



Summary of Monetary Committee Discussion on Management of the Foreign Exchange Reserves and Committee Decisions of May 8, 2012

1. Quarterly reportage to the Monetary Committee about management of the reserves (first quarter of 2012)

Per decision of the Monetary Committee, representatives of the Market Operations Department reported to the Committee about the management of the reserves in the first quarter of 2012. The level of the reserves, the return on the portfolio, and the main exposures of the portfolio to currency, price, and credit risks were presented.

2. Quarterly reportage to the Minister of Finance about management of the reserves (first quarter of 2012)

Background

In accordance with Section 40(c) of the Bank of Israel Law and the Memorandum of Understanding between the Bank of Israel and the Minister of Finance, representatives of the Market Operations Department presented the Committee with the quarterly report on foreign exchange reserve management for presentation to the Minister of Finance.

Decision of the Monetary Committee

The Committee approved the report.

3. Request for revision of the strategic currency composition

Background

The maximum deviation of the strategic composition of currencies relative to the numeraire composition was set (at 10%) by the Monetary Committee, which also determines the currency composition of this deviation. Under the division of powers that the Committee approved, any change in the composition of this deviation—upward or downward relative to the numeraire—must be approved by the Committee. The Head of the Finance Division, speaking on behalf of the Market Operations Department, asked the Committee to give the Department the discretion to revise the deviation of the strategic composition relative to the numeraire in cases where the Department wishes to *reduce positions relative to the numeraire, thereby mitigating volatility*. *The Committee acceded to the Department's request: the Department will immediately report to the Monetary Committee of any reduction in position. It was made clear that any (resumed)*

increase in volatility relative to the numeraire does require the Committee's approval.

Decision of the Monetary Committee

The Monetary Committee confirmed that the Market Operations Department may revise the strategic composition of currencies by reducing volatility relative to the numeraire without obtaining the Committee's prior approval, provided it apprise the Committee of the change as soon as it is made.

The Committee approved the request by majority vote. One member voted against.

Rationale for the approval: the Committee members believed that as long as the change is made in the direction of convergence toward the numeraire, approval should not be needed. Since the numeraire reflects the neutral composition of currencies, if the Market Operations Department deems it correct to reduce the exposure to currencies that are not included in the numeraire, the Committee should be apprised of this but there is no need to wait for the Committee's approval because the time factor is important here. The Committee members believed that this one-way flexibility should be allowed.

Dissenting view: Since it is the Committee that approved the strategic composition of currencies, the Committee is responsible for this composition and should have to approve any change in it—even in the direction of convergence toward the numeraire (narrowing of positions). This is because even reversion to the numeraire—not only an increase in volatility relative to the numeraire—may aggravate risk today. The Committee chose the strategic composition that represents the risk that the Committee is interested in taking, and it should not be taken as a given that narrowing of positions is the Committee's preference. The right thing to do, the dissenter maintains, is to present to the Committee, for its approval, with any proposal that would change the level and composition of the deviation of the strategic composition relative to the numeraire.

Decision adopted on May 8, 2012.

Participants in the discussion:

Members of the Monetary Committee

Prof. Stanley Fischer, Governor of the Bank of Israel, Chairperson

Prof. Alex Cukierman

Dr. Karnit Flug, Deputy Governor of the Bank of Israel

Prof. Reuben Gronau

Prof. Rafi Melnick

Mr. Barry Topf, Senior Advisor to the Governor on Monetary Policy Issues

Other participants in the discussion:

Andrew Abir, Director of Market Operations Department

Eddy Azoulay, Chief of Staff to the Governor

Tal Biber, Head of Dealing Unit in Market Operations Department
Francoise Ben-Zur, Head of Finance Division in Market Operations Department
Guenia De Mayo, Head of Risk Management Unit in Market Operations Department
Hagit Waknin, Economist in Market Operations Department
Roe Levy, Economist in Market Operations Department
Esti Schwartz, Secretary of the Monetary Committee and the Supervisory Council