the sharpening of inflationary expectations and refinement of the inflation-proofing and adjustment mechanisms, institutional and informal alike. This process, which arose in reaction to the high rates of inflation during the mid-1970s, was reflected by the erosion of the "inflation brakes", i.e. by the elimination of various nominal rigidities which tend to stabilize the rate of inflation.[4] The economy switched almost completely to linked asset holdings; this created a situation in which price increases were responsible for much of the monetary expansion, which in itself is necessary for the continuation of the inflationary process, while the private sector avoided the "inflation tax" on its net unlinked claims on the public sector (see Table VIII–3). In recent years the net inflation tax was in fact negative.[5]

The monetary roots of the present stage of the inflationary process are to be found in the rapid monetary expansion of 1977–78. This was due partly to the foreign currency reform and the resulting capital movements, and also to the formidable growth of directed export credit. In view of the change in adjustment patterns in previous years, the 1977–78 monetary expansion, together with other factors, spurred demand for physical assets such as housing and durable goods, stimulated economic activity, and sent inflation soaring from 40 percent in 1977 to 110 percent in 1979.

The vigorous upturn in physical demands and in economic activity was brief, being cut short in the course of 1979. At the beginning of 1980 real demands

[3] Either to the consumer price index or to the exchange rate.

[4] These include *inter alia* the slow adjustment of inflationary expectations, various prices, and especially the exchange rate. These tend to stabilize the rate of inflation through a combination of wealth effects, liquidity effects, and the diversion of demands (to the balance of payments, for instance).

[5] It should be stressed that elimination of the inflation tax does not imply that the public sector has ceased to mobilize funds from the private sector through the expansion of its assets; rather, it means that these assets augment the wealth of the private sector without being subject to inflationary erosion.

Table

INDICATORS OF MONETARY EXPANSION,

(Percentages,

	1978	1979
1. Increase in liquid financial assets[a]	59	81
2. Increase in total financial assets[b]	64	103
3. Purchases of liquid financial assets[c]	—	14
4. Liquidity injection generated by public sector demand surplus[d] relative to liquid financial assets at start of period	22	14
5. Liquidity injection generated by Bank of Israel credit[e] relative to liquid financial assets at start of period	7	13
6. Increase in average balance of short-term bank credit compared with previous period	—	—
7. Increase in net flow of medium- and long-term credit[g] compared with previous period	86	128
8. Increase in consumer price index	48	111
9. Average real increase in housing prices	19	36
10. Gross national product	100	104
11. Private consumption and gross investment	100	108
12. Purchases of durable goods	100	133

[a] As defined in Table VIII–10, section A.
[b] As defined in Table VIII–10, section F.
[c] As defined in Table VIII–8, line 7.
[d] As defined in Table VIII–7, line 1.

continued to weaken noticeably, and though they subsequently revived somewhat, their average level for the year was lower than in 1979. The contraction of demands was reflected most glaringly by a sharp drop in imports, but the GNP advance was also checked and the unemployment rate moved upward in the course of the year reviewed. Inflation continued to run at an increasingly fast pace until the end of 1979, after which it tailed off; in 1980 and the beginning of 1981 it reached a 130 percent annual average rate.

From the monetary aspect there were several factors that worked to restrain demands and economic activity in 1979 and arrest the acceleration of inflation. First of all, a much heavier purchase of physical assets, accompanied by price increases in the secondary markets and by the absorption of liquidity through import- and tax-intensive demands, helped to redress the imbalance in the composition of real and financial portfolios. At the same time Israel's terms of trade took a turn for the worse, and this siphoned off additional liquidity through the balance of payments. The effect of these changes was reinforced by the restrictive credit policy introduced by the Bank of Israel in the first half of 1979 and tightened further toward the end of that year. The combined im-

VIII–2

PRICES, AND ECONOMIC ACTIVITY, 1978–80

at annual rates)

	1978		1979		1980	
1980	1st half	2nd half	1st half	2nd half	1st half	2nd half
148	49	69	63	102	131	165
176	—	—	—	—	125	222
29[f]	—	—	13	16	34	24
22	—	—	8	20	24	20
14	9	5	9	17	17	11
107	—	—	—	103	104	111
122	—	92	57	350	7	367
133	39	56	80	147	119	151
−17	—	—	102	−28	−36	2
			Indexes: 1978=100			
106	96	104	103	104	104	108
100	96	104	109	107	97	103
119	89	111	134	133	102	136

[e] As defined in Table VIII–8, line 2.

[f] As defined in Table VIII–14, excluding credit for oil imports.

[g] As defined in Table VIII–13, line 3.

pact of these factors was reflected by a real decrease in bank credit and in the public's financial assets, as well as a rise in interest rates on nondirected credit. Liquid financial asset holdings of the public shrank 14 percent in real terms during 1979, with the decline gathering momentum in the final part of the year owing to jitters about a possible impairment of tradable bonds by the government. The public's total financial assets portfolio contracted 4 percent. Because of the curbs imposed on nondirected credit, total bank credit to the public[6] was down 5 percent in real terms. The real interest rates on nondirected credit in foreign currency shot up following the imposition of an interest surcharge and the adoption of measures to stabilize the real exchange rate (see below). The interest on nondirected credit in Israeli currency went up nominally from approximately 50 percent at the end of 1978 to 130 percent at the end of 1979, but the real level was still low. During this period the banks rationed credit to their customers, so that the shadow price of credit to borrowers was higher than what the banks charged.

The influence of the real monetary squeeze in 1979 and of other factors that depressed private demands was mainly reflected, as stated, in the arresting of

Table VIII-3

ESTIMATED INFLATION TAX ON THE MONETARY BASE AND THE CREDIT SUBSIDY, 1976–80 [a]

(IS million, at 1976 prices)

	Average monetary base (tax base) (1)	Rate of tax [b] (2)	Gross tax (1×2) (3)	Total subsidy on short- and long-term credit [c] (subsidy base) (4)	Net inflation tax (3–4) (5)
1976	741	0.34	252	803	–551
1977	789	0.37	292	833	–541
1978	690	0.43	297	768	–471
1979	412	1.05	433	1,219	–786
1980	300	1.19	357	880	–523

[a] The estimated inflation tax on the private sector monetary base and the subsidy component of short- and long-term credit in Israeli currency.

[b] The tax rate equals the percentage rise in prices during the year, less interest paid on the narrow monetary base on account of liquid asset deposits with the Bank of Israel. This is the rate of inflationary erosion of the real monetary base during the year.

[c] The subsidy component of long-term credit is estimated as the average real balance of total subsidized long-term credit (nonindexed) granted by the government, multiplied by the difference between the rate of price increase plus 4 percent real interest p.a. and the weighted interest on the outstanding credit balance. The subsidy component of short-term credit is estimated by multiplying the real balance of the rediscount component of directed credit in Israeli currency by the difference between the effective average interest rate on overdraft accounts and the discount rate on directed credit in Israeli currency.

SOURCE: Based on Central Bureau of Statistics data.

the uptrend in domestic uses and economic activity. Inflation continued to worsen until the end of 1979. The faster reaction of uses and economic activity mirrored imperfections in the various markets, including that for productive factors; these imperfections tend to render the movement of prices somewhat inelastic in the short run. During this period supply-side factors, such as the wage agreements signed at the beginning of the year, global inflation, and the slashing of subsidies, also made their impact felt. In 1980 the Bank of Israel continued to implement a stringent credit policy, and in fact even tightened it. Bank credit to the public expanded by 110 percent during the year, but since prices rose 133 percent, there was a 10 percent real decline. The effective nominal interest on overdraft accounts ranged from 160 to 200 percent; in real terms it exceeded 10 percent, and during certain periods even reached 20 percent. The real interest on nondirected credit in foreign currency ranged within the same limits. Though the average interest paid by the business sector was lower,

[6] Excluding credit for oil imports and to local authorities (see the section on credit).

Table VIII-4

ESTIMATED COST OF NONDIRECTED BANK CREDIT, 1978-80

(Percentages, at annual rates)

	Nominal cost				Nominal cost, deflated by estimated expected rate of inflation[b]		
	Average effective cost of overdraft facilities[a] (1)	Cost of excess drawings on overdraft accounts (2)	Interest on nondirecced foreign currency credit, in $ terms (3)	Estimated expected rate of inflation[b] (4)	Average effective cost of overdraft facilities[c] (5)	Cost of excess drawings on overdraft accounts (6)	Interest on non-directed foreign currency credit[d] (7)
1978							
I	49	64	10	46	2	12	-4
II	49	64	11	48	1	11	-4
III	49	64	11	41	6	16	0
IV	52	64	14	51	1	9	-12
1979							
I	63	99	14	68	-3	18	-19
II	69	102	25	80	-6	12	13
III	92	129	26	99	-4	15	19
IV	132	175	29	129	1	20	6
1980							
I	171	236	31	142	12	39	12
II	159	216	26	133	11	36	7
III	179	245	24	124	25	54	11
IV	197	258	29	140	24	49	23

[a] Data of the Department of the Examiner of Banks; consists of the basic interest rate, commitment fees, value-dating, and the higher interest charged for drawings in excess of approved credit ceilings.

[b] The average rise in the consumer price index in the current and the previous quarter. Since this average price increase does not necessarily reflect the inflationary expectations at every point in time, the interest listed here (column 5) should be regarded as only an indicator of the real interest the public expects to pay (see the section on credit).

[c] The nominal cost (column 1) deflated by the estimated expected rate of inflation (column 4). The figure for 1979 does not fully reflect the cost of such credit that year since much of the credit granted was rationed.

[d] The interest on nondirected foreign currency credit in dollar terms (column 3), inflated by the average rise in the exchange rate in the current and the previous quarter, and deflated by the estimated expected rate of inflation.

the real cost of bank credit was probably high, at any rate on the margin (see the section on credit).

The focusing of the efforts to curb monetary expansion on credit appears to have hit businesses particularly hard. This sector has resorted heavily to borrowed funds, especially in recent years, owing to tax considerations and the low real interest charged on certain types of credit. The credit squeeze in 1979–80 inhibited the financing of production and forced the sector to reduce stocks. The situation was aggravated at the beginning of 1980 by a sharp contraction of private consumption, largely due to the fiscal measures introduced at the end of the preceding year, and to the expected consistent implementation of an overall restrictive economic policy, which would depress real incomes and employment. These expectations also had a dampening effect on investment demand, which was already affected by the gradual scaling up of the rate of linkage of development loans and by the uncertainty concerning implementation of the recommendations of the committee dealing with tax reform.

The weakening of real demands was most noticeable in import- and tax-intensive products, such as inventories, equipment, and durable goods. This blunted the contractionary influence of the credit squeeze on the public's financial asset holdings. The real decrease in tax receipts, which was not accompanied by any pruning of public sector spending, resulted in the sector's demand surplus generating a larger liquidity injection.[7] At the same time a smaller amount of liquidity was pumped out this year through private sector purchases of foreign currency for financing its balance of payments. This trend, which began in the second half of 1979, enabled the public to gradually rebuild its financial assets portfolio despite the ongoing credit squeeze. The drastic shrinkage of its liquid assets in 1979 and the pessimistic expectations regarding the level of economic activity, incomes, and employment deterred the public from immediately utilizing this extra liquidity to reflate its demands. In the first half of 1980 it increased its liquid financial assets by 2 percent and its other financial assets even more, so that its total financial assets portfolio expanded 6 percent in real terms.

During this period the public also turned to the securities market, causing prices to rise and created self-fulfilling expectations; this enhanced the attraction of financial assets compared with commodities and the real markets. Around midyear sales of bonds picked up smartly after fears of adverse government measures with respect to such paper evaporated and the issue of 100 percent indexed bonds was resumed. Concurrently demands began to rebound as destocking ran its course and expectations of a restrictive fiscal policy subsided. This revival was accompanied by a real decline in purchases of financial assets by

[7] The reference is to the estimated payments related to the public sector's demand surplus, as calculated from financial statements of the relevant units. The estimate based on national accounts data does not show a real increase in 1980 (see the section dealing with the public sector).

Table VIII-5

TURNOVER VELOCITY OF DEMAND DEPOSITS AND MONETARY AGGREGATES, 1977–80

	Average turnover velocity of demand deposits in IS[a]	Annual average turnover velocity of monetary aggregates relative to domestic uses[b]		
		Money supply (1)	Money supply, unlinked deposits, and Patam (2)	Total liquid assets[c] (3)
1977	34.75	9.87	5.58	2.97
1978	38.38	12.02	4.78	2.80
1979	66.25	17.20	5.52	3.21
1980	105.63	22.00	5.10	3.09

[a] Total debits to Israeli currency demand deposits in banks, divided by the annual average volume of these deposits.

[b] Total domestic uses divided by the annual average balance of the monetary aggregates.

[c] All the assets in column (2) plus bonds held by the public.

SOURCE: Velocity of demand deposits—Department of the Examiner of Banks, *Banking Statistics*; money supply and nonindexed deposits—Table VIII-A1; indexed assets—Table VIII-A2; domestic uses (excluding direct defense imports)—Table II-1.

the public; nevertheless, the real value of its holdings continued to swell with the advance in stock exchange quotations. The public's portfolio of financial assets increased 12 percent (in real terms) during the second half of 1980; the growth of liquid financial assets accelerated to 5 percent, but this failed to regain all the ground lost in 1979, when there was a 6 percent annual average real decline.

This expansion of the public's financial assets was not one of the main factors in the revival of real demands and economic activity. On the contrary, it resulted from the shifting of demands from real to financial channels. The monetary expansion, which occurred despite the credit restrictions, did not depress the real interest rates on nondirected credit; in fact they even continued to move up in the second half of the year (see the section on credit). The reason probably lay in the segmentation of the money market in the short term, which inhibits in particular the flow of credit between households and business other than through the system of financial intermediaries (see the definition in Part II of this chapter). Keeping real interest rates on nondirected credit at a high level undoubtedly damped down the recovery of real demands and economic activity.

The monetary expansion, which reflected the growth of financial demand and not an exogenous increase in liquidity supply, apparently did not stoke inflation

during the year reviewed. However, it helped to keep inflationary expectations at their high level and provided the liquidity for additional rounds of price increases without further harming economic activity. The monetary expansion of 1980 may have created the potential for a continued acceleration of inflation at a later stage, but in assessing this one must take into account that the sizable 1980 increase in financial assets came on the heels of a real contraction in the preceding year. Moreover, to a large extent the upswing rested on the flimsy foundation of a real rise in stock exchange quotations.

3. MONETARY POLICY

As in 1979, the Bank of Israel's monetary policy concentrated on restraining the growth of short-term bank credit. The main tool used was the periodic setting of quotas on the volume of nondirected credit in Israeli and foreign currency. These quotas were based on the desirable nominal growth targets for total bank credit (excluding that for financing oil purchases and diamonds), with only a partial adjustment to fluctuations in the rate of inflation.[8] In addition, the interest surcharge on nondirected foreign currency credit[9] remained in force, and the fines for liquidity shortfalls and the interest paid on the banks' liquid assets were raised.

In 1980 the Bank of Israel also acted to reduce the overfinancing of foreign sales through the export funds, in view of the substantial contribution of such credit to monetary expansion.[10] Moreover, the interest rates on directed export credit were partly adjusted to the changes in the rates charged on nondirected credit in Israeli currency and to the international market rates. The subsidy component of directed export credit remained large, constituting an important factor in assuring a real return to the exporter. In this connection the limitations

[8] The nondirected bank credit quotas were fixed in accordance with the target growth of total bank credit to the public (excluding oil and diamonds), and allowed for the expected increase in directed credit. The target for total bank credit expansion was set at 5 percent a month, with the immediate inflation goal being 6 percent a month. The quotas were partly linked to the exchange rate. These steps mitigated the effect of deviations of the actual rate of inflation from its planned rate, without permitting a complete adjustment to the actual inflation. (On the role of nominal targets in a disinflationary policy see Chapter I).

[9] The interest surcharge in most months of the year reached a 12 percent annual rate, as in 1979. In November 1980 it was reduced to 9 percent owing to the high interest rates in the international currency markets. The interest surcharge and quotas were not imposed on all types of nondirected credit (see the section on credit).

[10] Under this policy it was decided to transfer part of the export financing to the category of nondirected credit. This change will enable exporters to enjoy the credit subsidy without drawing on all of the credit quotas allotted them, thereby diminishing the expansionary monetary effect of export credit.

of using directed credit as one of the principal tools for promoting export should be stressed. Such credit, as already mentioned, has an expansionary monetary effect, and the incentive it provides is by no means optimal, leading to a distorted resource allocation (see the section on industry in Chapter VI).

The concentration of monetary policy on credit curbs reflects the limitations fettering the monetary authorities, which are called upon to play a central role in implementing disinflationary policies. In Israel open-market operations in government bonds do not fulfill an important function as a monetary policy instrument, since original-issue bonds are sold directly to the public in unlimited quantities, with their real yield to maturity determined by the government.[11] In this situation, and given the high rates of inflation prevailing in Israel, government bonds have become near-money. The same applies to Patam (local residents' foreign currency deposits). Liquidity absorption could probably be increased by selling foreign currency to the public for balance of payments purposes, but this would be at the price of eroding the real exchange rate and a deterioration in the current account. Since March 1979 maintaining the real exchange rate has been preferred to increasing liquidity absorption through the balance of payments, on the assumption that a real upvaluation of the currency is justified only as part of a concerted disinflationary effort utilizing a wide array of policy instruments.

Because of the constraints on the employment of other policy instruments, monetary policy focused on nondirected credit, which has a relatively narrow base. In view of the limited short-term substitutability between bank credit and alternative sources of funds, and especially the limited possibility of channeling funds between households and business,[12] this policy led to a steep rise in real interest rates, which harmed business activity and had a warping effect on resource allocation. The Bank of Israel therefore refrained from restricting credit more drastically.

Some of the accompanying effects of the restrictive credit policy are of a short-term nature. In the longer run one can expect a flow of financial resources that will by-pass the system of financial intermediaries, but this will result in a less efficient transfer of resources and weaker control by the monetary authorities. In any case the relatively small volume of nondirected credit does not provide a sufficient basis for the conduct of an efficient long-range disinflationary policy. Such a policy must focus on reducing the public sector's demand surplus and

[11] The Bank of Israel can of course operate in the secondary bond market, but the influence of such activity is limited and mainly of a short-term nature. The Bank may also alter the selling price of the bonds within certain limits, but only as a means of smoothing fluctuations in the real price during the month (the adjustment to the consumer price index is made once a month).

[12] These limitations are related *inter alia* to the high degree of government intervention in the capital market and to tax barriers.

the liquidity injection engendered by directed credit. This approach also possesses definite short-term benefits, and is preferable from the aspect of economic efficiency.

The transition to long- and medium-term credit allocation on linked terms was continued in 1980. The decision to link such finance was taken in May 1979 in recognition of the inefficiency and arbitrariness of the wealth and income redistributive effects of granting long-term credit under conditions of rapid, irregular inflation.[13] It should be stressed, however, that the advantages of the new method cannot be fully exploited unless the tax structure is adjusted to the inflationary conditions. Because of the perverse effects of the failure to adjust the tax structure, the recommendations of a committee that studied this subject aroused considerable public interest in 1980, but no steps have yet been taken to implement them.

The preliminary recommendations of the committee dealing with the reform of the capital market were also submitted this year. It called for a diminution of government intervention in medium- and long-term credit allocation, and also recommended that investment subsidies should not be given in the form of cheap credit. Adoption of these proposals, together with the linkage of loans, would make for a more efficient allocation of long- and medium-term financial resources and reduce the expansionary monetary effects of the investment promotion policy.

Long- and medium-term saving continued to be encouraged in the year reviewed. The real rates of return were raised, the period of saving shortened, and the terms made more flexible (at the beginning of 1981 the public could even put its money in a new scheme for a two-year period only). It should be noted in this context that expanding medium- and long-term financial saving has less of a restrictive monetary impact than curbing the public sector's demand surplus, since in the short run it neutralizes the liquidity effects of such an injection but not its wealth effects. Under such conditions it is doubtful whether any benefits accrue from encouraging medium-term financial saving by drastically shortening the period of saving, especially if its growth is at the expense of long-term financial saving and not of liquid asset accumulation or commodity purchases. The sensitivity of medium- and long-term financial saving to rates of return is not known, and so the advantages of promoting saving in this manner must be weighed against the resulting increased interest burden.

[13] These effects find their main expression in marked deviations of real interest and subsidy rates from their expected levels, with the unexpected portion of the subsidy creating capital gains (or losses), which are arbitrary from the social aspect and inefficient from the economic aspect. The unforeseen subsidy does not stimulate the subsidized activity, and the uncertainty as to its size impairs the effectiveness of the expected subsidy.

4. MONETARY EXPANSION AND ITS SOURCES

(a) The Public's Financial Wealth

The private nonfinancial sector holds an extensive portfolio of financial assets and liabilities, which constitute mutual obligations between it and the system of financial intermediaries, the public sector, and the foreign sector. A provisional estimate appearing in Table VIII-6 shows that the public's asset holdings reached IS219 billion at the end of 1980, while its liabilities came to IS72 billion;[14] its net financial wealth was therefore at least equal to this year's GNP. The value of the public's compulsory loan holdings, homes, buildings, equipment, and durable goods is estimated at IS430 billion.[15]

The real growth of the public's net financial wealth accelerated in 1980 to reach 22 percent, after it had slowed the year before. The real growth of the public's total wealth, as measured here, also accelerated in 1980, with the weight of financial assets moving up further. The uptrend in the public's net financial wealth can be mainly attributed to the sustained increase in its net claims on the public sector. This in turn was due partly to the channeling of a large share of the public's current saving to financing the public sector's demand surplus, and partly to the inflation-related capital gains, which in real terms erode the private sector's unlinked liabilities to the public sector.

The contraction of the public's long-term liabilities, together with the heavier resort to short-term credit, greatly increased the weight of its short-term liabilities in recent years. This trend was arrested in 1980, when the erosion of long-term debts passed its peak and a restrictive short-term credit policy was applied.

The funneling of private saving to financial assets, which steadily depressed the weight of physical wealth (in particular productive capital), was largely due to tax considerations. The escalation of inflation made financial assets more attractive, as they provide a hedge against inflationary erosion and taxation, and this because of the tax discrimination between nominal financial gains and nominal profits from productive activity.[16] This tax policy has also led to the withdrawal of equity capital from businesses and to an increasing reliance on credit to finance operations.

The inadequacy of the tax system under conditions of rapid inflation has had two major perverse effects: First, it makes it possible to significantly reduce tax payments by diverting income, thereby generating a larger liquidity injec-

[14] This estimate does not include foreign currency holdings and noncontributory pension scheme rights, so that the downward bias in the asset figure is probably greater than that for liabilities. The definitions in Table VIII–7 differ slightly from those in Table VIII–10, particularly as regards shares.

[15] This estimate excludes land, raw material stocks, and such valuables as works of art, jewelry, etc.

[16] The reference is to households and nonfinancial companies. By contrast, tax considerations prompt financial companies to step up their investment in real estate.

Table VIII-6
ESTIMATED FINANCIAL AND OTHER WEALTH OF THE PRIVATE NONFINANCIAL SECTOR,[a] 1978–80
(IS million, at current prices)

End of year	1978	1979	1980	Percent real increase[b] Average 1976–78	1979	1980
A. Financial assets	**39,948**	**81,792**	**219,238**	**16**	**–3**	**15**
1. Liquid assets	12,927	23,843	59,810	7	–13	8
2. Shares of financial concerns	3,300	6,225	24,946	45	–11	72
3. Medium-term assets	11,911	25,879	60,456	23	3	0
4. Long-term assets	11,810	25,845	74,026	14	4	23
B. Liabilities	**14,555**	**29,888**	**71,543**	**15**	**–3**	**3**
1. Short-term liabilities	8,541	19,283	47,602	40	7	6
a. Nondirected credit in Israeli and foreign currency	4,183	8,468	21,118	46	–4	7
b. Directed credit in Israeli and foreign currency	3,730	8,284	20,059	34	5	4
c. Supplier credit and direct credit from abroad	628	2,531	6,425	32	90	9
2. Long-term liabilities[c]	6,014	10,605	23,941	–5	–17	–3
a. In Israeli currency, less subsidy component	3,493	3,670	7,622	–6	–50	–11
Subsidy component	2,679	6,250	9,730	–9	10	–33
b. In foreign currency (incl. liabilities to foreigners)	2,410	6,697	15,819	–6	31	1
C. Net financial wealth (A–B)	**25,393**	**51,904**	**147,695**	**16**	**–3**	**22**
D. Other wealth	**78,205**	**182,245**	**431,946**	**15**	**10**	**2**
1. Compulsory loans	4,830	9,620	21,000	–3	–6	–6
2. Physical assets[d]	73,375	172,625	410,946	17	11	2

[a] The financial and other wealth of the private nonfinancial sector, which comprises households and nonfinancial firms, is estimated as the difference between its claims on the public sector, Bank of Israel, rest of the world, and the system of financial intermediaries. The financial intermediaries as defined here are commercial banks, credit and savings cooperatives, mortgage banks, investment banks, financial institutions required to report on their operations to the Examiner of Banks, insurance companies, and provident and pension funds. This group accounts for the overwhelming proportion of financial intermediation in Israel. Owing to statistical limitations, financial institutions not required to report on their activities are not defined as financial intermediaries, even though they constitute part of the private nonfinancial sector. Because of the definition of financial intermediaries used in this table, the data here differ from those on assets and liabilities

(continued at the bottom of p. 249)

tion through the public sector's demand surplus and intensifying inflationary pressures. Secondly, it diminishes productive investment incentives, thus warping decisions concerning the structure of productive activities and the use of various inputs. These factors impede economic growth and further aggravate the inflationary pressures.

Some efforts have been made to enhance the profitability of productive activity through special tax arrangements, such as the inventory income tax relief. These arrangements have heightened the importance attached by producing firms to tax considerations, and while they have increased the return on productive activity, from the aspect of economic efficiency they cannot equal the introduction of a system of taxing real profits.

(b) Sources of Monetary Expansion

There have been three main sources of change[17] in the financial assets and liabilities of the public (see Table VIII–7):

(1) Net payment flows on goods and services account and transfers between the private sector on the one hand and the public and foreign sectors on the other. These flows represent the private saving that augments financial wealth.

(2) Flows connected with the creation and repayment of liabilities between the private nonfinancial sector and other sectors. These flows are mainly effected through the financial intermediaries, which also channel most of the funds originating in the public and foreign sectors.

(3) The revaluation of liabilities between the various sectors as a result of both formal linkage devices and changes in the subjective evaluation of various liabilities. The latter may find a measurable expression in the market (e.g. tradable securities), but they also include changes in the subjective evaluation of future payments which cannot be measured directly.[18]

[17] Various statistical difficulties preclude a classification fully consonant with economic definitions. These difficulties are also mirrored in the quality of the data and in unexplained residuals.

[18] Tables VIII–7 and VIII–8 attempt to measure the change in the evaluation of the private sector's future unlinked liabilities. However, we do not deal with such changes in the flow of future receipts generated by linked medium- and long-term assets, it being assumed that the public evaluates them according to their adjusted value (i.e. including accrued linkage increments and interest thereon, even though these cannot be immediately realized).

(continuation of notes to Table VIII-6)

of the public appearing in other tables in this chapter. For a more detailed presentation of the items in this table see Table VIII–A3.

[b] Deflated by the consumer price index.

[c] This item has been adjusted for securities of the public held by financial intermediaries.

[d] Durable goods, residential buildings, and equipment owned by companies. Raw material and other inventories owned by companies and households should also be included, but the relevant data were not available when this chapter was written.

Table VIII–7

CHANGES IN THE FINANCIAL WEALTH OF THE PRIVATE NONFINANCIAL SECTOR, 1977–80

(IS million, at current prices)

	1977	1978	1979	1980
1. Liquidity injection generated by public sector demand surplus	1,288	1,379	2,006	5,975
2. Private sector import surplus on goods and services	351	775	3,463	2,917
3. Flows of liabilities between the public and other sectors	1,266	3,072	6,418	10,791
a. Development and other credit from the public sector[a]	491	999	1,800	4,919
b. Credit from the Bank of Israel[b]	607	1,158	1,845	3,680
c. Credit from domestic sources of financial intermediaries	583	672	2,065	4,404
d. Net flow of liabilities from abroad[c]	–415	243	708	–2,212
4. Other factors and unidentified sources[d]	140	985	–430	–95
5. Purchases of assets by the public (1–2+3+4)	2,343	4,661	4,531	13,754
6. Revaluation of assets purchased during the period[e]	580	665	1,344	4,796
7. Revaluation of financial items in assets portfolio[e]	6,765	10,814	35,969	116,196
8. Total change in the public's financial assets (5+6+7)	9,688	16,140	41,844	137,446
9. Revaluation of the public's liabilities[e]	3,263	2,712	8,915	30,864
10. Total change in the public's liabilities (3+9)	3,529	5,784	15,333	41,655
11. Change in net financial wealth of the public (8–10)	6,159	10,356	26,511	95,791

[a] Includes net government credit to private nonfinancial sector, less net net long-term capital raised for local authorities and the National Institutions (see Table VIII–9, lines 6 and 8).

[b] Directed credit in Israeli and foreign currency.

[c] Calculated as the difference between the import surplus of the private sector net of unilateral transfers and the sector's net purchases of foreign currency.

[d] Other Bank of Israel income and expense accounts, Bank of Israel credit to the commercial banking system, items related to security and real estate transactions between the public and financial intermediaries, and errors and omissions.

[e] Valuation changes during the period due to linkage and exchange rate differentials, variations in market prices of tradable assets, and changes in liabilities on account of long-term credit due to its subsidy component.

The year reviewed witnessed a significant real increase in the liquidity injection generated by the public sector demand surplus, from roughly IS2 billion in 1979 to IS6 billion, or by about 30 percent, following a substantial real decrease in the preceding year. In contrast to 1979, when the public sector's activities led to a liquidity absorption during the first half of the year and the pumping in of liquidity in the second half, in 1980 there was a growing injection throughout the year. This can be attributed to the fact that the public sector does not tend to significantly alter its real goals even when real tax revenue shrinks. Thus, despite the weaker tone of the economy in 1980 and the 3 percent real decrease in tax revenue, the public sector's expenditure on consumption and investment and its transfer payments grew in real terms.

At the same time the real absorption through foreign currency purchases for financing the private sector's current account (including unilateral transfers) tumbled 64 percent in real terms, after soaring 150 percent in 1979, and amounted to IS2.9 billion. This was due both to the sharp contraction of civilian imports (reflecting *inter alia* a heavy running down of raw material stocks other than oil and diamonds) and to the expansion of exports, which at least to some extent can be credited to the easing of domestic demands. Particularly striking was the small volume of foreign currency purchases in the first half of the year, when economic activity was flagging. Purchases began to pick up in the final part of the year, apparently because of restocking.

The amount of money put into the economy because of the public sector demand surplus, less the amount mopped up through the current account, came to about IS3 billion, compared with a IS1.4 billion net absorption in 1979. This implies a reduction of financial savings in 1979 and an increase in the year reviewed.

The amount of liquidity injected by the private sector's transactions with and through the system of financial intermediaries reached IS10.8 billion in 1980, as against IS6.4 billion the year before. In real terms this represented a decrease of one-third, following a 27 percent growth in 1979. Among the major factors responsible for this development were the tight credit policy and the sagging demand for investments, which pulled down the volume of credit granted for long and medium periods. The liquidity injection related to Bank of Israel credit (most of it for exports) increased from IS1.8 billion in 1979 to IS3.7 billion, but held virtually steady in real terms.[19]

The data on net capital flows, calculated as the difference between the private sector's total foreign currency purchases and its current account, indicate that in 1980 there was a net capital export, estimated at $280 million. No figures are available on the growth of foreign banknote holdings, but apparently it was

[19] The lion's share of such finance consists of directed export credit. In 1980 the banks reduced the balance of the special loan granted to ease their liquidity position.

Table VIII-8

CHANGES IN LIQUID FINANCIAL ASSETS, 1979-80
(IS million)

	1979	1980	1979		1980	
			1st half	2nd half	1st half	2nd half
1. Contribution of public sector to liquid financial assets (basic injection)[a]	1,597	6,136	-104	1,701	2,450	3,686
a. Public sector injection	1,480	4,916	-328	1,808	2,716	2,200
b. Net sale of tradable bonds to the public[b]	117	1,220	224	-107	-266	1,486
2. Directed Bank of Israel credit (mostly through the export funds)	1,845	3,680	536	1,309	1,904	1,774
3. Sale or purchase (-) of foreign currency by the private sector	-2,755	-5,129	-374	-2,381	-2,121	-3,008
4. Other factors[c]	565	257	422	143	272	-15
5. Net exogenous injection (1+2+3+4)	**1,252**	**4,944**	**480**	**772**	**2,507**	**2,437**
6. Increase due to domestic banking activities[d] (7-5)	1,005	2,909	-233	1,238	1,206	1,703
7. Purchase of liquid financial assets	2,257	7,853	247	2,010	3,713	4,140
8. Exchange rate differentials on Patam deposits and bonds	7,696	24,904	2,582	5,114	7,833	17,071
Thereof: On purchases during the period	1,528	2,784	664	497	273	2,343
9. Total change in liquid financial assets (7+8)	**9,953**	**32,757**	**2,829**	**7,124**	**11,546**	**21,211**

[a] The injection generated by the demand surplus, as presented in Table VIII-9, is estimated as the public sector's contribution to liquid financial assets, plus its net long-term capital market operations.

[b] Includes IS300 million in sales of dollar bonds in 1980; the estimated contribution to liquid financial assets therefore has a downward bias.

[c] Consists mainly of the absorption or injection generated by various items in the Bank of Israel's statement of income and expenses, such as receipts and payments of interest, fines for liquidity deficiencies, and the special loan to banking institutions.

[d] Residually calculated.

SOURCE: Tables VIII-10 and VIII-A6.

particularly large in the last quarter of 1979 and the first quarter of 1980, due to jitters over possible government action in the capital market. The estimated private short-term capital export, which is very sensitive to fluctuations in international interest rates, is put at $160 million in 1980. The growth of this item in the course of the year was consistent with the changes in international interest rates in dollar terms.[20] Most of the short-term capital outflow occurred in the first and last quarters of the year, when the interest rate on the U.S. dollar reached 18 percent.

The capital movement estimates, both the derived estimates described above and the balance of payments figures, are statistically not very reliable.[21] According to the former, there was a net capital export in 1980, while the balance of payments shows a capital import, albeit a smaller one than in 1979. The trends revealed by the two estimates were thus similar.

Purchases of financial assets with the liquidity injected by the public sector, plus the net credit flows and less the amount absorbed through the private sector's current account, totaled IS13.8 billion in 1980, as opposed to IS4.5 billion the year before—a real increase of 32 percent, compared with a 45 percent real decrease in 1979. The ratio between these net injections and financial asset holdings at the beginning of the year rose from 11 percent in 1979 to 17 percent in 1980.

The rest of the change in the public's financial assets and liabilities—which, as stated, represents the revaluation of financial assets—rose in 1980 owing both to the escalation of inflation and to the real rise in security quotations. There was also a higher revaluation of liabilities this year, but since it lagged behind the rate of asset revaluation, the financial portfolio expanded appreciably.[22]

It is also of interest to examine the changes in the liquid asset base, and this because of the assumption that variations in liquid assets are closely connected with the development of prices and economic activity[23] (see Table VIII–8).

[20] The reason apparently lay in the fact that in the short run there is no perfect correlation between fluctuations in domestic interest rates and changes in the local cost of foreign credit. It should be noted that the interest rates in foreign currency terms, which are listed in Table VIII–4, include the surcharge imposed by the Bank of Israel. This was not levied on part of the credit classified as nondirected (in particular that for oil imports), nor on other capital movements, notably supplier credit.

[21] The two estimates differ widely owing to errors and omissions in the various balance of payments items and to the difficulty of clearly differentiating between private and public sector transactions.

[22] If the rise in real interest rates had been accompanied by a decline in the public's evaluation of its medium- and long-term saving, this estimate would be biased upward (see note 18). In any case it is not possible to assess the sensitivity of the public to the sharp year-to-year variations in the net value of the financial portfolio, especially when they are caused by the volatility of the market prices of securities.

[23] In the last two years the change in the liquid asset base (which, in addition to the monetary base, includes bonds and Patam holdings of the public before revaluation)

Table

FINANCIAL OPERATIONS OF THE PUBLIC SECTOR
(IS million at current prices,

	1978
1. Bond issues and receipt of earmarked and other deposits	3,169
2. Redemption of bonds and earmarked and other deposits	2,238
3. Net capital mobilized[a] (1–2)	**931**
4. Government credit to the private sector[b]	1,228
5. Repayment of government credit to the private sector[b]	319
6. Net government credit (4–5)	**909**
7. Financial resources raised by the government (3–6)	22
8. Financial resources raised by local authorities and National Institutions[c]	–90
9. Total net financial resources raised by public sector (7+8)	**–68**
10. Public sector injection	1,447
11. Injection generated by public sector demand surplus[d] (9+10)	**1,379**
12. Estimated demand surplus, national accounts definition[d]	2,299

[a] Capital raised through the sale of tradable bonds, deposits, and nontradable bonds held against long- and medium-term savings.
[b] Excludes credit to local authorities and repayments thereof.
[c] Includes long-term credit inflows and outflows of local authorities and the National Institutions with the private sector; excludes changes in their short-term credit balances.

In 1980 there was a nominal increase of more than 300 percent in the liquid asset base and a real increase of 71 percent. Moreover, in contrast to 1979, when most of the expansion took place in the second half of the year, in 1980 the growth curve rose sharply throughout the year.

5. FINANCIAL ASSETS PORTFOLIO OF THE PUBLIC

The year reviewed witnessed a livelier demand for financial assets, and their real balance swelled 18 percent. This renewed the rising real growth trend which had been evident for several years but was interrupted in 1979, when the level retreated 4 percent in real terms.

An analysis of the financial portfolio in recent years points up several persisting influences, among them the combination of a low level of economic activity and growth with high inflation and a tax structure which, with the

was the main monetary indicator used by the Bank of Israel, instead of the traditional monetary base. This is explained by the highly elastic supply of tradable bonds and Patam; with the rapid acceleration of inflation such assets were increasingly substituted for money holdings.

VIII–9

AND ITS ESTIMATED DEMAND SURPLUS, 1978–80
based on fund flows)

		1979		1980	
1979	1980	1st half	2nd half	1st half	2nd half
4,725	10,809	2,544	2,181	3,694	7,115
2,399	4,831	1,136	1,263	2,065	2,766
2,326	**5,978**	**1,408**	**918**	**1,629**	**4,349**
2,259	5,726	832	1,427	2,048	3,678
495	1,207	209	286	545	662
1,764	**4,519**	**623**	**1,141**	**1,503**	**3,016**
562	1,459	785	–223	126	1,333
–36	–400	26	–62	–92	–308
526	**1,059**	**811**	**–285**	**34**	**1,025**
1,480	4,916	–328	1,808	2,716	2,200
2,006	**5,975**	**483**	**1,523**	**2,750**	**3,225**
3,271	7,655				

[a] The difference between the estimates in lines 11 and 12 is due to the inclusion of several financial items in the demand surplus as defined in the national accounts, as well as to advance payments for services.

SOURCE: Table VIII–B7 and calculations of the Bank of Israel Research Department.

worsening of inflation, has exerted an increasingly discriminatory effect on the posttax structure of relative rates of return.[24] These developments not only induced the public to hold more financial assets at the expense of physical assets, but also influenced the composition of the financial assets portfolio. A telling factor here was the tax discrimination between nominal income from interest and linkage increments on the one hand and income from preferred sources on the other; this affected the weight of linked and unlinked assets and spurred the commercial banking system to turn to the share market to mobilize funds, thus giving a fillip to trade therein.[25]

Besides the aforementioned basic factors, the growth of the financial assets

[24] Such as discrimination between nominal fully taxable income accruing from the revaluation of inventories and nominal income that is either tax-exempt or taxed at a limited rate, such as that earned from property or capital gains on listed securities. Other examples are the tax concessions granted on savings through social insurance funds, which increase with the erosion of income tax brackets, and the treatment of interest outlays connected with the financing of share purchases as compared with those related to bond purchases.

[25] Another reason for the large volume of bank equity issues was the desire to show improved capital ratios, which was particularly important for the banks' international business.

Table

FINANCIAL ASSETS OF

(Balances in

End of period	1976	1977	1978	1979
A. Liquid assets	**5.3**	**7.7**	**12.2**	**22.1**
1. Money	1.4	1.9	2.7	3.5
2. Patam deposits	0.7	1.7	4.0	9.2
3. Bonds[b]	2.8	3.6	4.9	8.8
3'. Thereof: In foreign currency	0.3	0.5	0.7	1.2
4. Pazak and CDs	0.4	0.5	0.6	0.8
B. Shares	**1.1**	**2.6**	**4.4**	**7.7**
Thereof: Bank shares	0.6	1.7	2.9	6.5
C. Medium-term assets	**3.5**	**7.1**	**11.6**	**25.4**
1. Restitution deposits	1.5	3.3	5.0	10.0
2. Savings schemes and linked deposits	2.0	3.8	6.6	15.4
D. Long-term assets	**4.3**	**7.0**	**11.8**	**25.8**
1. Social insurance funds	3.9	6.4	10.9	23.9
2. Life insurance	0.4	0.6	0.9	1.9
E. Total financial assets, excl. shares	**13.0**	**21.8**	**35.6**	**73.3**
F. Total financial assets, incl. shares	**14.2**	**24.4**	**40.0**	**81.0**
Thereof:				
1. Money and CDs (A1+A4)	1.8	2.4	3.3	4.3
2. Foreign currency assets (A2+C1+A3')	2.5	5.5	9.7	20.4
3. Linked short- and medium-term assets (C2+A3-A3')	4.5	6.9	10.8	22.8
4. Mutual funds	0.9	1.6	2.4	4.3

[a] In this table the "public" excludes the government, Bank of Israel, and commercial banks. For lack of data no adjustment was made for the rest-of-the-world sector, i.e. financial assets of foreigners were not deducted and foreign financial assets of Israeli residents were not added. There is some double-counting in this table, since the measurement of financial assets includes liabilities and financial assets of financial institutions.

VIII-10

THE PUBLIC,[a] 1976–80

IS billion)

1980		Weight in total assets, Dec. 1980	Percent increase from previous period				Percent real increase in annual average balance	
				1980				
June	Dec.		1979	Total	June	Dec.	1979	1980
33.7	**54.9**	**25**	**–14**	**6**	**1**	**5**	**–4**	**–6**
4.9	7.0	3	–38	–15	–7	–8	–23	–28
14.9	22.4	10	8	5	9	–4	17	14
12.5	23.4	10	–14	15	–5	21	–4	–11
1.7	2.4	1	–20	–15	–5	–9	—	—
1.4	2.2	1	–37	21	20	1	–28	–17
14.6	**34.9**	**16**	**–18**	**95**	**27**	**53**	**–8**	**27**
10.5	23.3	10	9	53	7	43	–1	30
38.9	**59.8**	**27**	**3**	**1**	**3**	**–2**	**5**	**5**
13.8	19.5	9	–6	–16	–7	–10	–6	–11
25.1	40.3	18	10	12	9	4	14	15
40.5	**74.0**	**33**	**3**	**23**	**5**	**17**	**9**	**11**
37.3	68.9	31	4	24	5	18	9	11
3.2	5.1	2	0	15	13	2	0	9
113.1	**188.7**	**84**	**–3**	**10**	**3**	**7**	**3**	**4**
127.7	**223.6**	**100**	**–4**	**18**	**5**	**12**	**1**	**6**
6.3	9.2	4	–38	–9	–2	–6	–24	–26
30.4	44.3	20	–1	–7	0	–7	5	7
35.9	61.3	27	0	7	5	4	4	–6
7.0	13.7	6	–13	36	9	25	—	5

[b] Total bonds issued to noninstitutional investors, less bonds in the Bank of Israel portfolio and those held by commercial banks; includes tradable bonds of the type sold to the public and held by social insurance funds and other institutional investors.

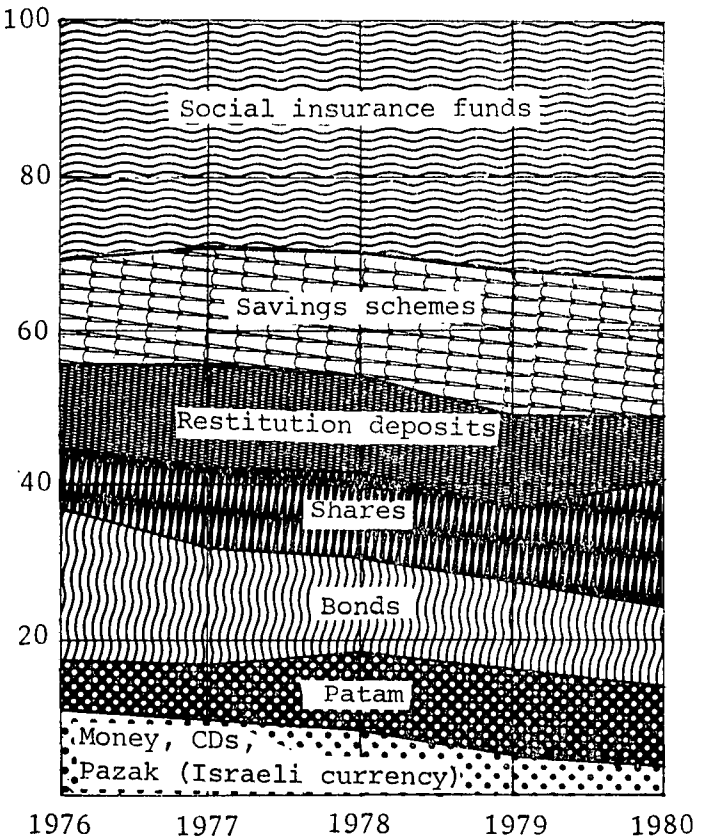
SOURCE: Tables VIII-A1, VIII-A2, VIII-B8, VIII-B18, and VIII-B22.

portfolio in 1980 was largely influenced by cyclical developments, such as the renewed buildup of durable goods stocks, as well as by the low real level of nonbank share and bond prices at the end of 1979, the waning of fears about a possible impairment of bonds, and above all, the glum business outlook, which discouraged investment in real assets in favor of liquid financial assets. The public was especially reluctant to invest in homes, and their relative price continued to soften.[26]

Figure VIII-2

FINANCIAL ASSETS PORTFOLIO OF THE PUBLIC, 1976-80

(Percentages)

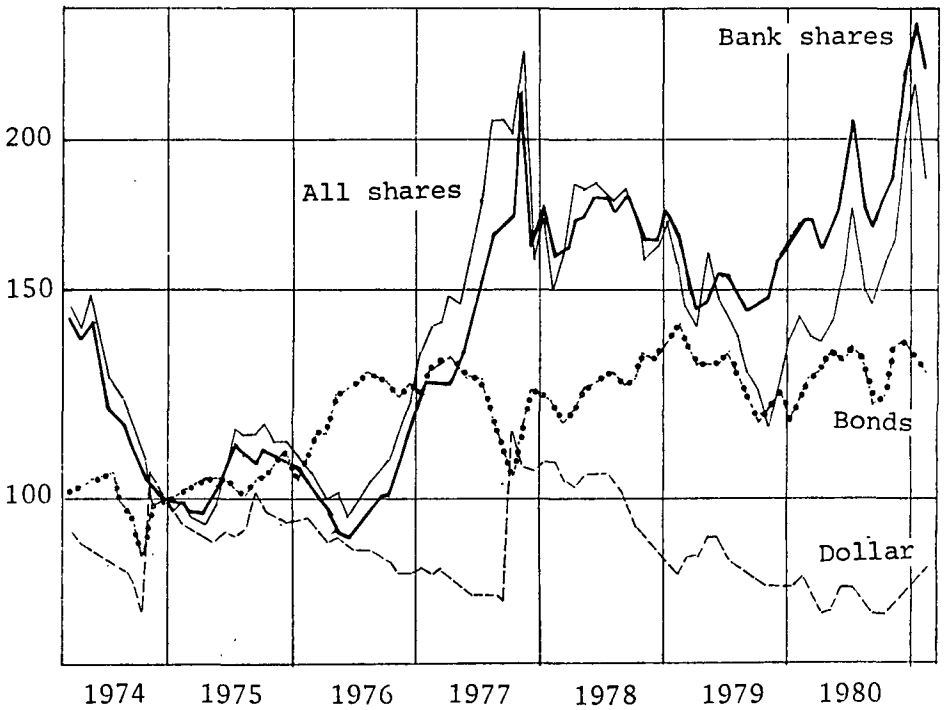


SOURCE: Table VIII-10.

[26] It is interesting that the uncertainty that deterred the public from acquiring homes did not keep it from buying shares, whose prospects were also highly uncertain. This is probably explained by the disadvantages of holding such assets as dwellings for relatively short periods (owing to tax considerations and the expenses involved in real estate transactions) and by the indivisibility of housing investment.

Figure VIII–3

OVERALL REAL RATE OF RETURN INDEX FOR FINANCIAL ASSETS, 1974–81
(Dec. 1974=100)



Semilogarithmic scale.

There were three main features in the expansion of the financial assets portfolio in 1980:

(a) The booming demand for securities,[27] whose weight in the portfolio rose from 20 to 26 percent, with shares setting the pace.

(b) The real growth of liquid financial assets (which did not fully offset the previous year's decline). In addition, the weight of bank shares—which have become highly liquid because of the banks' intervention to stabilize their prices—increased without producing any real change in long- or medium-term financial saving. As against this, the growing volatility of real returns (see Table VIII–11) tended to diminish the portfolio's liquidity.

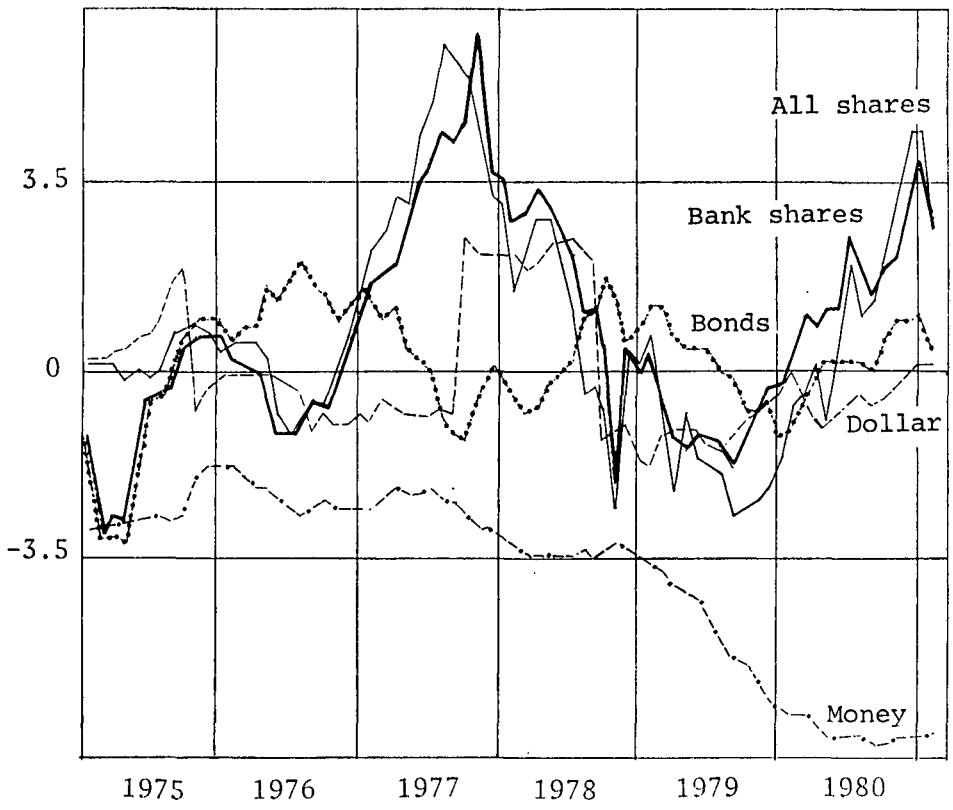
(c) The drop in the weight of assets denominated in foreign currency from 25 to 20 percent.

[27] This chapter discusses securities issued with a prospectus (including government and Jewish Agency securities exempt from this requirement but listed for trade on the stock exchange), with the stress on transactions of the public (households and non-financial firms). Owing to statistical limitations the data on issues to the public include purchases and redemptions of securities sold to the public by the financial sector.

Figure VIII-4

12-MONTH MOVING AVERAGE RATE OF RETURN ON FINANCIAL ASSETS, 1975-81

(Percentages; calculated for the end of each period)



In 1980 the real contraction of the money supply abated somewhat. There were several reasons for this: the hectic stock market trade, which apparently tied down more money; the checking of the acceleration of inflation;[28] and perhaps also the exhausting of the possibility of using money substitutes for executing transactions.[29] The administrative reduction of the liquidity of Patam deposits was another contributory factor.

Concurrently there was a real increase in other unlinked financial assets (time deposits and especially negotiable certificates of deposit). When the liquidity ratios on these assets were lowered, the banks raised their real returns, even after tax (however, they still remained negative—see Table VIII-11). The stronger demand this year for negotiable certificates of deposit can also be ascribed to the decrease in the real minimum required investment because of

[28] These two factors led to a similar development in 1977.

[29] In this connection unutilized balances in overdraft accounts should also be regarded as a money substitute.

inflationary erosion and to the smaller yield variance. The total portfolio of unlinked financial assets shrank in real terms by only 9 percent in 1980, in contrast to 38 percent the year before.

As already mentioned, the real expansion of Patam slackened from 8 percent in 1979 to 5 percent. Since its appearance after the foreign currency reform of 1977, the public has regarded this asset as the leading substitute for money; even in 1979, when the real exchange rate stabilized, demand for Patam continued to mount owing to fears of a possible worsening of indexed bond terms. In 1980 transfers between Patam accounts were forbidden and the commission charged for converting from one foreign currency to another was hiked.[30] These steps reduced the liquidity of Patam in general and depressed the real balance of Patam demand deposits. As against this, Patam time accounts continued to appreciate with the rise in interest rates and the upvaluation of the dollar, in which most of these funds are invested.

The public's demand for bonds rose 15 percent in real terms in 1980, reversing the decline begun in 1975. The turnabout occurred after a further 5 percent real decrease in the first half of the year; in the second half the level spurted 21 percent in real terms. The change in the market value of the bond portfolio resulted from both rising secondary market prices and from new issues, which in real terms netted 3.6 times more than in 1979. The rebounding of the bond market from the slump into which it had slid at the end of 1979 because of mounting anxieties about a possible impairment of such paper was stimulated by the raising of the indexation rate in July from 80 to 100 percent and by the heavier demand for mutual funds specializing largely in fixed-term securities. The higher rate of indexation made bonds more attractive, even though it did not significantly increase their real rate of return. In 1980 bond yields were high[31] but more volatile. The Bank of Israel reduced its intervention in the secondary market, but this was only partly offset by the increased intervention of institutional investors after bonds issued to the public began to serve as cover for the banks' savings schemes and for the social insurance funds' accumulation.

The market value of shares almost doubled in real terms during 1980, bringing up their weight in the portfolio to 16 percent, compared with 9 percent at the end of 1977. The 1980 performance can be attributed to both the general advancing trend in the relative demand for shares in recent years and to a cyclical upswing in 1980. The growth during the past few years is explained by tax concessions, the banking concerns' pushing of bank shares, which account for the greater part of equity trade, and the high degree of substitutability between Patam deposits and bonds, which apparently exceeds that between Patam

[30] The amount of Patam which mutual funds could own was also limited. This indirect form of holding Patam conferred certain tax advantages.

[31] The term "return" or "yield" refers to the overall return during a given period; "yield to maturity" is the return on bonds held until redemption date.

and shares. Equity demand was also influenced by recurring fears of an adverse change in bond terms. The banking concerns promote the share market directly through their control of a highly effective marketing and advisory apparatus, and indirectly by regulating the prices of shares they favor. By reducing yield fluctuations they stimulate the public's demand. In 1980, however, they failed to avert a considerable volatility in yields, which was caused by waves of speculative demand, with numerous individuals entering the market when it showed a bullish tone and pulling out when the market changed direction.

No adequate explanation can be offered for the timing of the cyclical upswing in share quotations at the end of 1979 or its extent; but as soon as the public began to sense that they would rise, this created self-fulfilling expectations. In the year reviewed the level shot up 63 percent in real terms, with demand booming because of an anticipated further advance in quotations rather than an assessment of the economic value of the shares. This was particularly true of bank shares: it is doubtful whether the growth of the banks'

Figure VIII-5

STANDARD DEVIATION OF 12-MONTH MOVING AVERAGE RATE OF RETURN ON FINANCIAL ASSETS, 1975-81

(Percentages)

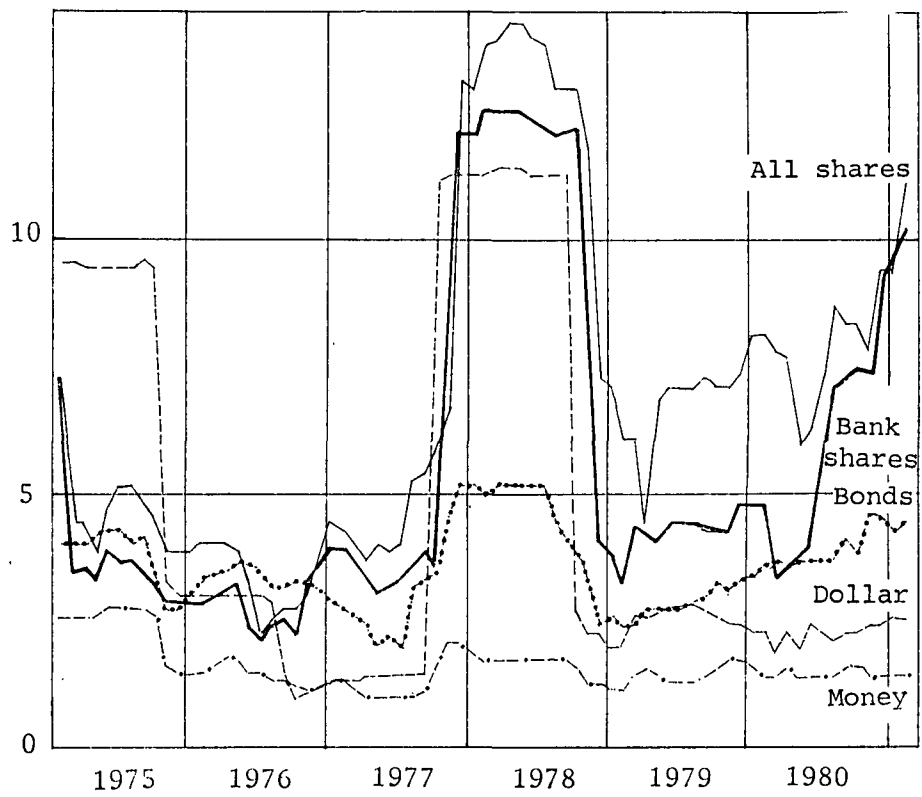


Table VIII-11

RATES OF RETURN ON FINANCIAL ASSETS AND THEIR STANDARD DEVIATION, 1978–80

(Percentages)

	Real return during the year[a]			Monthly standard deviation		
	1978	1979	1980	1978	1979	1980
Money supply	-33	-53	-57	1.2	1.7	1.5
Negotiable certificates of deposit[b]						
Before tax	-12	-35	-23			
Less tax deducted at source	-19	-41	-35	1.3	1.7	1.4
Dollar deposits (Patam)						
Demand	-18	-13	-8	2.3	2.4	2.4
Time	-13	-7	0	2.3	2.4	2.5
Linked bonds (direct holdings)						
Return during the year	7	-7	10	2.5	3.2	4.5
Yield to maturity on original issues	2	2	2	—	—	—
Mutual funds specializing in bonds	-2	-7	11	—	2.6	3.4
Shares						
All shares	2	-25	63	7.3	7.4	9.4
Bank shares	2	-4	41	4.1	4.9	9.1
DM restitution deposits	-3	-4	-12	2.6	3.5	4.1
Savings schemes—yield to maturity[c]	—	1	2			
Social insurance funds—yield to maturity[d]	4	4	4			
Total financial assets	**-2**	**-8**	**4**			

[a] The return net of tax deducted at source, unless specified that it is before tax.

[b] The return varies considerably between customers.

[c] The return on the accumulation in savings schemes during the year.

[d] Discounting the effect of income tax concessions, which varies in accordance with the marginal tax rate and the number of years to maturity.

SOURCE: Bank of Israel calculations and the Tel Aviv Stock Exchange.

profitability during the year warranted the steep jump in the prices of their shares.[32]

Mutual funds were in heavy demand in 1980 (they serve as an indirect instrument for holding financial assets, especially bonds, shares, and foreign currency). The chief reason for this was the introduction of a new type of fund whose shares are traded with no spread between the bid and ask price. These funds are suited to very short-term holdings, and so they compete with negotiable certificates of deposit, which require a large minimum initial investment. In contrast to the CDs, the return on these funds is not known in advance but it is tax-exempt. The more buoyant demand for mutual funds this year can also be credited to an energetic marketing campaign and to their efficient management, as a result of which they outperformed a randomly selected portfolio with an identical composition. All told, security holdings through mutual funds expanded 36 percent in real terms, and sales of their shares were six times larger than in 1979.

Restitution deposits and their yields declined in 1980. These are held in Deutsche marks, which weakened against the dollar this year, without account owners being awarded adequate interest compensation. This, together with the continued ban on the transfer of these deposits to heirs, led to a 16 percent real contraction of their balance despite an increase in restitution receipts.

Savings schemes and linked deposits were 12 percent up on 1979. The banks, interested in promoting this type of saving, were allowed to raise the yield (by more than one percentage point) and to reduce the period of saving: in place of the six-year schemes in force until the end of 1979, at the beginning of 1980 the public could register for a three-year scheme, and later on one for four years. At the beginning of 1981 it was given an opportunity to join a two-year scheme for a limited period, and many customers were attracted.

The accumulation in social insurance funds increased 24 percent in real terms during the year to reach IS69 billion, while that in bank-administered provident funds rose 13 percent (see Table VIII–17). Advanced study funds also expanded appreciably, following an increase in employers' contributions and the addition of further groups of workers to the membership roll. By contrast, the accumulation in pension funds grew more moderately this year, with an increase in contributions due to the continued switch to comprehensive pension arrangements being largely offset by a decline in real wages. There was no real change in 1980 in severance fund payments to members.

Life insurance in force amounted to IS5 billion this year. The companies' accumulation dipped 2 percent in real terms following a sizable surrender of policies, which was probably due to a shift from life insurance to other savings channels.

[32] Among the factors that increased the banks' profitability in 1980 were the greater volume of financial activity in the economy and nondirected Israeli currency credit quota profits.

6. CREDIT TO THE PUBLIC

(a) Type of Credit

Credit to the public[33] falls into three main categories:

(1) Credit for domestic activities, extended by the Israeli banking system and its overseas offices, chiefly for the short-term financing of business transactions.[34]

(2) Directed short-term export credit granted through the banking system. This is intended primarily to finance the various stages of the export process (imports, production, and shipments), but part of it is used for maintaining diamond stocks.[35]

(3) Long- and medium-term credit, mostly for financing nondwelling investment and the purchase of private housing.

Besides its contribution to the growth of the public's financial assets and net financial wealth, credit fulfills a very significant economic function in that it finances current productive activity as well as investment in plant, equipment, and housing.[36]

Examination of the financing of current activity mainly necessitates an analysis of the average level of short-term credit (for the domestic market and exports), while for nondwelling and dwelling investment it is necessary to analyze long-term credit flows. However, one must not disregard the credit flows within the business sector itself and the substitutability of various types of credit (this

[33] Credit to the public, as discussed here, consists of credit granted for various periods by the commercial banking system in Israel and its offices abroad, by the system of financial intermediaries (defined in this Report as the "institutional structure of the capital market") for long and medium terms, supplementary long- and medium-term finance granted under special arrangements, in particular by the government, and credit from earmarked foreign currency deposits. Excluded from this definition are certain types of foreign credit, notably supplier credit, and credit flows between private nonfinancial units.

[34] This consists of nondirected credit in Israeli and foreign currency and directed credit in Israeli currency (whose outstanding balance is small). Part of the nondirected foreign currency credit is for financing preferred activities, such as imports and oil stocks. The discussion below excludes credit for oil, which is used to finance stocks whose size is determined by the government and has only a limited effect on domestic activities. In principle, that part of the oil credit which is passed on to consumers should probably be included in credit to the public and the balance treated as credit to the government.

[35] Unlike decisions regarding oil stocks, those concerning diamond stocks are taken solely by the business sector, and so credit to the diamond industry must be treated as credit to the private sector. Moreover, it should be noted that during certain periods at least the method of financing diamond stocks resulted in surplus funds, which were used for other purposes.

[36] This does not imply that part of the credit is not diverted, directly or indirectly, to financing other activity, including the purchase of financial assets by households or business.

Table VIII-12

COST OF CREDIT AND ITS STANDARD DEVIATION, 1978–80

(Percentages)

	Annual real cost of credit[a]						Monthly standard deviation (before tax)		
	Before tax			After maximum tax deductions[b]					
	1978	1979	1980	1978	1979	1980	1978	1979	1980
1. Nondirected short-term bank credit									
Overdraft accounts	2	−11[c]	19	−19	−36	−27	1.2	1.2	1.2
In foreign currency	−6	9	16	−23	−30	−31	2.3	2.4	2.4
2. Directed credit									
In Israeli currency	−24	−45	−39	−29	−49	−50	1.2	1.6	1.7
In foreign currency	−14	−8	−3	−25	35	−36	2.2	2.4	2.3
3. Total short-term credit[d]	−11	−10	1	−24	−36	−35			
4. Long-term credit[e]									
For housing	−38	−32	−18						
Industrial development loans	—	−26	−6	—	−30	−17			

[a] Defined as the nominal cost of credit deflated by the actual rise in prices. This definition differs from the one used in Table VIII-4, which is based on estimated inflationary expectations.

[b] Assuming that interest on credit has been recorded as an expense for tax purposes, that the tax rate is 60 percent, and that the return from the use of the credit is tax-free. For development loans the tax rate is assumed to be 30 percent.

[c] This does not reflect the full cost owing to the rationing of credit in 1979.

[d] Weighted according to the distribution of industrial credit.

[e] Assuming an 80 percent average annual price rise during the period of the loans. The cost of such credit has been estimated by weighting linked and unlinked loans actually granted.

finds partial expression in the conversion of short- into long-term credit). The most appropriate way to determine the total liquidity available to the various sectors would seem to be to add the average short-term credit flows to the net long- and medium-term flows.[37] This indicator shows a 9.2 percent real contraction of total credit in 1980, following real increases of 5 and 19 percent in 1979 and 1978 respectively—evidence that the liquidity situation in the various sectors was far graver in 1980 than in the two preceding years.

(b) Major Trends

In 1980 the volume of credit shrank in real terms, after the uptrend had begun to tail off in the previous year. Commercial bank credit for the domestic market (excluding oil) and exports expanded at an annual average 105 percent rate in nominal terms, but after deflating by the implicit price index for domestic uses, the level dipped 11 percent, following a 1 percent rise in 1979. Net long-term credit was up 122 percent in nominal terms, but down 3 percent in real terms, after a 28 percent increase in 1979.

The tight credit policy implemented by the Bank of Israel during the last two years and the linkage of long- and medium-term loans sharply pushed up real interest rates in the economy. The average real cost of overdraft facilities shot up from approximately 2 percent in 1978 to 18 percent in 1980.[38] The real cost of nondirected foreign currency credit rose even faster, while that of directed foreign currency credit also went up but was still negative. On the other hand, directed Israeli currency credit became much cheaper. The average real cost of short-term credit, which had been negative (about –11 percent) in 1978, stabilized at zero in the year reviewed. The real interest on medium- and long-term credit also rose in 1980.

Table VII–12 shows an entirely different picture for real interest rates after tax. Economic units incurring tax-deductible interest expense on credit for financing activities that generate income not subject to tax enjoyed a negative real interest on all types of credit in 1980. What is more, their real interest rates declined from an average of 24 percent in 1978 to 36 percent in 1980. It should be noted, however, that the possibility of deducting financing costs on tax-free activities does not exist for most households or for firms that do not have to pay tax because of losses, special tax concessions, and the like. While it is difficult to estimate the average rate of interest actually paid, after allowing for tax outlays, it would seem that the pretax interest rates represent the marginal rates for many economic units.

[37] Justification for this method may be found in the fact that most of the credit for domestic activity and exports is renewed within one year, and so it resembles long- and medium-term credit. An exception is linked credit for financing domestic activity.

[38] These annual data relate to ex post real costs. This calculation provides a reasonable estimate of the average cost over a period of one year, but not for shorter periods (see below).

Table VIII-13

MAIN INDICATORS OF CREDIT GROWTH, 1977-80[a]

(IS million, at current prices)

	1977	1978	1979	1980	Percent annual real increase[b] 1978	1979	1980
1. Commercial bank credit, excl. oil—							
average balance[c]	3,130	6,095	10,937	22,369	19.7	0.6	-10.9
2. Gross long- and medium-term credit[d]	1,569	2,521	4,720	10,152	-4.8	2.1	-1.0
To households	416	656	1,261	2,942	-5.7	-8.1	5.0
To the business sector	1,135	1,817	3,285	6,898	-5.5	4.5	-2.3
3. Long- and medium-term credit, less repayments	689	1,283	2,928	6,511	14.5	27.9	-3.1
4. Total credit (1+3)	**3,819**	**7,378**	**13,865**	**28,880**	**18.7**	**5.3**	**-9.2**

[a] Excludes credit to local authorities and the National Institutions.

[b] Items 1, 3, and 4 have been deflated by the implicit price index for domestic resource use, excluding direct defense imports; item 2 has been deflated by the implicit price index for uses of medium- and long-term credit (see Table VIII-A11).

[c] Excludes credit from Israeli bank branches abroad owing to lack of data for 1977 and 1978. The inclusion of such credit in 1979 and 1980 would show a real decrease of 12 percent in bank credit and 11 percent in total credit in 1980.

[d] Includes credit to the public through the National Institutions which cannot be classified by economic sector (see Table VIII-A10).

SOURCE: Bank of Israel calculations.

Since the adoption of a restrictive credit policy in the second quarter of 1979, the real cost of nondirected foreign currency credit has been roughly equal to the real international market interest rate (in foreign currency terms) plus the interest surcharge imposed by the Bank of Israel.[39] The average real cost of such funds during this period reached 13 percent, with the foreign interest rates being mostly responsible for the fluctuations. The real interest on overdraft accounts was low in 1979, rising to about 12 percent (annualized) during the first half of 1980 and to 24 percent in the second half. This picture, however, must be viewed with reservation, both because of statistical shortcomings of the estimate itself[40] and because it results in large unexplained differentials between the cost of nondirected credit in foreign currency and that in Israeli currency. It should be recalled that the interest charged on overdraft facilities in 1979 did not reflect their shadow price to borrowers owing to the rationing of credit. Moreover, the real interest estimate for the second half of 1980 may be upward-biased, since this period witnessed mounting expectations of a surge in economic activity and perhaps also a further worsening of inflation.

(c) Short-Term Credit

The Bank of Israel concentrated, as in 1979, on curbing bank credit granted mainly for short periods, by restricting nondirected credit growth through the setting of ceilings and by measures designed to retard the expansion of directed export credit. As a result, the rate of increase in short-term credit (other than for financing oil imports) trailed far behind the rise in prices, so that in real terms the level sagged 10 percent, as opposed to 5 percent in 1979.

In the early part of 1980 the volume of credit was far below the permitted limits, but during the rest of the year the quotas were fully utilized; the restrictions therefore proved effective during most of 1980 (some deviations were recorded at the beginning of 1981). The effect of the credit freeze was also felt in the banks' liquidity deficiencies in 1980. Because of the larger volume of credit on the one hand and the sizable public sector liquidity injections on the other, the deficiencies averaged some 40 percent lower than in 1979. The decline, however, was not evenly spread over the year: in some months the liquidity shortfalls were small, while in others they soared to approximately IS400 million (in May and June), and at the end of the year they stood at IS635 million. These

[39] During this period the policy was to maintain the real rate of exchange by devaluating the sheqel at a rate equal to the difference between the domestic rate of inflation and that abroad.

[40] The real rate of interest is estimated as the difference between the nominal interest on such credit and the estimated expected rate of inflation (calculated as the average of the inflation rates in the current and the previous quarter). While ordinarily this method is valid, it is not perfect; it is probably unsuited to periods of sharp changes in the rate of inflation and when the public has access to additional information enabling it to form its expectations.

Table VIII–14

COMMERCIAL BANK CREDIT TO THE PUBLIC, 1979–80

	Balance at end of 1980 (IS billion)	Percent increase from previous year						
		Dec. levels		Annual average	1979		1980	
		1979	1980	1980	1st half	2nd half	1st half	2nd half
Credit for financing domestic activities[a]	18.2	83	82	82	82	83	66	99
Thereof:								
Nondirected credit in Israeli currency	8.3	78	103	85	70	87	120	88
Nondirected credit in foreign currency	9.5	94	68	80	102	85	32	115
Directed export credit	19.7	131	145	148	109	156	143	147
Excl. diamonds	11.0	140	134	141	128	152	130	138
Diamond Fund	8.6	120	160	158	85	161	162	159
Total bank credit, excl. oil	**37.9**	**101**	**110**	**111**	**92**	**111**	**99**	**122**
Credit for oil imports	8.9	405	259	388	348	469	358	182
Total bank credit	**46.8**	**117**	**128**	**188**	**103**	**132**	**124**	**132**

[a] The definition has been revised: includes linkage increments on the linked portion of nondirected credit in Israeli currency and credit from Israeli bank branches abroad; excludes credit for oil imports; includes IS400 million in directed credit for financing domestic activities. The definition used here differs from that in other Bank of Israel publications and in Table VIII–A9, in that credit for financing domestic activities does not include local authorities and the National Institutions.

SOURCE: Table VIII–A9; credit to local authorities is from the report on the sectoral distribution of credit.

swings can be largely ascribed to the banks' policy of regulating the Stock Exchange quotations of their shares.

The setting of ceilings encouraged the banks to offer their customers indexed credit, since the indexation increments were not subject to the credit quotas. Borrowers also found that it paid to accept such credit, since in real terms it was less expensive (7.5 percent) than unlinked credit or nondirected foreign currency credit. In consequence, in 1980 nondirected indexed credit expanded about 5 percent in real terms, whereas nondirected credit granted in Israeli currency on nonindexed terms and that in foreign currency contracted.

As in previous years, the real volume of directed export credit extended through the Diamond Fund rose strongly. The amount of finance from this source, which accounts for roughly 45 percent of total export credit, is not directly connected with the volume of diamond exports, but is related primarily to the size of the industry's stocks. Because of this, and the fact that during certain periods there was a surplus of such funds which was used for financial activities, the Bank of Israel decided in the latter part of 1980 to gradually scale down the Diamond Fund.

(d) **Long-Term Credit**

The flow of gross long- and medium-term credit was, at approximately IS10 billion, up 115 percent nominally. After deflating by the annual average change in the implicit price index of its uses, the level inched down 1 percent, following a 2 percent rise in 1979.

The growth of such credit was affected by two factors in the year reviewed: the stiffening of its terms and the cutting back of investment by more than can be attributed to this change.

The real pretax interest on development loans for medium and long periods was significantly higher than in 1979.[41] The real posttax interest was probably also higher, since the inventory and other tax reliefs left less income to benefit from the concessions on long-term linked loans. The increased interest cost is explained by the linkage of development loans, which was decided upon in 1979 and began to make its impact felt in 1980: whereas in 1979 unlinked loans accounted for 86 percent of total industrial development loans, in 1980 the figure plummeted to 23 percent.

Besides the change in credit terms, the general economic situation—in particular the flagging of economic activity—contributed to the slackening of investment and to the related credit. The lackluster performance of the economy was accompanied by uncertainty as to how it would develop in the future, and this in turn dampened demand for new investment. The lack of clarity regarding

[41] Thus, for example, the weighted real pretax cost of industrial development loans was –6 percent in 1980, compared with –26 percent the year before.

the mooted changes in the existing tax structure and their timing also depressed investment demand, since implementation of the recommendations submitted by the committee appointed to study this subject could significantly affect the profitability of investment.

At the same time certain factors stimulated demand for such credit. The most prominent one was the fixing of nondirected short-term credit ceilings, which directly and indirectly spurred the business sector to finance its current activities with long- and medium-term borrowed funds, as these were not subject to quantitative restrictions. As a result, the volume of such finance contracted much more moderately than investment. In agriculture there was also an institutional change—the conversion of outstanding short-term credit into long-term loans so as to ease the sector's serious liquidity position.

The difficulties of procuring working capital caused many firms to turn directly to the capital market to issue dollar bonds. This produced some IS300 million, much of which was used to reduce short-term credit balances.

The amount of directed government credit for purchasing homes was up 33 percent in real terms in 1980. The increase in the size of the loans relative to housing prices goes a long way to explain this development. The fact that a growing proportion of the credit is linked (about 50 percent in 1980, as against 15 percent the year before) did not deter the public from utilizing such funding, owing to the easy repayment terms.

Other credit to households, consisting mainly of social insurance fund loans to members and employers' loans to their staff, was down 28 percent, owing to the dearer cost of the former type of credit and to the higher effective interest rate on employers' loans this year following the raising of the imputed interest for tax purposes.

II. COMPONENTS OF THE CAPITAL MARKET

7. THE GOVERNMENT'S FINANCIAL OPERATIONS

The degree of government intervention in the whole process of medium- and long-term capital mobilization is very high. It determines the rate of return to savers, the interest rate for borrowers, and the criteria for granting credit. Government intervention in the setting of the borrowing and lending rates does not ensure a balance between the supply of funds (in the main household savings) and the demand therefor, which is primarily influenced by the volume of domestic investment and the rate of financing. If a gap arises between the sources and uses of funds, the government acts to regulate the flows.

In 1980 the committee appointed to study the functioning of the capital market submitted its recommendations, which called for the diminution of government intervention, particularly in the onlending of the funds raised. The basis for such a reform had been laid in the previous year, when the government decided to link both development loans to the business sector and housing loans to households. Even if government intervention remains substantial after implementation of the recommendations, they can pave the way for reducing the distortions that arose over the years in the capital market and for making it more efficient while reducing the government's role.

The sale of its bonds and the deposit of the proceeds of earmarked and other issues netted the government some IS6 billion this year—a real increase of 11 percent (see Table VIII–9). Net government lending to the private sector rose to a similar extent.

The amount of funds raised by the government through the capital market (less credit granted) for financing its current operations reached approximately IS1 billion this year, compared with IS600 million in 1979.[42]

8. THE SHARE MARKET

The share market rallied smartly in 1980: the market value of equities nearly doubled in real terms, as prices shot up at a 63 percent real rate and a large number of new issues were floated. However, the upswing did not last as long as the previous boom, which fizzled out in late 1977, and the fluctuations in yields and sales were less sharp (see Figure VIII–3 and Table VIII–15).

Share prices started to recover at the end of 1979, after they had sunk to a relatively low real level; self-fulfilling expectations sent them climbing at an accelerating rate, with marked fluctuations around the trend, notably a 4.5 percent real downturn in March and a steeper 14 percent retreat in August. In March demand slumped following the announcement in the previous month of several new policy measures: the mandatory reporting by commercial banks of large cash transactions, the obligating of tax assessees to declare their capital, and the imposition of restrictions in the foreign exchange market. These probably made the investing public fear the introduction of further measures likely to affect shares. The August price slide was accentuated by the failure of the banking concerns to support prices to a degree that would ensure their stability. Toward the end of January 1981 the equity market again turned bearish, and in February shareholders took a 16 percent real loss. The decline was checked

[42] The estimated amount of funds mobilized by the government through private savings is biased downward, since it does not take into account noncontributory (i.e. budgetary) pension arrangements in the public sector. Inclusion of this component would greatly increase the resources flowing to the government for financing its current operations, while increasing government expenditures on account of contributions to the pension schemes by a similar sum.

Table VIII-15

DEVELOPMENTS IN THE SECURITIES MARKET, 1977–80

(IS billion)

	1977	1978	1979	1980		
					Monthly average	
				Total	Jan.-June	July-Dec.
A. Bonds						
1. Net issues, at Dec. 1980 prices[a]	–5.6	–4.1	0.4	1.6	–0.4	2.0
To the public	–3.0	–2.7	0.5	1.8	–0.4	2.2
For savings schemes	–2.6	–1.4	–0.1	–0.2	0.0	–0.2
2. Overall real rate of return on indexed bonds (%)[b]	–0.8	2.0	–5.7	10.4	5.7	4.4
3. Stock Exchange trade, at Dec. 1980 prices	4.8	4.3	6.2	5.2	2.3	2.9
4. Annual rate of Stock Exchange turnover (%)	13.4	13.4	9.8	17.1	15.5	18.0
B. Shares and convertible securities						
1. Issues, at Dec. 1980 prices	3.6	3.3	0.7	2.1	0.7	1.4
2. Percent annual increase in issues at constant prices (annual rates)	300	–8	–79	200	100	300
3. Overall real rate of return (%)	34.7	3.4	–23.7	62.9	22.2	33.3
4. Stock Exchange trade, at Dec. 1980 prices						
On the floor	11.4	9.9	8.0	18.1	6.7	11.4
On and off the floor	19.7	19.5	23.3	46.2	17.7	28.5
5. Annual rate of Stock Exchange turnover (%)	64.7	44.8	37.9	70.6	62.5	74.2
C. Total securities market						
1. Total issues, at Dec. 1980 prices (A1+B1)	–2.0	–0.8	1.1	3.7	0.3	3.4
2. Weight of bonds in total Stock Exchange trade (%)	29.6	30.3	43.7	22.3	25.6	20.3
3. Weight of securities in the financial assets portfolio,[c] at end of period (%)	25	23	20	26	22	26

[a] The net data for 1977 (the total and its distribution) are an estimate, which is less reliable than the other data. No figures were available on the net flow of bonds between the public and financial institutions. The data for 1977 were deflated by the annual average increase in the consumer price index and for subsequent years by the monthly increase.

[b] Before 1979 includes option bonds.

[c] As defined in Table VIII-10.

in March after the banking concerns stepped in to prop up prices, and in April the level rose 5.5 percent in real terms.

The buoyant market permitted the floating of new issues. These were 200 percent higher in real terms than in 1979, but still fell 40 percent short of the 1977 figure. This was due to the sluggish response to market developments and to the slight interest displayed by nonfinancial companies because of the cutting back of their investment programs and the availability of convenient alternative long-term sources of finance: these companies, for instance, were allowed to issue dollar bonds, which yielded them $60 million. The financial sector, whose shares dominate demand and Stock Exchange trade, stepped up its issues by 240 percent in real terms in order to expand its equity base; these accounted for 80 percent of total issue proceeds in 1980.

The activity of "interested parties" in bank shares, intended mainly to regulate prices, expanded at a formidable 60 percent real rate in 1980, accounting for 11 percent of total trade in such shares. This massive intervention succeeded in moderating the advance of bank shares in a feverish bull market, and their real return was only a third of that for all stocks. However, the variations in demand were so strong that the banking concerns could not fully cope with them; the volatility of bank shares grew sharper as the year wore on, approaching that of the equity market in general.

Among other stocks, whose prices are generally not regulated, the most prominent developments were the 179 percent real return gain in the real estate group and an even more daunting 235 percent gain in industrials. There was some economic justification for these differential rates of increase, since some stocks started from low levels and industrial firms enjoyed extensive tax concessions (even though the recession dampened their profitability). Investment company shares, whose starting prices were higher than those of nonbank concerns, moved up at a more moderate 69 percent real rate.

Another manifestation of the stock market boom was the much higher turnover rate this year, when total trade in equities nearly doubled.

9. THE BOND MARKET

The upsurge in the public's demand for bonds was reflected by a much larger net issue of such securities this year. Stock Exchange turnover contracted in real terms, as part of the trade was apparently conducted off the floor in the wake of increased intervention by institutional investors.

The volatility of real bond yields reflected drastic changes in the public's demand, which were only partly offset by the regulatory activities of various financial institutions and the Bank of Israel. The yield fluctuations grew sharper in the course of the year (see Table VIII–11 and Figure VIII–5). As to the regulation of trade, there was a greater institutional intervention in the market

for bonds of the type issued to the public. The banks were obligated to buy them as cover for their savings schemes, and social insurance funds were this year permitted to trade in such paper. This introduced a powerful factor capable of toning down the swings in bond prices.

By contrast, in 1980 the Bank of Israel reduced its intervention even in nominal terms: it ended the year with a IS200 million net sale from its portfolio, as opposed to a net purchase of about the same amount in the previous year. This depressed its weight in total Stock Exchange bond turnover from 16 percent in 1979 to 5 percent.

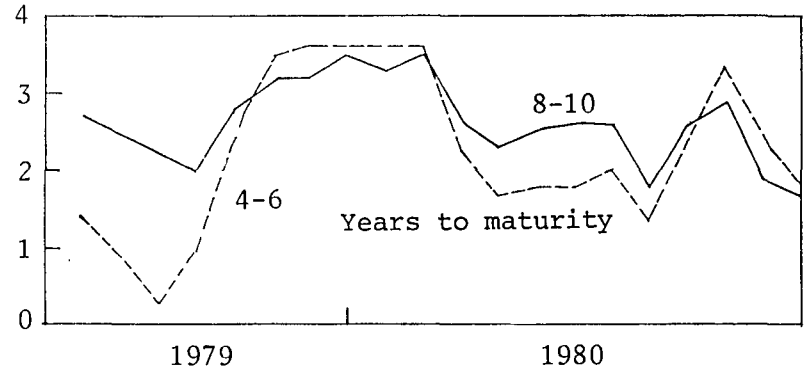
In 1980 bond issue terms were altered: nongovernment bonds traded in dollars were offered to the public at an interest rate varying with the return on Patam local residents' foreign currency deposits. These securities reduce the risk to investors in dollar-denominated bonds; they also give companies certain tax advantages compared with Patam accounts. The issue of double-option bonds was discontinued this year in the absence of demand by the public. As stated, the flotation of bonds fully linked to the consumer price index was resumed in place of the 80 percent indexed issues, but without any essential change in the net return to the general public.[43] For tax reasons, it is more advantageous to banks to hold partially indexed bonds; their yields to maturity have therefore declined compared with fully indexed issues.

The rates of return on medium- and long-term bonds were similar in 1980 —about 11 percent in real terms. The return on short-term paper was very low, ranging from 0.5 to –3.5 percent. These securities resemble in their charac-

Figure VIII–6

AVERAGE NET REAL YIELDS TO MATURITY OF INDEXED BONDS, MONTHLY, 1979–80

(Percentages)



SOURCE: Table VIII–B15.

[43] The net yield on the new fully indexed bonds (1.95 percent) is identical to that on 80 percent indexed bonds under an average multiyear inflation rate of 72.5 percent.

teristics unlinked liquid assets, which had a negative real return in 1980. In those months when demand for fixed-interest securities was very brisk (April to August), the prices of 5–6 year bonds (fully indexed) were relatively high and the yields to maturity were lower than in other groups. The high prices of medium-term bonds is explained by the limited supply coupled with mounting demand. The real 15 percent jump in the quotations of double-option bonds was apparently due to the heavier demand this year for dollar savings schemes, for which they serve as cover, while the discontinuation of their issue resulted in an inelastic supply.

10. MUTUAL FUNDS

The major change that occurred in 1980 in the public's demand for mutual funds dates to the launching in July of a new type of fund (a money market fund), whose shares are bought and sold at the same price, i.e. with no sales charge included in the asked price. In a period of high inflation, when intensive portfolio management assumes added importance in order to prevent the erosion of asset values, such a fund has a great attraction: its advantage over a direct financial investment lies in the possibility of diversifying the investment, even the smallest one, over a wide range of securities and at a lower transaction

Table VIII–16

MUTUAL FUND OPERATIONS, 1976–80

(Percentages, unless otherwise stated)

	Net issues[a] (IS million)	Real change in net issues	Net issues divided by funds' assets at end of previous year	Weight of funds' assets in listed securities portfolio at end of year	Composition of funds' assets at end of year[b]		
					Bonds traded in Israeli currency	Shares traded in Israeli currency	Foreign currency assets
1976	182	–26	35	20	68.5	7.5	22.7
1977	218	–11	25	21	62.4	12.7	24.9
1978	219	–33	14	20	58.8	15.2	26.0
1979	–49	–112	–2	23	69.8	11.5	18.4
1980	2,128	—	42	23	66.6	21.7	11.7

[a] Defined as mutual fund shares sold at issue price, less redemptions at redemption price.
[b] Excludes cash.
SOURCE: Bank of Israel calculations.

cost than that of a direct financial investment. Thus it will be seen that the fund managements are engaged in activity differing somewhat in nature from that customary in the past.

The introduction of the money market funds was followed by a sharply fluctuating sale of their shares. July and early August witnessed a flurry of sales, but there was a net redemption at the end of August and in September. This apparently happened when the public realized that the funds' return depended on the returns of the individual securities in their portfolio, and that it could even be negative in the short run. The weight of these funds in total mutual fund assets stood at 12 percent at the end of December (down 5 percent from their end-August level). About half their portfolio consisted of indexed bonds, while 40 percent was in shares and 10 percent in foreign currency-related assets.

The composition of the industry's portfolio (see Table VIII–16) is determined both by the fund managements and by the investing public, which shifts from one fund to another according as its preferences change. In the course of the year reviewed the weight of shares rose from 12 to 22 percent, while foreign currency assets sank from 18.4 to 11.7 percent. These changes were influenced to some extent by the requirement to reduce the proportion of Patam in each fund's portfolio to no more than 10 percent.[44] The weight of bonds also dipped, from 70 to 67 percent.

The industry enjoyed a 25.5 percent real return in 1980. Arraying the rates of return by type of fund shows a close correspondence with the returns on their principal components. Funds investing heavily in shares had high but sharply fluctuating returns, as indicated by their standard deviations.

The large slice of the securities market captured by mutual funds (which by the end of 1980 reached 23 percent of total securities traded in Israeli currency), their ability to influence market trends, and the keen competition to attain higher returns would seem to justify legislative action to place their operations under closer supervision.

11. SOCIAL INSURANCE FUNDS AND INSURANCE COMPANIES

In 1980 household accumulation in social insurance funds was up 10 percent in real terms, compared with 16 percent in the previous year. The share of the social insurance funds in the public's financial asset holdings continued to increase, reaching 31 percent at the end of the year. The rising trend in the weight of the provident funds, especially those run by the financial sector, was sustained in 1980, when they accounted for 46 percent of the public's total assets in social

[44] If this directive had gone into effect at the end of 1979, it would have been necessary to reduce the funds' Patam holdings by about a quarter. This does not necessarily indicate the degree to which it affected such holdings at the end of 1980, since they may have contracted for other reasons.

insurance funds, as against 40 percent in 1977. The weight of pension funds, on the other hand, continued to fall, reaching 37 percent at the end of 1980, compared with 43 percent in 1977.[45]

Trends in social insurance fund operations resemble to some extent those in the financial and capital markets as a whole, and this was even more manifest in 1980: the weight of bank-administered provident funds in the social insurance fund subsector rose, and the funds greatly stepped up their secondary

Table VIII–17

LIABILITIES AND ACCUMULATION OF SOCIAL INSURANCE FUNDS AND LIFE INSURANCE COMPANIES, 1978–80

(IS billion)

	Liabilities to the public, at Dec. 1980 prices			Net accumulation	Percent real increase in accumulation[a]	
	1978	1979	1980	1980	1979	1980
Social insurance funds						
Pension	22.1	22.3	25.8	0.7	76	5
Provident	23.0	24.6	31.9	2.1	0	10
Thereof: Financial sector	17.8	19.9	26.0	1.7	–7	13
Severance pay	5.0	5.2	5.8	0.3	63	–2
Advanced study	1.3	1.2	2.1	0.5	14	26
Other funds	0.5	0.4	0.4			
Total	**53.7**	**55.8**	**68.9**	**3.6**	**16**	**10**
Insurance companies						
Life insurance reserve[b]	4.6	4.4	5.1	0.6	11	–5
Total balance sheet of insurance companies	**9.9**	**9.0**	**9.5**			

[a] Deflated semiannually by the consumer price index.

[b] Less reinsurance.

SOURCE: Based on Central Bureau of Statistics data.

[45] The estimated weight of the pension funds in total social insurance fund accumulation is apparently biased downward somewhat. This is because of the actuarial deficit existing in some of the pension schemes; in other words, the value of their investments (which measures the public's assets in the schemes) is smaller than the present value of members' rights. The deficit has been reduced substantially in recent years, following changes in members' rights on the one hand and an increased return on recognized investments on the other.

securities market transactions after the curbs were removed on their activity in bonds of the type issued to the public. In addition, the provident funds' liquidity may have grown with the aging of their membership. The incremental social insurance fund accumulation was accounted for primarily by provident funds managed by the financial sector, followed by advanced study schemes. The pension funds expanded more moderately, while severance pay funds failed to show any real increase (see Table VIII–17).

The accumulation in bank-administered provident funds resumed its uptrend in 1980, after a temporary decline in 1979. This pattern was similar to that of the voluntary savings plans, and was influenced by developments in the financial and capital markets as well as by rate of return changes, which largely stemmed from the tax concessions granted on current contributions: the maximum amount eligible for such relief was raised, thereby stimulating the expansion of contributions. Another possible reason was the higher percentage of provident fund accounts approaching maturity this year, i.e. the date from which withdrawals are permitted. This enhanced the public's ability to redistribute its assets portfolio.

The accumulation in advanced study schemes rose 26 percent in real terms this year, following the hiking in 1979 of employers' contributions from 2.5 to 7.5 percent of wages and the addition of new groups of employees to the membership roll. Beginning in 1980 members may draw on the amount credited to their account after six years, even for purposes other than advanced study. This has transformed the schemes into a regular savings plan, similar to those run by banks but with more advantageous terms owing to the tax concessions and their higher return.

The pension funds underwent marked institutional changes in 1979, when a large percentage of the workers in producing sectors shifted from basic to comprehensive pension plans, with employee and employer contributions rising from 11 to 18 percent of wages. Furthermore, additional components were included in wages for pension computation purposes. Comprehensive pension plans offer employees more rights than do the basic plans, and it is reasonable to assume that this will dampen to some extent the public's voluntary savings. Withdrawals from pension funds rose at a substantial real 14 percent rate, as opposed to 3 percent the year before.

The net real accumulation in severance pay funds was similar to the 1979 figure, which had risen as a result of the collective agreements signed in the producing sectors, under which employers undertook to adjust their severance pay reserves in line with the future liabilities. It is interesting to note that there was no heavier withdrawal from severance pay funds this year despite the increase in layoffs and the reduction of the workforce in several sectors of the economy.

In conformity with Treasury regulations, social insurance funds invest the bulk of their net resources in securities. This amounted in 1980 to 84 percent

of their accumulation, roughly the same as in the previous year. The funds are required to hold 92 percent of their accumulation in recognized securities, but since they started the year with a surplus investment, they were able to divert less of their current accumulation to the purchase of securities and still keep within the requirement (see Table VIII–B17). With the lifting of the restrictions on social insurance fund activity in the secondary bond market this year, such transactions expanded noticeably. Net purchases of tradable bonds were in the vicinity of IS800 million, while net sales of shares totaled IS400 million (on the influence of the social insurance funds in the secondary market see the section on the bond market above). Loans to fund members fell substantially, apparently because the indexation of new loans this year dampened demand. Treasury limitations on social insurance fund lending may also have had an effect. The large amount of fund-owned bonds reaching redemption, which entailed the loss of a month's indexation increments, together with the high inflation, depressed the funds' return a bit. For the subsector as a whole this amounted to more than 0.5 percent, with the figure varying among the different types of funds.

The public's accumulation in life insurance companies fell 5 percent in real terms, following an 11 percent increase in the previous year. This savings channel accounted for 4.6 percent of total financial asset accumulation, with the weight of the life insurance reserve standing at 2.3 percent at year's end (see Tables VIII–A5 and VIII–10). A 2 percent drop in premium receipts and a 5 percent increase in claims payments were responsible for the smaller accumulation. Apparently there was some shift to alternative long-term savings plans, with the consequence that the nonsaving element in life insurance accumulation rose at the expense of the saving element.

General insurance premium receipts were 123 percent up on 1979, with the increase in the motor vehicle branch being a relatively moderate 95 percent and that in other classes a steep 141 percent. The growth of motor vehicle premium receipts was the outcome of a 23 percent increase in the price of motor vehicles, a 5 percent rise in the number of vehicles, and a real increase in insurance tariffs.

Appendix Tables

Table VIII–A1

MONEY SUPPLY AND UNLINKED ISRAELI CURRENCY DEPOSITS OF THE PUBLIC, 1978–80

(Balances in IS million)

End of period	Money supply				Unlinked deposits			Total	
	Original data			Seasonally adjusted					
	Currency in circulation (1)	Demand deposits (2)	Total (1+2) (3)	Total (4)	Negotiable certificates of deposit (5)	Time deposits in IS (Pazak) (6)	Deposits against liabilities in IS (7)	IS million (3+5+6+7) (8)	Percent increase from previous period (9)
1978	878	1,837	2,715	2,654	78	513	54	3,361	36.6
1979	1,205	2,338	3,543	3,460	447	341	67	4,398	30.8
1980	2,128	4,878	7,006	6,835	1,884	343	305	9,538	116.9
January	1,232	2,304	3,537	3,602	607	322	85	4,551	3.5
February	1,320	2,411	3,731	3,831	716	308	104	4,859	6.8
March	1,494	2,934	4,428	4,329	689	300	115	5,533	13.9
April	1,468	2,828	4,296	4,309	937	299	147	5,679	2.6
May	1,567	2,990	4,557	4,490	1,056	298	182	6,094	7.3
June	1,622	3,288	4,910	4,861	1,126	289	142	6,467	6.1
July	1,750	3,609	5,359	5,408	1,220	291	316	7,186	11.1
August	1,842	3,578	5,420	5,366	1,315	288	133	7,156	–0.4
September	2,041	3,988	6,029	5,981	1,309	294	155	7,787	8.8
October	1,979	3,863	5,842	5,961	1,388	291	198	7,720	–0.9
November	2,011	4,199	6,210	6,311	1,542	301	176	8,230	6.6
December	2,128	4,878	7,006	6,835	1,884	343	305	9,538	15.9

SOURCE: Department of the Examiner of Banks, *Banking Statistics;* monthly balance sheet of the banking institutions; State Loans Administration.

Table

LINKED ASSETS OF THE PUBLIC IN THE BANKING

(IS

	Approved savings scheme deposits		Linked long-term deposits[a]
	Total (1)	Principal (2)	(3)
1978	6,373	3,051	232
1979	14,491	5,722	912
1980	37,167	11,903	3,155
January	15,716	6,076	969
February	16,963	6,407	1,055
March	18,027	6,962	1,189
April	18,947	7,254	1,321
May	21,032	7,839	1,491
June	23,375	8,702	1,771
July	24,387	8,956	1,929
August	25,546	9,279	2,023
September	27,801	9,705	2,311
October	29,786	10,081	2,479
November	33,349	10,861	2,711
December	37,167	11,903	3,155

[a] Includes linkage increments. The principal amounted to IS169 million at the end of 1978, IS516 million at the end of 1979, and IS1,383 million at the end of 1980.

[b] Includes foreign currency valuation adjustments due to changes in the external value of the various currencies. The data can be translated into foreign currency terms by dividing by the relevant exchange rate.

VIII-A2

SYSTEM AND ITS BOND AND SHARE HOLDINGS, 1978-80

million)

Foreign currency deposits (Patam)[b]		Tradable bonds[c]	Tradable shares[d]		Total linked assets (1+3+4+5+6+7)
Restitution (4)	Other (5)	(6)	Total (7)	Bank shares (8)	(9)
5,008	4,026	4,850	4,668	2,847	25,157
9,961	9,164	8,780	8,101	6,538	51,409
19,472	22,360	23,300	36,207	23,323	141,661
10,322	10,053	9,080	9,393	6,888	55,533
10,842	11,047	8,900	10,588	7,207	59,395
10,480	11,279	9,740	10,753	7,639	61,468
11,624	12,340	11,310	11,877	7,961	67,419
12,528	13,501	12,490	12,498	7,998	73,540
13,832	14,906	12,450	15,544	10,447	81,878
14,336	15,358	13,580	18,360	12,037	87,950
15,241	16,335	14,920	17,923	11,964	91,988
16,168	17,319	16,290	19,973	13,585	99,862
16,607	18,544	18,210	27,185	19,022	112,811
18,054	20,621	21,270	30,525	20,582	126,530
19,472	22,360	23,300	36,207	23,323	141,661

[c] At market prices; excludes bonds held by the commercial banks and the Bank of Israel; includes bonds held by social insurance funds and other institutional investors.

[d] At market prices; includes shares held by commercial banks, which amounted to IS421 million at the end of 1979 and IS1,290 million at the end of 1980.

SOURCE: Monthly balance sheet of the banking institutions and calculations of the Tel Aviv Stock Exchange and Bank of Israel.

Table

ESTIMATED WEALTH OF THE PRIVATE

(IS million at current prices,

Assets	1975	1976	1977	1978	1979	1980
Liquid assets[a]	**4,584**	**6,100**	**9,638**	**16,227**	**30,068**	**84,756**
Money supply	1,061	1,349	1,872	2,715	3,544	3,964
Time deposits and CDs	373	429	546	691	833	2,449
Foreign currency deposits (incl. time deposits)	567	877	1,804	4,938	11,183	28,644
Tradable bonds	2,143	2,705	3,406	4,583	8,283	21,753
Shares of financial intermediaries	440	740	2,010	3,300	6,225	24,946
Medium-term financial assets[b]	**2,452**	**3,730**	**7,197**	**11,911**	**25,879**	**60,456**
Earmarked deposits of the public	109	132	174	319	624	1,194
Savings schemes and linked deposits	1,324	2,078	3,760	6,584	15,294	39,790
Patam restitution deposits	1,019	1,520	3,263	5,008	9,961	19,472
Long-term financial assets	**2,818**	**4,290**	**6,973**	**11,810**	**25,845**	**74,026**
Deposits in social insurance funds	2,584	3,935	6,424	10,869	23,938	68,931
Life insurance	234	355	549	941	1,907	5,095
Other wealth	**22,871**	**28,043**	**47,687**	**78,205**	**182,245**	**431,946**
Compulsory loans	1,770	2,410	3,310	4,830	9,620	21,000
Physical assets	21,101	25,633	44,377	73,375	172,625	410,946
Durables	2,762	3,820	6,085	9,329	17,995	45,500
Residential buildings	8,342	10,930	17,431	30,476	83,418	193,591
Nonresidential buildings and equipment	9,997	10,883	20,861	33,570	71,212	171,855
Total	**32,725**	**42,163**	**71,495**	**118,153**	**264,037**	**651,184**

[a] The differences between this item and the liquid assets item in Table VIII–10 stem from the difference in the definition of the public and the private nonfinancial sector (see note [a] to Table VIII–6). The item "Time deposits and CDs" consists of deposits in commercial banks and other financial institutions. Foreign currency deposits consist of demand and time deposits in the banking system, nonresident deposits held by Israeli residents (e.g. exporters), Patam local residents' deposits, deposits against foreign credit obtained directly from abroad, and importers' deposits. Tradable bonds are total bonds issued to the public less bonds held by the Bank of Israel, commercial, investment, and mortgage banks, other financial institutions required to report to the Examiner of Banks, and insurance companies. Shares of financial intermediaries are shares issued by commercial banks, mortgage banks, institutions financing specific sectors, and insurance companies.

[b] The differences between this item and the corresponding item in Table VIII–10 stem from the inclusion here of earmarked deposits of the public, as well as savings schemes and linked deposits in investment and mortgage banks (in addition to the savings schemes and linked deposits in commercial banks). The data on savings schemes include the

VIII-A3

NONFINANCIAL SECTOR, 1975-80

end-of-year data)

Liabilities	1975	1976	1977	1978	1979	1980
Short-term liabilities[c]	**1,706**	**2,076**	**4,895**	**8,541**	**19,283**	**47,602**
Nondirected credit						
Israeli currency	702	889	1,233	1,920	3,231	8,098
Foreign currency	15	35	1,090	2,263	5,237	13,020
Directed credit						
Israeli currency	440	564	813	990	1,689	3,775
Foreign currency	371	417	1,365	2,740	6,595	16,284
Credit from abroad (supplier and direct)	178	171	394	628	2,531	6,425
Medium- and long-term liabilities[d]	**2,572**	**3,166**	**3,876**	**6,014**	**10,605**	**23,941**
Long-term Israeli currency credit						
Excl. the subsidy component	1,824	1,854	2,330	3,493	3,670	7,622
Incl. the subsidy component	2,677	3,387	4,372	6,172	9,920	17,352
Long-term foreign currency credit	732	1,290	1,480	2,410	6,697	15,819
Securities held by financial intermediaries	16	22	66	111	238	500
Total	**4,278**	**5,242**	**8,771**	**14,555**	**29,888**	**71,543**
Net wealth (incl. the long-term credit subsidy)[e]	28,447	36,921	62,724	103,598	234,149	579,641
Total	**32,725**	**42,163**	**71,495**	**118,153**	**264,037**	**651,184**

accrued value of the grant and not the full amount recorded at the time the accounts were opened.

[c] Nondirected Israeli currency credit comprises credit from the commercial banking system and short-term credit from mortgage banks (to building contractors), less credit to local authorities. Nondirected foreign currency credit includes credit from the banking system in Israel, *inter alia* for oil imports. Credit from abroad is granted by overseas branches of Israeli banks, suppliers, and others.

[d] The subsidy component of long-term Israeli currency credit is estimated as the present value of the stream of repayments according to the actual inflation rate. In this calculation repayments are spread over six years (the estimated average period of the loans), with interest on the stock of loans weighted accordingly.

[e] Calculated as the difference between total assets and total liabilities of the private non-financial sector; includes the estimated subsidy component of long-term Israeli currency credit.

Table VIII-A4

THE MONETARY BASE BY COMPONENT, 1978–80

(Balances in IS million)

End of period	Currency in circulation (1)	Liquid assets of banking institutions (2)	Narrow monetary base (1+2) (3)	Liquidity exemptions (4)	Recognized liquidity deficiencies (5)	Broad monetary base (3+4+5) (6)	Percent increase in broad monetary base (7)
1978	878	1,158	2,036	221	10	2,267	29.8
1979	1,205	1,093	2,298	464	3	2,765	22.0
1980	2,128	2,415	4,543	657	6	5,206	88.3
January	1,232	1,583	2,815	419	3	3,237	17.1
February	1,320	1,380	2,700	417	3	3,121	–3.6
March	1,494	1,525	3,019	392	4	3,415	9.4
April	1,468	1,709	3,177	521	9	3,707	8.6
May	1,567	1,472	3,039	531	8	3,579	–3.5
June	1,622	1,796	3,418	572	5	3,995	11.6
July	1,750	2,108	3,858	698	8	4,564	14.3
August	1,842	2,102	3,944	575	7	4,526	–0.8
September	2,041	2,233	4,274	621	6	4,901	8.3
October	1,979	2,462	4,441	681	35	5,157	5.2
November	2,011	2,269	4,280	691	39	5,009	–2.9
December	2,128	2,415	4,543	657	6	5,206	3.9

SOURCE: Liquid assets of banking institutions—monthly balance sheet of the banking institutions; liquidity exemptions and recognized deficiencies—monthly liquidity report of the banking institutions; currency in circulation—Department of the Examiner of Banks, *Banking Statistics*.

Table VIII-A5

ASSET ACQUISITIONS BY THE PRIVATE NONFINANCIAL SECTOR, 1978–80

(Net flows in IS million)

	1978	1979	1980		
			Total	First half	Second half
Money supply[a]	843	828	3,421	1,366	2,055
Time deposits and CDs[a]	76	196	1,191	642	549
Foreign currency deposits[b]	1,938	1,555	2,644	2,465	179
Tradable bonds[c]	–596	–1,257	–2,209	–1,364	–845
Shares[c,d]	332	104	1,317	642	675
Restitution deposits	349	125	485	176	309
Savings schemes[e]	761	954	1,888	830	1,058
Long-term linked deposits in the banking system	117	327	707	337	370
Social insurance	694	1,411	3,674	1,314	2,360
Life insurance	147	288	636	268	368
Total asset accumulation	**4,661**	**4,531**	**13,754**	**6,676**	**7,078**

[a] The change in the balance during the period.

[b] Demand deposits, time deposits, nonresident deposits held by Israeli residents (e.g. exporters), and deposits against foreign credit obtained directly from abroad.

[c] Transactions in tradable securities in the secondary market between the private nonfinancial sector and the system of financial intermediaries, in particular social insurance funds and the commercial banking system.

[d] Includes purchases of original-issue shares of the insurance, finance, and bank group, less dividends of the private nonfinancial sector.

[e] Savings schemes administered by commercial banks and financial institutions.

SOURCE: Bank of Israel calculations.

Table

SOURCES AND COMPONENTS OF CHANGES

(IS

		Jan.	Feb.	Mar.
1.	Basic public sector injection[a]	465	542	352
	Thereof: Government	400	481	280
2.	Bank of Israel injection	726	182	282
	Directed Israeli currency credit	246	76	-14
	Directed foreign currency credit	175	268	311
	Credit to banks	16	-196	0
	Other factors[b]	289	34	-15
3.	Total exogenous injection (1+2)	**1,191**	**724**	**634**
4.	Foreign currency sales of the private sector	-267	-852	-282
5.	Change in narrow liquid asset base (3+4)	**924**	**-128**	**352**
6.	Liquidity exemptions and recognized deficiencies	-45	-2	-24
7.	Change in broad liquid asset base (5+6)	**879**	**-130**	**328**
	Change in broad monetary base	472	-117	294
	Increase in Patam time and demand deposits	565	123	61
	Increase in bonds holdings	-158	-136	-27
8.	Change in liquidity deficiencies	402	-25	-232

[a] The public sector as customarily defined, plus net proceeds from the direct sale of bonds to the public.

[b] Consists mainly of the absorption or injection through the Bank of Israel's income

VIII–A6

IN THE LIQUID ASSET BASE, 1980

million)

Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
–24	467	648	512	386	915	291	813	769
–90	389	546	425	274	795	165	696	632
708	85	195	671	378	–27	486	147	104
395	206	153	403	305	206	236	72	–70
108	–222	204	–176	–103	234	–19	41	645
0	–4	0	0	1	0	6	17	78
205	105	–162	444	175	–467	263	17	–549
684	**552**	**843**	**1,183**	**764**	**888**	**777**	**960**	**873**
–276	–285	–159	–390	–122	–733	–610	–431	–722
408	**267**	**684**	**793**	**642**	**155**	**167**	**529**	**151**
134	9	38	129	–124	45	89	14	–67
542	**276**	**722**	**922**	**518**	**200**	**256**	**543**	**84**
293	–129	416	569	–38	375	256	–148	197
308	197	263	–211	–226	–151	22	468	–200
–59	208	43	564	782	–24	–22	223	71
176	–239	186	–151	145	–33	244	–323	–845

and expense accounts (such as interest paid on liquid assets in Israeli and foreign currency, fines for liquidity deficiencies, etc.), the absorption or injection through Patam restitution deposits, and discrepancies between the balance sheets of the commercial banks and that of the Bank of Israel.

Table VIII-A7

ESTIMATED CONVERSION OF PATAM RESTITUTION DEPOSITS, 1978–80

(IS million)

	Personal restitution receipts (1)	Accrued interest (2)	Exchange rate and devaluation differentials (3)	Total potential increase (1+2+3) (4)	Actual increase (5)	Amount converted into IS (4–5) (6)	Conversion rate (%)	
							A [a] (6/4) (7)	B [b] (6/[1+2]) (8)
1978	641	182	1,124	1,947	1,745	202	10	25
1979	1,145	332	4,785	6,262	4,953	1,309	21	89
1980	2,401	941	9,036	12,378	9,511	2,867	23	86
January	163	49	431	643	361	282	44	133
February	144	22	507	673	520	153	23	92
March	148	87	-429	-194	-361	167	—	71
April	157	30	1,192	1,379	1,143	236	17	126
May	171	35	913	1,119	904	215	19	104
June	181	128	1,229	1,538	1,303	235	15	76
July	208	34	541	783	505	278	36	115
August	216	35	883	1,134	904	230	20	92
September	213	160	732	1,105	927	178	16	48
October	248	82	427	757	439	318	42	96
November	253	40	1,425	1,718	1,447	271	16	92
December	299	239	1,185	1,723	1,418	305	18	57

[a] This calculation assumes that the recipients treat exchange rate and devaluation differentials in the same manner as restitution and interest receipts.

[b] This calculation assumes that the recipients treat exchange rate and devaluation differentials as capital gains on the deposits.

SOURCE: *Personal restitution receipts* and exchange rate differentials—Controller of Foreign Exchange; interest on Pazak and Tamam—Bank of Israel balance sheet; actual increase—monthly balance sheet of the banking institutions.

Table VIII-A8

COMPOSITION OF DIRECTED CREDIT TO THE PUBLIC, 1979–80

	End-year balances				Annual averages			
	IS million		Percent increase		IS million		Percent increase	
	1979	1980	1979	1980	1979	1980	1979	1980
1. Directed IS credit for domestic activities	206	326	0	58	203	303	–19	50
Working capital funds	171	222	8	30	161	202	–17	25
For industry	70	132	7	87	68	112	–18	66
For agriculture	32	50	55	58	19	49	–43	157
Supervised agricultural credit	47	32	45	–33	46	31	137	–34
Employers Loan Fund[a]	22	8	–45	–61	28	10	–52	–64
Other	35	103	–27	198	41	101	–29	143
2. Export credit in Israeli currency	1,430	3,368	95	136	1,045	2,442	78	134
Export Production Fund	1,213	2,859	100	136	905	2,146	81	137
Citrus and Cotton Funds	172	423	85	146	101	220	74	118
Indirect Export Fund	45	87	33	92	39	76	27	93
3. Export credit in or linked to foreign currency	6,522	15,992	142	145	4,257	10,716	93	152
Credit for export shipments in IS, linked to foreign currency	2,113	4,645	186	120	1,255	3,138	130	150
Diamond Fund (in foreign currency)	3,316	8,634	120	160	2,223	5,742	71	158
Imports-for-Export Fund (foreign currency)	1,092	2,713	142	148	779	1,836	119	136
4. Foreign currency rediscounts outside the funds	75	292	75	290	54	159	59	195

[a] Excludes indexation increments.

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

Table

OUTSTANDING CREDIT TO THE PUBLIC[a]

(Balances in IS million,

	For financing exports			
	Credit in Israeli currency[b] (1)	Foreign currency credit, excl. diamonds[c] (2)	Diamond Fund (3)	Total (1+2+3) (4)
1978	733	1,233	1,507	3,474
1979	1,430	3,280	3,316	8,027
1980	3,368	7,649	8,634	19,652
January	1,451	3,558	3,532	8,540
February	1,441	3,989	3,869	9,299
March	1,349	4,215	4,344	9,908
April	1,862	4,367	4,564	10,793
May	2,008	4,551	4,825	11,384
June	2,161	4,987	5,365	12,512
July	2,661	5,051	5,651	13,363
August	2,870	5,222	6,128	14,221
September	3,101	5,506	6,791	15,398
October	3,489	5,954	7,316	16,759
November	3,542	6,550	7,879	17,971
December	3,368	7,649	8,634	19,652

[a] Excludes credit to the government and the National Institutions.

[b] Credit from the Export Production, Indirect Export, and Citrus Funds.

[c] Credit from the Export Shipments Funds, Imports-for-Export Fund, financing of shipments from the banks' own foreign currency resources, and foreign currency rediscounts outside the funds.

[d] Revised definition: includes indexation increments on credit linked to the consumer price

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FROM THE BANKING SYSTEM, 1978–80

at current prices)

For financing domestic activities					
		Nondirected foreign currency credit[e]			
Directed Israeli currency credit (5)	Nondirected Israeli currency credit[d] (6)	Total (7)	Total excl. oil (8)	Subject to interest surcharge or deposit requirement (9)	Total credit for domestic market, excl. oil (5+6+8) (10)
276	2,472	2,297	1,790	1,746	4,538
283	4,356	8,510	6,036	5,287	10,675
434	9,411	18,794	9,906	7,456	19,751
346	4,250	9,129	6,015	5,207	10,611
345	4,419	9,645	6,043	5,191	10,807
346	5,236	9,971	6,027	5,227	11,609
358	4,973	10,223	6,226	5,235	11,557
364	5,429	11,418	6,480	5,402	12,273
378	6,576	12,126	6,834	5,380	13,788
390	6,565	12,836	7,137	5,408	14,092
418	6,675	14,340	7,250	5,654	14,343
415	7,744	14,971	7,477	5,770	15,636
410	7,362	16,564	7,982	6,009	15,754
409	8,035	17,830	9,119	6,935	17,563
434	9,411	18,794	9,906	7,456	19,751

index. Indexation increments on nondirected credit in Israeli currency totaled IS980 million at the end of 1979, rising to IS2,446 million at the end of 1980. Indexation increments on directed Israeli currency credit in connection with the Employers Loan Fund totaled IS39 million at the end of 1979 and IS51 million at the end of 1980. Nondirected credit in Israeli currency includes the banks' participation in credit from earmarked deposits.

[e] Revised definition: includes credit from Israeli bank branches abroad.

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

Table

MEDIUM- AND LONG-TERM CREDIT BY

(IS million,

	Total credit	Credit to households			Other credit
		Total	Mortgage credit		
			Directed	For private housing	
Through the capital market intermediaries					
1978	1,980	582	290	109	183
1979	3,863	1,182	615	141	426
1980	7,369	2,643	1,793	308	542
First half	2,600	759	495	69	195
Second half	4,769	1,884	1,298	239	347
By the government, other than through the capital market intermediaries					
1978	433	74			74
1979	748	79			79
1980	2,070	299			299
First half	878	99			99
Second half	1,192	200			200
From earmarked foreign currency deposits in commercial banks					
1978	400				
1979	654				
1980	1,573				
First half	555				
Second half	1,018				
Total					
1978	**2,813**	**656**	**290**	**109**	**257**
1979	**5,265**	**1,261**	**615**	**141**	**505**
1980	**11,012**	**2,942**	**1,793**	**308**	**841**
First half	**4,033**	**858**	**495**	**69**	**294**
Second half	**6,979**	**2,084**	**1,298**	**239**	**547**

[a] The National Institutions constitute a source of funds for the system of capital market intermediaries narrowly defined, and hence are not included among the recipients of

VIII-A10

DESTINATION, 1978–80

at current prices)

Credit to producing and service sectors					Credit to local authorities	Credit to National Institutions[a]
Total	Industry	Agriculture	Construction	Services		
1,200	546	234	89	311	198	
2,267	928	525	162	652	414	
4,064	1,444	978	127	1,515	662	
1,554	587	373	64	530	287	
2,510	857	605	63	985	375	
217	80	12	19	106	94	48
428	90	18	19	301	130	111
1,266	262	97	130	777	197	308
519	117	17	81	304	126	134
747	145	80	49	473	71	174
400[b]	100					
590	194	58	13	325	1	63
1,568	99	55	72	1,342	1	4
551	43	18	20	470	1	3
1,017	56	37	52	872	—	1
1,817[b]	**726**	**246**	**108**	**437**	**292**	**48**
3,285	**1,212**	**601**	**194**	**1,278**	**545**	**174**
6,898	**1,805**	**1,130**	**329**	**3,634**	**860**	**312**
2,624	**747**	**408**	**165**	**1,304**	**414**	**137**
4,274	**1,058**	**722**	**164**	**2,330**	**446**	**175**

credit in this framework.

[b] No sectoral breakdown of such credit is available for 1978.

Table

GROWTH OF MEDIUM- AND

(Percen

	Total credit	Credit to households			Other credit
		Total	Mortgage credit		
			Directed	For private housing	
Nominal rate of change[a]					
1978	60.5	57.7	62.0	84.7	44.4
1979	87.2	92.2	112.1	29.4	96.5
1980	109.2	133.3	191.5	118.4	66.5
Rate of change in prices					
1978	68.7[b]	67.2[b]	78.3[c]	78.3[c]	50.0[d]
1979	82.1[b]	109.1[b]	129.7[c]	129.7[c]	78.3[d]
1980	117.5[b]	122.1[b]	118.5[c]	118.5[c]	131.0[d]
Real rate of change					
1978	-4.9	-5.7	-9.1	3.6	-3.7
1979	2.8	-8.1	-7.7	-43.7	10.2
1980	-3.8	5.0	33.4	0	-27.9

[a] The growth rates are biased downward, since a sectoral distribution of credit from earmarked deposits is not available for 1978 (see the note to Table VIII-A10).

[b] Index constructed from the weighted average of the credit granted to the relevant group.

[c] According to the housing item in the consumer price index, annual average.

[d] According to the consumer price index, annual average.

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LONG-TERM CREDIT, 1978–80

tages)

To producing and service sectors					To local authorities	To National Institutions
Total	Industry	Agriculture	Construction	Services		
60.1	71.2	80.9	54.3	23.1	58.7	166.7
80.8	66.9	144.3	79.6	192.4	86.6	262.5
110.0	48.9	88.0	69.6	184.4	57.8	79.3
69.5[b]	73.0[e]	60.0[f]		67.0[f]	67.0[g]	67.0[g]
73.0[b]	67.0[e]	78.0[e]		76.4[f]	76.0[g]	76.0[g]
115.0[b]	112.0[e]	111.0[e]		117.7[f]	121.0[g]	121.0[g]
-5.5	-1.0	13.1		-26.3	-5.0	59.7
4.5	0.0	37.2		65.7	-6.0	106.0
-2.3	-28.8	10.9		30.6	-28.6	-19.3

[e] Derived from constant-price investment data.
[f] Derived from constant-price investment data for services, electricity, water, and transportation.
[g] According to the implicit deflator for public investments.
SOURCE: Bank of Israel estimates.

Table VIII-B1

ASSETS AND LIABILITIES OF THE BANKING INSTITUTIONS,[a] 1979–80

(IS million)

End-year balances	1979			1980		
	Israeli currency	Indexation increments	Foreign currency	Israeli currency	Indexation increments	Foreign currency
Assets						
Liquid IS assets with the Bank of Israel[b]	1,093			2,415		
Foreign currency deposits with the Bank of Israel			17,552			37,757
Loans and deposits abroad			15,209			41,684
Nondirected credit[c]	3,372	984		6,965	2,446	
Participation in directed credit	629	39	14	1,000	58	100
Nondirected foreign currency credit to local residents[d]			5,962			14,007
Foreign currency credit to local residents from approved earmarked deposits			2,573			6,047
Credit to the public from earmarked deposits[e]	3,596	5,806		6,895	17,266	
Credit to the public from government deposits	1,595	93		2,450	587	
Securities of Israeli companies and institutions	2,766	6,709	44	3,866	19,276	202
Premises and equipment	362			680		
Loans to the government from the banks' own means	1,109	1,372	1,071	2,264	4,912	1,207
Government bonds	1,198	944		3,142	3,765	
Loans to the government from earmarked deposits	5,793	13,400	1,656	10,243	40,858	4,531
Deposits with banking institutions and cash items in process of collection	414	407	1,416	754	1,193	3,491
Negotiable certificates of deposit	73			160		
Other accounts	3,609	454	583	8,930	1,634	2,189
Sundry accounts	1,009[f]	38[f]	8,478[g]	2,697[f]	51[f]	20,767[g]
Contingent accounts[h]	2,270	198	6,772	5,497	513	16,967
Total assets	**28,888**	**30,443**	**61,331**	**57,958**	**92,559**	**148,950**

Liabilities						
Equity capital and capital notes	1,767	60	465	4,721	221	962
Foreign deposits[i]			22,977			58,280
Rediscounts for banks	335			250		
Demand deposits	2,338			4,878		
Time deposits	341	1		343	0	
Negotiable certificates of deposit	520			2,044		
Approved savings schemes	5,890	8,602		12,046	25,120	
Linked long-term deposits	516	396		1,383	1,772	
Foreign currency deposits of local residents			19,125			41,832
Approved earmarked deposits	8,917	20,136	331	16,013	60,013	792
Earmarked government deposits[j]	2,135	31	933	3,685	580	2,132
Government accounts[k]	38		1	133		97
Deposits from banking institutions and cash items in process of collection	381	214	1,415	644	644	3,661
Other accounts	3,415	3	547	7,822	4	2,589
Sundry accounts	1,070[l]	38[l]	8,479[f]	3,002[l]	51[l]	20,775[f]
Contingent accounts	2, 270	198	6,772	5,497	513	16,967
Total liabilities	**29,942**	**29,677**	**61,044**	**62,462**	**88,917**	**148,088**

[a] The balance sheet, as published by the Department of the Examiner of Banks, has been adjusted to conform to the definitions in this chapter.

[b] Israeli currency deposits with the Bank of Israel treated as a liquid asset, treasury bills, and vault cash.

[c] Revised definition: includes the banks' participation in credit granted to the public from earmarked deposits.

[d] Excludes credit from overseas branches of Israeli banks.

[e] Excludes the banks' participation, which is presented here under nondirected credit.

[f] Rediscounts for the public in Israeli currency.

[g] Foreign currency rediscounts for the public and the Jewish Agency.

[h] Acceptances, guarantees, and documentary credits.

[i] Deposits of foreign banks and overseas branches of Israeli banks, nonresidents, new immigrants, and temporary residents, less sums redeposited with the Bank of Israel.

[j] Utilized earmarked deposits.

[k] Demand, time, and unutilized earmarked government deposits.

[l] As in note[f], plus deposits against liabilities.

Table VIII-B2

NET CLAIMS ON FOREIGNERS, 1978–80

($ million)

End of period	Bank of Israel				Banking institutions				Net foreign currency assets in banking system (4+8) (9)
	Foreign currency assets (1)	Liabilities		Net foreign currency assets (1–2–3) (4)	Foreign currency assets[c] (5)	Liabilities		Net foreign currency assets (5–6–7) (8)	
		Patach deposits[a] (2)	Other[b] (3)			Patach deposits[d] (6)	Other[e] (7)		
1978	**2,970**	**396**	**206**	**2,368**	**3,457**	**2,088**	**2,935**	**–1,565**	**802**
1979	3,169	519	223	2,427	4,302	2,935	3,565	–2,198	230
1980	3,494	605	222	2,667	5,523	3,681	4,040	–2,199	469
January	3,178	515	257	2,406	4,298	3,063	3,423	–2,188	218
February	3,124	503	253	2,368	4,336	3,129	3,360	–2,153	215
March	3,405	477	226	2,702	4,232	3,152	3,227	–2,147	554
April	3,521	483	233	2,805	4,437	3,294	3,222	–2,078	727
May	3,562	505	233	2,824	4,583	3,345	3,464	–2,225	599
June	3,487	517	233	2,737	4,874	3,466	3,618	–2,210	527
July	3,570	528	233	2,810	4,796	3,502	3,590	–2,296	513
August	3,599	544	231	2,824	4,729	3,533	3,583	–2,387	437
September	3,494	558	230	2,706	4,797	3,561	3,589	–2,352	354
October	3,402	555	227	2,621	5,047	3,603	3,871	–2,427	194
November	3,311	557	223	2,531	5,231	3,646	4,042	–2,460	71
December	3,494	605	222	2,667	5,523	3,681	4,040	–2,199	469

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

[b] Includes deposits of foreign banks and Israeli currency deposits in the IMF.

[c] Loans to and deposits with foreign banks and overseas branches of Israeli banks, loans to nonresidents, foreign securities, and vault cash.

[d] Includes Patach accounts of foreign-based Israeli firms, nonresidents, and exporters, less amounts redeposited with the Bank of Israel.

[e] Deposits of foreign banks and overseas branches of Israeli banks.

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

Table VIII–B3

OUTSTANDING ISRAELI CURRENCY CREDIT TO THE GOVERNMENT FROM THE BANKING SYSTEM, 1978–80
(IS million)

	From the Bank of Israel			From banking institutions				Total net Israeli currency credit to the govt. (3+7) (8)
	Credit to the govt.[a] (1)	Govt. and National Institution deposits[b] (2)	Net Bank of Israel credit (1–2) (3)	Credit to the govt. (4)	Govt. securities (5)	Less: Govt. deposits[c] (6)	Net credit from banking institutions (4+5–6) (7)	
1978	3,037	982	2,055	631	359.	23	967	3,022
1979	5,367	3,576	1,791	1,109	1,198	38	2,270	4,061
1980	8,865	9,969	–1,104	2,264	3,142	133	5,273	4,169
January	5,627	3,347	2,280	1,017	1,309	40	2,286	4,566
February	4,700	2,515	2,185	1,079	1,431	49	2,461	4,646
March	2,872	3,125	–253	1,139	1,428	65	2,502	2,249
April	2,718	2,538	180	1,145	1,566	94	2,617	2,797
May	2,734	2,580	154	1,225	1,767	93	2,898	3,053
June	3,674	2,534	1,140	1,372	1,888	100	3,160	4,300
July	2,682	2,316	365	1,376	2,396	102	3,669	4,035
August	2,025	2,268	–243	1,487	2,303	113	3,676	3,433
September	3,118	2,467	651	1,652	2,398	122	3,928	4,579
October	2,317	2,298	19	1,761	2,502	120	4,143	4,162
November	2,863	2,276	587	1,775	2,864	116	4,523	5,110
December	8,865	9,969	–1,104	2,264	3,142	133	5,273	4,169

[a] Includes the monthly debits to the government's account for Bank of Israel profits transferred to the Treasury.
[b] Includes the Bank of Israel's capital and the "other accounts" item in its balance sheet.
[c] The government's Israeli currency deposits, its participation in the working capital funds, and the difference between its deposits for loan purposes and the loans actually granted.
SOURCE: Bank of Israel balance sheet and the monthly balance sheet of the banking institutions.

Table

INDICATORS OF THE BANKING INSTITUTIONS'

(IS

	Required liquidity on ordinary deposits[a] (1)	Required liquidity on CDs[b] (2)	Required liquidity on other items[c] (3)	Total gross required liquidity (4)
1978	1,307	130	117	1,554
1979	1,487	190	190	1,867
1980	2,866	406	494	3,766
January	1,440	221	226	1,887
February	1,390	163	178	1,731
March	1,690	180	200	2,070
April	1,648	215	289	2,152
May	1,755	232	256	2,243
June	1,898	253	249	2,400
July	2,101	441	261	2,803
August	2,059	271	290	2,620
September	2,297	297	324	2,918
October	2,243	291	297	2,831
November	2,413	338	325	3,076
December	2,866	406	494	3,766

[a] Demand deposits and deposits against liabilities in Israeli currency.

[b] Includes time deposits and those withdrawn before maturity.

[c] Nondirected credit, savings, directed credit, and unutilized balance of earmarked deposits.

[d] Liquidity deficits represent the balance between liquid assets and the required liquidity net of liquidity exemptions. The liquid assets on which this table is based are taken from liquidity reports, and include certain adjustments which do not appear in the liquid assets

VIII–B4

LIQUIDITY IN ISRAELI CURRENCY, 1978–80

million)

Required liquidity less liquidity exemptions (5)	End-of-month liquidity deficit (–)[d] (6)	Average daily liquidity deficit (7)	Deficit/gross required liquidity[e] (daily average, %) (8)	Deficit/net required liquidity (daily average, %) (9)
1,333	–280	–92	–6.4	–7.6
1,403	–460	–382	–22.1	–32.3
3,109	–1,160	–473	–14.4	–18.2
1,468	–57	–201	–11.3	–15.1
1,314	–82	–114	–6.4	–8.4
1,678	–314	–154	–8.2	–10.5
1,631	–144	127	6.2	8.1
1,712	–383	47	2.2	3.0
1,828	–197	–302	–13.0	–17.1
2,105	–348	99	3.8	5.1
2,045	–203	–161	–6.0	–7.9
2,297	–236	–27	–0.9	–1.2
2,150	8	–73	–2.5	–3.3
2,385	–315	–43	–1.4	–1.9
3,109	–1,160	–473	–14.4	–18.2

data from the banking institutions' monthly balance sheet, which are presented in Table VIII–A4.

[e] Gross required liquidity before deduction of liquidity exemptions and recognized liquidity deficiencies; the net required liquidity is after subtraction of these items.

SOURCE: Monthly liquidity report of the banking institutions and Department of the Examiner of Banks, *Banking Statistics.*

Table VIII-B5

SOURCES AND USES OF MEDIUM- AND LONG-TERM FUNDS OF THE CAPITAL MARKET INTERMEDIARIES,[a] 1978–80

(Gross flows in IS million)

	1978	1979	1980		
			Total	First half	Second half
Sources					
1. Savings of the public	1,143	2,229[b]	5,929	1,971	3,958
2. Loan repayments	1,439	2,129	4,038	1,764	2,274
By households	302	472	883	370	513
By business	894	1,270	2,387	1,054	1,333
By local authorities	243	387	768	340	428
3. Other sources	129	176	252	-140	392
National Institutions (net)	45	63	294	39	255
Foreign sector (net)	25	-94	-392	-283	-109
Bank of Israel (net)	—	90	77	41	36
Other	59	117	273	63	210
4. Total sources	**3,011**	**4,534**[b]	**10,219**	**3,595**	**6,624**
Uses					
5. Total medium- and long-term credit	1,980	3,863	7,369	2,600	4,769
6. Net transfer of funds	485	-165[b]	81	266	-185
To the government	231	-205[b]	-736	-258	-478
To banking institutions	254	40[b]	817	524	293
7. Net short-term uses (incl. currency and demand deposits)	128	243	1,542	326	1,216
8. Surplus of expenditure over income	447	663	1,251	561	690
9. Dividends and other net payments[c]	-29	70	-24	-158	134
10. Total uses	**3,011**	**4,534**	**10,219**	**3,595**	**6,624**

[a] Defined as the system of financial intermediaries engaged primarily in the mobilization of medium- and long-term funds for investment in financial assets, such as loans, deposits, and securities. For a detailed definition see the Annual Report for 1977, Ch. XIX.

[b] Revised datum.

[c] Mainly in connection with general insurance transactions.

SOURCE: Bank of Israel estimates.

Table VIII-B6

FLOW OF FUNDS BETWEEN THE CAPITAL MARKET INTERMEDIARIES[a] AND THE GOVERNMENT AND BANKING INSTITUTIONS, 1978–80

(IS million)

		Long-term assets and liabilities[b]			Current long-term transactions[c]			
		Receipts o/a assets (1)	Payments o/a liabilities (2)	Surplus of receipts over payments (1–2) (3)	Receipts (4)	Payments (5)	Surplus of receipts over payments (4–5) (6)	Total surplus (3+6) (7)
Government	1978	1,940	284	1,656	891	2,778	–1,887	–231
	1979	2,875	458	2,417	1,641	3,853	–2,212	205
	1980	6,691	880	5,811	3,840	8,915	–5,075	736
	First half	2,690	408	2,282	1,295	3,319	–2,024	258
	Second half	4,001	472	3,529	2,545	5,596	–3,051	478
Banking institutions[d]	1978	80	142	–62	295	487	–192	–254
	1979	76	93	–17	1,049	1,072[e]	–23[e]	–40[e]
	1980	195	692	–497	1,266	1,586	–320	–817
	First half	17	279	–262	448	710	–262	–524
	Second half	178	413	–235	818	876	–58	–293

[a] See note [a] to Table VIII-B5.

[b] Deposits, loans, and securities (including interest and linkage differentials received and paid). In the case of the government col. 1 consists mainly of repayments of past deposits by the Accountant General, and col. 2 of repayments of deposits of the Accountant General with the capital market intermediaries and Finance Ministry participation in savings scheme grants.

[c] Deposits, loans, and sales and purchases of securities. Col. 4 consists mainly of sums redeposited by the government.

[d] The commercial banking system, less medium- and long-term transactions included in the data on the capital market intermediaries.

[e] Revised datum.

SOURCE: Bank of Israel estimates.

Table VIII–B7

DOMESTIC SOURCES AND USES OF FUNDS FOR THE GOVERNMENT'S MEDIUM- AND LONG-TERM FINANCIAL TRANSACTIONS,[a] 1978–80

(Gross flows in IS million)

	1978	1979	1980		
			Total	1st half	2nd half
Sources					
1. Sale of government bonds (voluntary)	1,226	2,278	5,220	1,392	3,828
2. Financial institution deposits of earmarked security issue proceeds	1,523	1,936	4,630	1,893	2,737
3. Nonearmarked deposits of commercial banks and financial institutions	420	511	959	409	550
4. Repayment of deposits with financial institutions	277	443	836	406	430
5. Direct repayment of credit	57	75	428	164	264
6. Receipts o/a of the government's securities portfolio (incl. sales of shares from the portfolio)	13	4	97	87	10
7. Surplus of domestic sources (–) or uses (+)—residual	850	588	1,910	1,130	780
Total domestic sources	**4,366**	**5,835**	**14,080**	**5,481**	**8,599**
Uses					
1. Redemption of government bonds	1,149	1,195	2,108	984	1,124
2. Repayment of financial institution deposits of earmarked security issue proceeds	994	990	2,094	827	1,267
3. Repayment of nonearmarked deposits of commercial banks and financial institutions	48	117	394	117	277
4. Savings scheme grants (in place of interest) and interest compensation to pension funds	47	97	235	137	98
5. Deposits in financial institutions for granting loans	889	1,641	3,852	1,295	2,557
6. Credit provided directly	433	748	2,071	879	1,192
7. Purchase of shares and bonds	19	21	69	33	36
8. Net payments o/a of exchange rate and linkage insurance	787	1,026	3,257	1,209	2,048
Total domestic uses	**4,366**	**5,835**	**14,080**	**5,481**	**8,599**

[a] This table is based on flows of funds between the government and the rest of the economy, including financial transactions between the government and the local authorities.

SOURCE: Bank of Israel estimates.

Table VIII-B8

MARKET VALUE OF SECURITIES LISTED FOR TRADING ON THE TEL AVIV STOCK EXCHANGE, 1976-80[a]
(IS billion)

	Market value			Weight in total securities held by the public (%)			Percent real increase in market value		
	1976	1979	1980	1976	1979	1980	1978	1979	1980
A. Bonds									
1. Linked to and traded in foreign currency	0.34	1.19	2.37	8.8	7.2	4.1	-7.3	-19.6	-14.5
2. Index-linked issued to the public[b]	1.52	10.7	30.11	39.3	65.0	51.6	23.4	16.4	20.8
3. Option-type loans (linked and unlinked)	1.43	0.2	0.17	36.9	1.2	0.3	-74.1	-84.5	63.5
4. Double-option (linked to the index or dollar)	—	0.7	1.9	—	4.3	3.2	—	18.3	16.5
5. Estimated bonds not yet listed for trade[c]	0.14	0.02	0.44						
6. Total bonds	**3.43**	**12.81**	**34.99**	**88.7**	**77.8**	**60.0**	**-6.5**	**-3.7**	**17.3**
Thereof:									
7. In commercial banks' portfolio	0.53	2.9	9.3	13.7	17.6	15.9	-2.1	33.2	37.7
8. In Bank of Israel portfolio	0.15	1.13	2.27	3.9	6.9	3.9	6.5	30.4	-13.8
9. Estimated holdings of the public[d] (6-7-8)	**2.75**	**8.78**	**23.42**	**71.1**	**53.3**	**40.1**	**-8.3**	**-14.4**	**14.5**
B. Shares and convertible securities[e]									
10. Traded in Israeli currency	1.07	7.9	35.85	27.6	48.0	61.5	17.0	-16.8	94.8
11. Traded in foreign currency	0.1	0.2	0.35	2.6	1.2	0.6	-39.2	-47.4	-24.9
12. Total shares and convertible securities	**1.17**	**8.1**	**36.2**	**30.2**	**49.2**	**62.1**	**15.1**	**-17.9**	**91.8**
13. In commercial banks' portfolio	0.05	0.42	1.3	1.3	2.6	2.2	15.7	-17.2	32.9
14. Estimated holdings of the public (12-13)	1.12	7.68	34.9	28.9	46.7	59.8	15.0	-18.0	95.1
C. Total bonds and shares held by the public (9+14)	**3.87**	**16.46**	**58.32**	**100.0**	**100.0**	**100.0**	**1.5**	**-16.1**	**52.1**

[a] Excludes securities not intended to be listed for trade, such as certain institutional bonds.
[b] Excludes bonds issued to institutional investors.
[c] The face value plus accrued linkage differentials and interest.
[d] Since institutional investors also hold bonds that were issued to the public, this estimate is biased upward; includes investment through mutual funds.
[e] Includes shares held by institutional investors.
SOURCE: Tel Aviv Stock Exchange and Bank of Israel.

Table

STOCK EXCHANGE

	Bonds[a]				
		Linked to c-o-l index		Linked to exchange rate or traded in foreign currency	
	Total	Short-term	Medium- and long-term		Double-option
					IS
1977	533	288	209	36	—
1978	724	300	337	46	41
1979	1,870	272	1,458	54	86
1980	3,656	203	3,240	123	90
					Percent annual
1978	35.8	4.1	61.2	27.7	—
1979	158.2	-9.4	332.6	17.3	109.7
1980	95.5	-25.4	122.2	127.7	4.6
					Weight in total Stock
1977	29.6	16.0	11.6	2.0	—
1978	30.4	12.6	14.2	1.9	1.7
1979	43.6	6.3	34.0	1.3	2.0
1980	21.6	1.2	19.2	0.7	0.5

[a] Excludes trade in unlinked bonds and the Short-Term Loan.

[b] Traded off the floor—according to reports of Stock Exchange members; excludes convertible bonds.

SOURCE: Tel Aviv Stock Exchange and Bank of Israel calculations.

VIII-B9

TURNOVER, 1977–80

Convertible securities	Shares		Total securities	Total shares traded on and off the floor[b]	
	Total	Commercial banks		Total	Commercial banks
million					
129	**1,135**	**542**	**1,797**	**2,186**	**1,200**
223	1,436	774	2,383	3,247	2,258
222	2,197	1,390	4,289	6,817	5,316
812	12,484	7,276	16,952	32,804	23,048
increase					
72.9	26.5	42.8	32.6	48.5	88.2
–0.4	53.0	79.6	80.0	109.9	135.4
265.8	468.2	423.5	295.2	381.2	333.6
Exchange turnover (%)				**Stock Exchange trade as a percent of total trade**	
7.2	63.2	30.2	100.0	51.9	45.2
9.4	60.2	32.5	100.0	44.2	34.3
5.2	51.2	32.4	100.0	32.2	26.1
4.8	73.6	42.9	100.0	38.1	31.6

Table VIII-B10

DOMESTIC SECURITY ISSUES AND NET CAPITAL MOBILIZED, 1977-80[a]

(IS million)

	Bonds sold to the public[b]				Shares and convertible securities (5)	Total net capital mobilized from the public (4+5) (6)	Tradable bonds issued for savings schemes			
	Sales (1)	Redemption (2)	Net Bank of Israel purchases on and off the floor (3)	Net capital mobilized (1-2-3) (4)			Sales (7)	Redemption[c] (8)	Net Bank of Israel purchases (9)	Net capital mobilized (7-8-9) (10)
1977	122	433	24	-335	397	62	—	290	—	-290
1978	1,067	1,523	-26	-430	554	124	189	439	—	-250
1979	1,572	1,456	218	-102	204	102	284	286	96	-98
1980	3,399	1,182	-264	1,481	1,432	2,913	614	732	42	-160
January	12	177	-7	-158	71	-87	—	28	42	-70
February	6	172	-31	-135	2	-133	—	17	—	-17
March	84	125	-14	-27	7	-20	—	47	—	-47
April	150	262	-53	-59	45	-14	107	50	—	57
May	296	107	-19	208	151	359	237	87	—	150
June	185	154	-12	43	129	172	65	102	—	-37
July	741	186	-10	565	361	926	162	43	—	119
August	898	122	-6	782	204	986	—	38	—	-38
September	89	111	4	-26	303	277	—	62	—	-62
October	143	153	-7	-3	43	40	—	86	—	86
November	366	213	-62	215	71	286	—	60	—	-60
December	429	400	-47	76	45	121	43	112	—	69

[e] Revised data. Excludes compulsory loan issues and redemption of nontradable compulsory loans. Bonds were purchased in the secondary market as cover for savings schemes; consequently, the data on issues for the schemes are biased downward.

[b] Includes sales to and redemption of bonds purchased by the financial sector, other than for savings schemes (until 1978), of the type issued to the public.

[c] The data are biased downward since they do not include certain interest receipts on bonds in the banks' portfolio.

SOURCE: Bank of Israel calculations.

Table VIII-B11

MONTHLY OVERALL RATE OF RETURN ON LISTED SECURITIES,[a] MUTUAL FUNDS, THE DOLLAR, AND DM, 1976–80
(December 1979=100)

	Indexed bonds		Bonds traded in foreign currency	Shares		Foreign currency deposits		Mutual funds
	Total	80% indexed		Total ordinary and preferred[b]	Commercial banks	German mark	Dollar[c]	
1976	22.0	—	17.2	21.1	15.5	17.3	21.9	24.0
1977	31.3	32.4	43.9	40.5	32.0	34.2	38.7	37.8
1978	50.2	48.4	52.8	62.0	48.8	49.6	50.2	53.3
1979	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
January	106.8	107.2	104.6	117.6	111.2	104.8	105.6	108.6
February	110.7	108.5	109.7	129.9	120.0	110.3	113.5	113.2
March	123.1	122.2	109.2	133.5	129.2	106.1	120.1	120.9
April	136.7	135.7	118.5	146.3	135.0	119.0	125.7	134.6
May	151.5	150.6	131.8	160.9	150.1	128.8	135.5	149.0
June	157.9	153.8	144.8	182.7	167.2	142.0	147.1	160.4
July	171.5	171.3	153.4	223.8	203.9	148.1	155.7	176.8
August	181.5	181.9	160.0	209.5	191.8	157.8	166.6	182.5
September	183.1	182.6	168.6	221.5	198.5	166.0	177.5	188.6
October	202.2	202.0	180.0	258.7	232.5	170.6	192.6	207.7
November	238.3	241.3	192.3	294.3	254.3	185.9	212.2	240.9
December	257.2	259.2	206.4	379.5	327.5	198.7	231.9	271.2
				Real overall rate of return (%)				
Jan.–June	5.7	3.0	–3.0	22.3	11.9	–5.0	0.4	7.4
July–Dec.	4.5	8.1	–8.7	33.2	25.6	–10.3	1.1	8.4
Jan.–Dec.	10.4	11.3	–11.4	62.9	40.6	–14.7	1.4	16.4

[a] From 1977 until November 1979 data are for the 23rd of each month; previously indexes were calculated for the end of the month and excluded interest payments and cash dividends. Since December 1979 the data are calculated for the end of the month.

[b] Excludes shares traded in foreign currency; the weight of preferred shares in the total is very low.

[c] Before 1977 the Natad dollar.

SOURCE: Central Bureau of Statistics; foreign currency and mutual funds—Bank of Israel.

Table VIII–B12

MARKET VALUE OF EXISTING SHARES BY ISSUING GROUP AND NEW ISSUES OF SHARES AND CONVERTIBLE SECURITIES,[a] 1980

(IS million)

	Market value of listed shares and convertible securities			Weight of group in total issues (%)					Weight of new issues in 1980 in total market value of group's shares at end-1979 (%)
	Weight of group in total market value, end of 1980		Percent real increase in market value of shares, 1980				1980		
	IS million	%		1977	1978	1979	%	IS million	
Commercial banks and bank holding companies	23,323	64.5	70.6	70.0	59.4	63.1	70.3	1,005.8	17.1
Mortgage banks	1,596	4.4	116.8	5.0	7.5	0.0	4.6	65.2	20.6
Specialized financial institutions	486	1.3	–7.4	1.7	0.5	2.0	1.6	22.7	10.1
Insurance	799	2.2	164.8	5.0	5.1	5.6	5.7	81.9	63.2
Total financial sector	**26,204**	**72.4**	**72.0**	**81.7**	**72.5**	**70.7**	**82.2**	**1,775.6**	**18.0**
Commerce and services	683	1.9	311.9	0.8	0.3	2.3	2.6	37.5	52.7
Land, building, development, and citrus[b]	1,562	4.3	183.9	1.9	6.9	5.3	7.1	101.7	43.1
Industry	4,392	12.1	313.0	12.4	11.4	15.4	3.6	51.9	11.4
Investment and holding companies	3,366	9.3	80.8	3.2	8.9	6.3	4.4	63.2	7.9
Total	**36,207**	**100.0**	**91.9**	**100.0**	**100.0**	**100.0**	**100.0**	**1,429.9**	**17.7**

[a] Excludes stock dividends, conversion of convertible bonds, issues not against cash, and existing shares listed for trade on the Stock Exchange.

[b] Includes an oil exploration company founded in 1978, which issued IS10 million worth of shares.

SOURCE: Tel Aviv Stock Exchange and Bank of Israel.

Table VIII-B13

OVERALL RATE OF RETURN INDEX FOR LISTED ORDINARY AND PREFERRED SHARES, 1975–80

(December 1979=100)

End of period	General Stock Exchange index	Insurance, finance, and banks				Investment companies	Industry	Commerce and services	Land, building, development[a]
		Total	Commercial banks	Mortgage banks	Specialized financial institutions				
1975	15.2	12.2	11.1	21.6	26.9	14.8	43.5	34.6	23.6
1976	21.1	17.6	15.5	37.0	38.4	21.3	63.0	45.9	39.5
1977	40.5	37.2	32.0	88.5	70.0	34.4	83.8	73.1	66.3
1978	62.0	54.4	48.8	94.2	86.9	72.9	111.0	83.7	124.7
1979	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1980									
March	133.5	131.4	129.2	154.5	139.6	147.9	134.7	144.1	127.1
June	182.7	172.4	167.2	235.6	182.0	207.6	241.3	250.9	208.8
September	221.5	205.5	198.5	300.6	215.8	218.8	375.9	314.1	279.3
December	379.5	337.4	327.5	448.4	297.3	392.7	756.5	573.6	650.2
Real change in 1980 (%)									
December levels	62.9	44.8	40.6	92.5	27.6	68.6	224.8	146.2	179.1
Annual average[b]	10.6	16.9	18.3	12.6	-8.4	-5.3	5.1	14.4	-23.5

[a] Until 1976 includes citrus.

[b] Deflated monthly by the consumer price index.

SOURCE: Central Bureau of Statistics.

Table VIII-B14

BANK OF ISRAEL OPERATIONS ON THE STOCK EXCHANGE, 1977-80

(IS million)

				1980		
					Monthly average	
	1977	1978	1979	Total	Jan.-June	July-Dec.
Net purchases[a]	41.5	9.7	160.5	-231.7	-19.9	-18.7
Volume of trade	72.0	179.3	610.4	347.5	36.1	21.8
Weight in total trade (%)[b]	6.8	12.4	16.3	4.8	8.7	2.7

[a] Does not include the Short-Term Loan or transactions off the floor. Net purchases in Table VIII-B10 include redemptions and purchases of newly issued bonds for the Bank of Israel's portfolio, and so they differ from the data presented here.

[b] Until 1977 trade in indexed and option-type bonds; since 1978 also double-option bonds (dollar- or index-linked).

Table VIII-B15

AVERAGE REAL NET BOND YIELDS TO MATURITY, MONTHLY, 1979-80

(Percentages)

Years to maturity	Indexed		Traded in foreign currency
	4-6	8-10	5
1979			
May	1.4	2.7	7.1
June	0.9	2.5	7.5
July	0.3	2.2	7.9
August	1.0	2.0	7.1
September	2.5	2.8	7.7
October	3.4	3.2	7.1
November	3.6	3.2	10.5
December	3.6	3.5	9.2
1980			
January	3.6	3.3	8.1
February	3.6	3.5	9.2
March	2.3	2.7	10.9
April	1.7	2.3	10.9
May	1.8	2.5	8.8
June	1.8	2.6	8.1
July	2.0	2.6	8.4
August	1.4	1.8	8.8
September	2.5	2.6	9.5
October	3.3	2.9	10.2
November	2.5	1.9	11.7
December	1.8	1.7	12.7

NOTES:

1. The yields shown in this table are averages of end-of-week data for government bonds.
2. The nominal yields were deflated by the consumer price index.
3. Bonds traded in foreign currency are represented by Hollis bonds.
4. The yield on bonds traded in foreign currency is in dollar terms. If, for example, a 10 percent devaluation is expected, the real expected yield on bonds traded in foreign currency is 7 percent, instead of 5 percent in dollar terms. If a real upward revaluation of 10 percent is expected, the real return will be 3 percent.
5. The yield to maturity of original-issue bonds linked 80 percent to the consumer price index was 2.3 percent, assuming a 30 percent annual inflation rate (1.9 percent assuming an 80 percent inflation rate). The yield on fully indexed bonds issued now is 1.9 percent.

Table

MUTUAL FUND ASSETS AND THEIR COMPOSITION,

(IS

Classification of fund by specialization[a]	Composition of assets portfolio,[b] 31.12.1980 (%)			Assets, at market value (end of year)	
	Indexed and option bonds	Foreign currency	Shares in Israeli currency	1979	1980
Indexed securities	88.4	4.5	7.1	1,925	7,070
Foreign currency	5.7	92.1	2.2	188	236
Shares and dual shares–foreign currency	3.4	5.2	91.3	23	742
Dual foreign currency–indexed	59.3	33.5	7.2	712	1,270
Dual shares–indexed	38.1	5.8	56.1	154	550
Mixed with guaranteed indexed	53.9	21.1	25.0	1,090	1,235
Mixed with guaranteed foreign currency	6.1	77.9	16.0	50	52
Mixed with guaranteed shares	33.0	7.7	59.3	14	409
Pure mix	46.0	17.4	36.6	151	491
Money market fund	50.5	9.1	40.4	—	1,587
Total funds	**66.6**	**11.7**	**21.7**	**4,307**	**13,642**

[a] A "speciality" fund is one which invests at least 75 percent of its assets in a particular category. A "dual" fund is one where the weight of the two asset categories comes to at least 80 percent and that of each category to at least 30 percent. A "mixed" fund is one which invests at least 50 percent of its assets in a particular category. A "money market" fund is one with no spread between its bid and ask price. A "pure mix" refers to those funds not included in the above classification.

VIII–B16

NET ISSUES, AND RATES OF RETURN, 1980

million)

Net issues in 1980[c]			Real rate of return weighted by market value of funds, 1980 (%)			Standard deviation of real monthly rate of return (%)[d]
Jan.-June	July-Dec.	Jan.-Dec.	Jan.-June	July-Dec.	Jan.-Dec.	
405	344	749	57.8	64.4	159.4	5.6
-33	-89	-122	47.7	42.5	110.5	6.8
131	289	420	151.7	135.8	493.6	21.4
-125	244	119	51.0	56.8	136.7	5.5
14	894	908	108.7	106.4	330.8	15.2
-146	-88	-234	65.7	69.1	180.2	7.2
20	-8	12	55.4	53.6	138.6	6.0
39	89	128	91.5	112.3	306.5	16.2
-12	-68	-80	75.6	81.4	218.5	9.9
—	228	228	—	—	—	—
293	**1,835**	**2,128**	**69.8**	**72.2**	**192.4**	**7.6**

[b] Does not add up to 100 percent because of the omission of cash and the rounding of figures.

[c] Mutual fund shares sold less redemptions, on a cash basis.

[d] The standard deviation measures the risk associated with quarterly changes in the real return on mutual fund shares in the last 18 months. The data here are not comparable with the standard deviations of the returns on other financial assets which appear in Table VIII–11, as here they are calculated as three-month moving averages and not on a monthly basis.

Table VIII-B17

FLOW OF SAVINGS IN SOCIAL INSURANCE FUNDS,[a] 1978-80

(IS million)

				Percent annual real increase[b]	
	1978	1979	1980	1979	1980
Deposits					
Pension funds	348	778	1,947	21.1	11.0
Provident funds	636	1,142	2,886	2.8	7.2
Financial sector	526	912	2,316	-0.4	9.2
Histadrut and companies	110	230	570	18.7	-0.1
Severance pay funds	114	281	678	42.9	0.0
Other funds	145	277	842	8.4	29.5
Total	**1,243**	**2,478**	**6,353**	**12.3**	**10.0**
Payments to members					
Pension funds	265	490	1,245	3.1	14.0
Provident funds	163	324	742	10.5	-0.1
Financial sector	123	269	585	19.8	-0.1
Histadrut and companies	40	55	157	-18.0	13.5
Severance pay funds	63	145	349	27.3	1.7
Other funds	58	108	342	0.5	35.7
Total	**549**	**1,067**	**2,678**	**7.8**	**9.8**
Net accumulation					
Pension funds	83	288	702	76.1	5.6
Provident funds	473	818	2,144	0.2	10.4
Financial sector	403	643	1,731	-6.7	14.5
Histadrut and companies	70	175	413	40.7	-0.1
Severance pay funds	51	136	329	63.1	-0.1
Others funds	87	169	500	13.8	25.7
Total	**694**	**1,411**	**3,675**	**15.8**	**10.1**

[a] The social insurance funds are classified according to function and not the institutional division used previously.

[b] Deflated by the semiannual average change in the consumer price index.

SOURCE: For 1978 and 1980—based on Central Bureau of Statistics data; for 1979—Bank of Israel.

Table VIII-B18

BALANCE SHEET OF SOCIAL INSURANCE FUNDS, 1978-80[a]

(IS million)

				Percentage distribution		
	1978	1979	1980	1978	1979	1980
Assets						
Securities	10,306	23,025	65,618	94.8	96.2	95.2
Loans to members[b]	177	244	325	1.6	1.0	0.5
Deposits and loans to others	155	120	1,373	1.4	0.5	2.0
Fixed assets	78	160	737	0.7	0.7	1.1
Employers' debt	43	99	239	0.4	0.4	0.3
Accrued interest and indexation increments receivable and other current assets	110	290	639	1.1	1.2	0.9
Total assets	**10,869**	**23,938**	**68,931**	**100.0**	**100.0**	**100.0**
Liabilities						
Pension reserve	4,486	9,592	25,853	41.3	40.1	37.5
Provident and advanced study reserve	4,921	11,065	33,939	45.3	46.2	49.2
Severance pay, social benefit, and other reserves	1,116	2,407	5,945	10.3	10.0	8.6
General and other reserves	26	14	16	0.2	0.1	0.1
Auxiliary reserve and undistributed profits	264	764	2,142	2.4	3.2	3.1
Current liabilities	56	96	1,036	0.5	0.4	1.5
Total liabilities	**10,869**	**23,938**	**68,931**	**100.0**	**100.0**	**100.0**

[a] Linkage increments are included in the relevant balance sheet items.
[b] Directly and through banks and financial institutions.
SOURCE: 1978, 1980—Central Bureau of Statistics; 1979—Bank of Israel.

Table VIII–B19

SOURCES AND USES OF SOCIAL INSURANCE FUNDS, 1978–80

(IS million)

Sources	1978	1979	1980	Uses	1978	1979	1980
Net savings deposits[a]	694	1,411	3,675	Net transfers[b]	616	1,184	3,086
Repayment of medium- and long-term loans	90	112	177	Medium- and long-term credit	107	169	335
				Net short-term credit (up to two years)	15	40	–27
				Net change in other short-term uses[c]	–10	31	309
				Surplus of expenditure over income and net purchase of real assets	56	99	149
Total sources	**784**	**1,523**	**3,852**	Total uses	**784**	**1,523**	**3,852**

[a] Net of payments to members; contributions to severance pay funds are treated as household savings.
[b] Net purchase of securities from original issues and in the secondary market.
[c] Includes the increase in outstanding short-term assets less the increase in short-term liabilities, as well as adjustment items.
SOURCE: 1978 and 1980—based on Central Bureau of Statistics data; 1979—Bank of Israel estimates.

Table VIII-B20

INCOME, OUTGO, AND ACCUMULATION OF LIFE INSURANCE COMPANIES IN ISRAEL,[a] 1978-80

(IS million)

	1978	1979[b]	1980
1. Income			
Premiums	224	421	955
Interest	58	115	336
Total	**282**	**536**	**1,291**
2. Outgo			
Payments to policyholders	77	131	319
Agents' commissions	37	62	150
Other current expenses	36	72	176
Gross profit[c]	26	38	85
Total	**176**	**303**	**730**
3. Surplus of income over outgo	106	233	561
4. Income from investment of life insurance funds	303	777	2,718
5. Accumulation (3+4)	**409**	**1,010**	**3,279**

[a] Israeli and foreign insurance companies in Israel and Lloyd's agents; before deducting reinsurance abroad and net of reinsurance in Israel.

[b] Revised data.

[c] Includes profits of reinsurers abroad.

SOURCE: Bank of Israel calculations based on Central Bureau of Statistics, *Insurance in Israel, 1978, 1979* and a preliminary CBS survey for 1980.

Table VIII-B21

GENERAL INSURANCE PREMIUM RECEIPTS,[a] 1978-80

	1978	1979[b]	1980
		IS million	
Total general premium receipts[c]	597	1,241	2,770
Motor vehicle insurance	246	489	956
Other insurance	351	752	1,814
		Percent annual increase	
Total general premium receipts	64.0	108.0	123.2
Motor vehicle insurance	67.0	98.6	95.5
Other insurance	61.0	114.5	141.2

[a] Of Israeli and foreign insurers and Lloyd's agents. Includes registration fees, including marine insurance and less reinsurance in Israel.

[b] Revised data.

[c] Includes registration and policy fees, collection fees, and other payments collected from policyholders.

SOURCE: Bank of Israel calculations based on Central Bureau of Statistics surveys.

Table VIII–B22

ASSETS AND LIABILITIES OF ISRAELI INSURANCE COMPANIES, 1978–80

	IS million			Percent		
	1978	1979[a]	1980	1978	1979[a]	1980
Assets						
Government or government-guaranteed bonds	1,209	2,372	6,273	60.4	61.4	66.3
Other securities	30	54	136	1.5	1.4	1.4
Loans on policies	19	38	92	1.0	1.0	1.0
Other loans	149	206	376	7.4	5.3	4.0
Time deposits	33	76	145	1.6	2.0	1.5
Real estate and investment in subsidiaries	101	140	312	5.1	3.6	3.3
Outstanding premiums	165	406	851	8.3	10.5	9.0
Sundry debtors	171	346	732	8.5	9.0	7.7
Cash and demand deposits	124	223	548	6.2	5.8	5.8
Total assets	**2,001**	**3,861**	**9,465**	**100.0**	**100.0**	**100.0**
Liabilities						
Paid-up share capital	64	84	144	3.2	2.2	1.5
General and other reserves	99	157	406	4.9	4.1	4.3
Life insurance reserve (less reinsurance)	941	1,907	5,095	47.0	49.4	53.8
General insurance reserve (less reinsurance)	205	414	1,012	10.2	10.7	10.7
Extraordinary risks reserve	53	96	217	2.7	2.5	2.3
Deposits of reinsurers	166	356	654	8.3	9.2	6.9
Pending and approved claims	371	691	1,584	18.6	17.9	16.8
Current liabilities	102	156	353	5.1	4.0	3.7
Total liabilities	**2,001**	**3,861**	**9,465**	**100.0**	**100.0**	**100.0**

[a] Revised data.

SOURCE: Bank of Israel calculations based on Central Bureau of Statistics surveys.