

CHAPTER XVI

MONEY SUPPLY, CREDIT, AND BANKING INSTITUTIONS

1. MAIN DEVELOPMENTS

Following two years of rapid monetary expansion, the trend was checked in 1979. Both liquid assets and credit rose rapidly in nominal terms, but the price level went up even faster. Consequently, the main monetary variables contracted in real terms.¹ This, however, must be viewed against the background of the huge expansion of 1978. Thus a comparison of annual averages shows that while real liquid assets remained unchanged, bank credit (except for fuel) was enlarged by 4 percent in real terms, as compared with a real increase of 8 percent in domestic uses. These developments reflect conflicting trends in the determinants of the monetary scene. During the first half of 1979 there was a contraction, caused by the Bank of Israel's action to increase the price of imported capital, a sharp drop in the government liquidity injection, and the growth of the basic deficit in the private sector's balance of payments. During the second half of the year, although the government injection swelled appreciably, the monetary contraction nevertheless continued, due to a further and very rapid growth in the amount of money absorbed through the balance of payments, as well as to the Bank of Israel's policy of restricting nondirected credit.

In 1977-78 Israel's money supply expanded rapidly. In 1977 the growth was fed by the government liquidity injection and by directed export credit extended by the Bank of Israel. In 1978 these factors were reinforced by the expansionary effect of the foreign currency liberalization. The decontrolling of capital movements to and from the country led to large short-term capital imports during the third quarter of 1978, owing to the restrictive monetary policy adopted on the domestic front and to the weakening of devaluation expectations, which had created a substantial gap between domestic interest rates and interest rates abroad. Fears that the foreign currency liberalization would be restricted raised capital imports to a peak in December 1978. Consequently, the supply of liquid assets increased substantially, and the real devaluation trend was temporarily checked.

The above developments prompted the Bank of Israel to restrain monetary ex-

¹To analyze the data in real terms, the rates of nominal change were deflated by the consumer price index. As regards the annual average, this index did not differ in 1979 from the implicit deflator for domestic uses (excluding direct defense imports).

pansion at the beginning of 1979 by limiting capital imports. At first, administrative checks were imposed, but in April an interest surcharge of 12 percent was levied on nondirected credit in foreign currency, while quantitative restrictions were maintained on nondirected credit in local and foreign currency. The dearer cost of credit from abroad began to make itself felt during the second quarter, when the private sector's short-term capital imports declined markedly. Moreover, during the first half of 1979 the government's liquidity injection contracted sharply, with the public sector's activities resulting in the absorption of some IL3 billion from the monetary system. Even taking into account the amount of money put into the economy by the Jewish Agency and the Bank of Israel, the total injection actually decreased in nominal terms during this period. These trends in the money supply, together with the growth in the basic deficit in the private sector's balance of payments, caused a nominal increase of 29 percent in the money base during the first half of 1979, compared with a 34 percent rise in the consumer price index.

Although the government's liquidity injection grew appreciably during the second half of the year, the steep rise in fuel prices, which greatly increased the absorption through the balance of payments, still led to a monetary squeeze. The increase in the government's liquidity injection was faster than the rise in the balance of payments deficit, and this could have moderated the contraction of liquid assets. However, the private sector preferred to purchase foreign exchange in the form of foreign banknotes to repay debts abroad, and this reduced the money supply. Accordingly, in the second half of 1979 the money base again expanded more slowly than the rise in the price level (46 percent as against 58 percent).

The changes in the money base and in the required liquidity ratios were supposed to determine the supply of assets and credit. However, the banks did not comply with the liquidity requirements and were perpetually in a deficit position. The size of these deficits is determined, on the one hand, by their cost to the banks and, on the other hand, by the demand for credit. In order to prevent the breakdown of monetary policy, the Bank of Israel acted throughout the year to limit the growth of nondirected credit. It fixed loan ceilings and made it prohibitive to expand credit beyond these ceilings by granting the banks low-interest loans to cover their deficits, on condition that they do not exceed the ceilings imposed. These measures slowed the growth of local and foreign currency credit, while real interest rates rose appreciably, even on credit granted in Israeli currency. On the other hand, directed credit for export continued to expand rapidly. All in all, credit grew more slowly than the volume of economic activity: total bank credit (except for fuel) increased 102 percent over the year; this represented a real decrease of 5 percent. However, the annual average volume of credit was some 4 percent larger in real terms in 1979 than in 1978, while the real increase in domestic uses (excluding direct defense imports) was approximately 8 percent.

The monetary contraction also affected liquid assets. Raising real interest rates on credit without hiking interest rates on assets created a significant gap between the two, so that the public preferred to reduce its liquid assets rather than accept credit. Thus, the liquid assets of the public (which include, besides money, time deposits, foreign currency deposits, and bonds) increased by 83 percent during the year, whereas the consumer price index climbed by 111 percent. As the liquid assets portfolio contracted, the weight of unlinked assets—especially money—continued to diminish markedly. This considerably lessened the possibility of blocking the rise in prices by eroding the value of unlinked assets.

The main monetary policy measures implemented during 1979 were the raising of real interest rates (through higher interest rates on foreign currency credit) and the restriction of nondirected credit in IL, which also led to an increase in the real interest paid on local currency credit. These steps helped to reduce demand for goods and services during the second half of the year and thus contributed to the economic slowdown in the final part of the year and especially during the first quarter of 1980. Monetary policy became more effective at the end of the year, since the curbing of credit became more stringent in November. Business firms were therefore compelled to use a larger proportion of their own capital, which costs them much more than credit since expenditure on credit is tax-deductible.

The decline in demand was reflected by a drop in private consumption and in investments, while the rise in public consumption and exports continued. These were the results of focusing policy measures on constraining private sector demand, while government demand mounted further and export incentives increased. It should be noted that encouraging exports through directed credit distorts the development of the various export branches and limits the effective scope of monetary policy because of the dependence of the liquidity injection on the development of exports.

During the second half of 1979 the higher interest rates were reflected only by a deceleration of economic activity, while inflation began to flag during the first quarter of 1980. The continued rapid inflation was caused by the persistent rise of costs during the second half of 1979 (reflecting the abolition of subsidies, higher fuel prices, and wage increases) and by the expectations that the inflation would go on gathering momentum. Later, the measures introduced in November—in particular the drastic cuts in credit and real disposable wages—led to a change in expectations, which in turn contributed to the slowing of inflation in the first quarter of 1980. The cooling of inflation is likely to be only short-lived if the monetary restraint is not accompanied by the curtailing of government spending and the rise of production costs.

From a long-range viewpoint, the monetary policy of 1979 raises two problems:

First, a policy based only on credit restriction cannot be sufficiently effective, because it may lead to a contraction of tax revenue, postponement of tax payments, and a smaller volume of supplier credit to the government, which in turn would result in an offsetting increase in the government's liquidity injection. Secondly, the additional interest charges imposed on foreign currency credit raised the real interest rate far beyond normal levels, and if this high level were maintained economic growth might be adversely affected. There therefore seems to be little alternative to a monetary policy based chiefly on limiting the government's demand surplus and the liquidity injection generated thereby.

2. CAUSES OF THE MONETARY EXPANSION

(a) Background to Monetary Policy

In 1977 and 1978 monetary expansion proceeded at a rapid pace: credit rose substantially and so did the public's liquid assets. In 1977 the main factor was the liquidity injected by the public sector and the Bank of Israel, while in 1978 this was reinforced by the expansionary influence of short-term capital imports following the liberalization of foreign currency control. Once the economy was open to capital movements, the imposition of domestic monetary restraint led unexpectedly to a strong inflow of capital beginning in the third quarter of 1978. It attained significant proportions in the last quarter of 1978 and the beginning of 1979 (see Table XVI-3), chiefly because the weakened devaluation expectations created a gap between domestic and foreign interest rates, thus making it advantageous to take credit in foreign currency (see Table XVI-4). The fears towards the end of 1978 that capital imports might be restricted also contributed to the massive expansion of such imports.

The large capital imports of the last quarter of 1978 vindicated the expectations that there would be no devaluation in the near future, and indeed during this quarter the exchange rate of the Israeli pound was actually revalued upward in real terms. The above developments underscore the problems of conducting monetary policy under conditions of foreign currency liberalization. When the interest rate abroad plus the expected rate of devaluation is lower than the domestic interest rate, foreign capital begins to flow into the country, increasing the supply of foreign exchange and thus raising the exchange rate of the Israeli pound. This revaluation enlarges the current account deficit and thereby heightens long-term devaluation expectations. Yet, despite these stronger expectations, the rise of the exchange rate may be checked, whereas domestic inflation may continue to further undermine the profitability of exports. If this process continues, it may create additional balance of payments difficulties and restrain export expansion.

In 1978, while the inflation gathered momentum, the economy was in a state of

Table XVI-1
CHANGES IN THE LIQUID ASSET BASE, 1978-79
(IL billion)

	1978	1979				
		Total	I	II	III	IV
1. Total basic injection by public sector ^a	9.9	15.9	-1.0	-0.1	7.3	9.7
Thereof: Due to						
government operations	6.1	9.8	-2.4	-1.2	5.9	7.5
2. Directed Bank of Israel credit	11.6	17.5	2.0	3.4	3.7	8.4
3. Loans to banks	..	3.3	..	2.4	0.9	..
4. Other factors ^b	-1.1	3.5	1.2	0.6	1.0	0.7
5. Total exogenous injections (1+2+3+4)	20.4	40.2	2.2	6.3	12.9	18.8
6. Net foreign currency sales by private sector	-5.3	-27.5	-0.3	-3.4	-7.8	-16.0
Thereof:						
Purchases to finance basic balance						
of payments deficit	-5.0	-32.9	-6.9	-5.3	-14.1	-6.6
Short-term capital imports	-0.3	5.4	6.6	1.9	6.3	-9.4
7. Change in narrow liquid asset base (5+6)	15.1	12.7	1.9	2.9	5.1	2.8
Thereof:						
Change in narrow money base	4.5	2.8	-0.5	1.6	-1.0	2.7
Bonds held by public	-4.4	-1.0	1.8	0.8	3.0	-6.6
Local residents' foreign currency time						
deposits (Patam)	15.0	10.9	0.6	0.5	3.1	6.7
Increase (—) or decrease (+) in liquidity						
deficiencies	-2.3	-0.5	-1.2	-0.4	-2.4	3.5

^a The sector's injection as customarily defined plus net proceeds from the direct sale of bonds to the public.

^b Consists mostly of the absorption or injection generated by various items in the Bank of Israel's statement of income and expenses (such as interest paid on liquid assets in local and foreign currency, fines for liquidity deficits, etc.), Patam restitution deposits, and discrepancies between the balance sheets of the commercial banks and the Bank of Israel.

full employment. Accordingly, the Bank of Israel introduced measures to limit domestic monetary expansion in the middle of the year. But this attempt to check inflation also checked the natural development of the exchange rate. To prevent harmful effects on the exchange rate, the Bank of Israel then acted in December 1978 to restrain monetary expansion by making credit from abroad more expensive. First, foreign currency credit was subjected to deposit requirements, but these limitations were soon abolished and in their stead administrative restrictions were placed on capital imports. In April an additional direct interest charge of 12 percent per annum was imposed on nondirected credit in foreign currency and ceilings were placed on nondirected credit in both local and foreign currency.

(b) Growth of the Liquid Asset Base

Although in January 1979 substantial amounts of credit still flowed into Israel

Table XVI-2
LIQUID ASSET BASE, 1977-79^a
(IL billion)

	Percent increase during the period						
	1977	1978	1979		1978	1979	
			1st half	2nd half		1st half	2nd half
1. Change in narrow money base	..	4.5	1.1	1.7			
2. Narrow money base	15.9	20.4	21.5	23.2	28.3	5.4	7.9
3. Patam deposits of the public ^b	..	15.0	1.1	9.8			
4. Revaluation increments on Patam accounts	..	5.2	11.0	20.4			
5. Balance of Patam accounts ^b	12.9	33.1	45.2	75.4	156.6	36.6	66.8
6. Bonds held by public ^b	..	-4.4	2.6	-3.6			
7. Revaluation increments on bonds	..	17.2	15.9	29.6			
8. Balance of bond holdings	35.7	48.5	67.0	93.0	35.9	38.1	38.8
9. Change in liquid asset base (1+3+6)	..	15.1	4.8	7.9			
10. Revaluation increments (4+7)	..	22.4	26.9	50.0			
11. Total liquid asset base (2+5+8)	64.5	102.0	133.7	191.6	58.1	31.1	43.3

^a The balance of each asset at the end of the year equals the balance at the end of the preceding year plus the accumulation and revaluation increments during the year in question.

^b For a definition of "public" see note a to Table XVI-6.

Source: Money base — monthly balance sheets of the banking institutions; Patam deposits — balance sheet of the Bank of Israel; bonds — State Loans Administration and Table XVI-3.

from abroad, foreign currency credit was frozen in February. During the second quarter the private sector's short-term capital imports contracted sharply (see Table XVI-3).² The sharp rise in the cost of nondirected foreign currency credit contributed to the decrease in capital imports in this period, which occurred despite the continuing public sector liquidity absorption throughout the first half of the year. This absorption, side by side with the sustained growth of economic activity, might otherwise have led to a further expansion of capital imports. In January-June 1979 public sector operations siphoned off approximately IL1 billion³ (see Table XVI-1). Even allowing for the liquidity injection of the Bank of

² The reference here is to short-term capital imports, derived from the basic deficit in the private sector's balance of payments and its net purchases of foreign exchange from the Bank of Israel. There was a similar trend in the actual capital imports of the financial sector, but not in short-term capital imports as a whole (as defined in Chapter VI). The discrepancies between the two estimates have not been resolved; they stem from differing definitions and categorization of the various sectors in the balance of payments items (see also Chapter III and VI).

³ To analyze the influence of government operations on the money market it is necessary to add to the estimated liquidity injection the net capital raised by the government through the sale of bonds to the public (hereafter called the "basic injection"). It should be noted in this connection that a substantial proportion of the bonds purchased by the public do not represent the absorption of liquidity, since they are merely a temporary substitute for holding money.

Israel (chiefly through the provision of directed export credit), the total amount of money pumped into the economy during this period was some 17 percent smaller nominally than the annual average figure for 1978.

During the first half of 1979 the balance of payments deficit of the private sector worsened seriously. This reflected in part higher fuel prices and increased fuel stocks accumulated in the country. In January-June 1979 the real volume of fuel imports was 16 percent larger than their average level in 1978; fuel prices rose by some 28 percent. Moreover, the substantially larger deficit was not accompanied by a corresponding growth in long-term capital imports. Consequently, the basic deficit in the private sector's balance of payments was (in dollar terms) four times larger than the average deficit for 1978 (see Table XVI-3).

The reduced government's liquidity injection, the deceleration of short-term capital imports, and the larger absorption through the balance of payments contributed to the decline of the money base increment (see Table XVI-1). Table XVI-2 shows that, despite the value-linkage of a considerable portion of liquid assets (bonds and foreign currency deposits), the liquid asset base,⁴ including revaluation increments, expanded more slowly than the rate of inflation: 29 percent as against some 34 percent during the period January-June 1979.

During the second half of 1979 the public's real holdings of liquid assets continued to diminish, as did the real volume of credit. However, the factors behind this development differed markedly from those operating in the first half of the year. Whereas it absorbed liquidity during the first seven months of the year, the public sector proceeded to pump in an average of some IL3 billion a month later in the year (see Table XVI-1). This might have led to a huge monetary expansion, but, unconnected with this phenomenon, there was a further worsening in the private sector's balance of payments as a result of the rise in fuel prices (which, in dollars, were 59 percent higher in the second half of 1979 than in the first half). Consequently, another \$250 million was added to the current account deficit of the private sector (see Table XVI-3). This enormous increase, accompanied by the stagnation of long-term capital imports, helped to siphon off a sizable proportion of the government liquidity injection. However, it could not completely neutralize it, particularly in the last quarter of 1979, when the government added a large amount of purchasing power while the basic deficit in the private sector's balance of payments declined. The public used this extra money to purchase foreign exchange in excess of what was required to finance the basic deficit of the private sector. In other words, during the last quarter of 1979 capital, in the wider sense, was exported in the form of foreign debt repayment, direct investment abroad, and

⁴ The liquid asset base includes the money base in local currency, the outstanding balance of bonds, and the banks' liquid foreign currency assets held against Patam deposits.

Table XVI-3

BALANCE OF PAYMENTS OF THE PRIVATE SECTOR, 1978-79
(\$ million)

	1978					1979				
	I	II	III	IV	Total	I	II	III	IV	Total
1. Deficit on goods and services account	298	348	498	189	1,333	603	456	782	528	2,369
2. Long-term capital imports and unilateral transfers	227	328	239	307	1,101	269	268	278	346	1,161
3. Basic balance of payments deficit (1-2)	71	20	259	-118	232	334	188	504	182	1,208
4. Foreign currency purchased from Bank of Israel	317	112	227	-314	342	-3	147	282	493	919
5. Derived short-term capital imports (3-4)	-246	-92	32	196	-110	337	41	222	-311	289
6. Actual short-term capital imports	-174	62	172	360	411	425	101	406	49	981
7. Actual short-term capital imports, including errors and omissions	-37	-1	348	421	732	583	-222	399	-206	554

Source: Table VI-11.

purchases of foreign banknotes. Several indicators show that there was a significant increase in purchases of foreign banknotes for private asset portfolios during this quarter, due to fear that the nomination of a new Minister of Finance and the worsening of the balance of payments would result in restrictions on foreign exchange. This signifies that the contraction of the liquid assets portfolio of the private sector was smaller than would superficially appear.⁵ The foreign loan repayments and the accumulation of foreign currency in the form of cash may also have been connected with the intensification of devaluation expectations. This conclusion is reinforced by the larger weight of Patam deposits in the assets portfolio of the private sector during the last quarter and a real decrease in purchases of linked bonds.

To sum up, were it not for the substantial absorption through the balance of payments in the second half of 1979, we would have witnessed an increase in the liquid assets portfolio of the private sector, owing to the size of the government liquidity injections. Looking at the situation from a different angle, one can conclude that the expansion of domestic liquidity by the government limited the effects

⁵ Total liquid assets increased during the second half of 1979 by approximately 41 percent, as compared with a rise of some 58 percent in the consumer price index. If we regard the entire capital export of the last quarter of the year as augmenting the liquid asset holdings of the private sector, this increment will total approximately 47 percent (see Table XVI-6).

of the deterioration in Israel's terms of trade on economic activity in general and private consumption in particular.

(c) Components of the Liquid Asset Base

The government's operations, which absorbed some IL3 billion, were largely responsible for checking the monetary expansion during the first half of the year. The main factor was the much larger net credit obtained by the government from the public and from banking institutions; in addition, the demand surplus also declined in real terms during the months concerned. The net increment of credit received by the government (through sales of bonds and bank loans) is a reflection of the liquidity injection and government demand surplus. In the first half of 1979 the estimated injection due to the demand surplus barely rose in nominal terms as compared with the preceding six months, although prices climbed by some 34 percent. That the liquidity injection caused by the government demand surplus contracted in real terms is explained by the increase in tax revenues, which outpaced the growth in government spending.

During the second half of the year the trend changed. The volume of government payments climbed rapidly in real terms, while tax revenues declined. Accordingly, the government's liquidity injection swelled to IL18 billion during this period (see Table XVI-4). Although the precise reasons for the growth of government expenditures in this period remain unclear, several possible explanations can be suggested: the contraction of credit from government suppliers, following the restraints imposed on credit in the economy; the execution of payments for activities performed during the first half of the year; and perhaps an increase in the government's real outlays. If the policy of monetary restraint did in fact cause the postponement of tax payments and a contraction of credit to the government, this would indicate that the effectiveness of monetary policy is limited, unless the demand surplus is reduced simultaneously.

The liquidity injection by the Bank of Israel through directed credit expanded by 51 percent in 1979 (in nominal terms), but its real volume diminished. The pattern differed in the various economic branches: credit to the diamond trade dropped sharply, while credit to other exporters rose rapidly. It should be stressed that the total volume of export credit grew appreciably—in both domestic and foreign currency.

The substantial injection of directed credit for exports reflects a tendency to subsidize exports through cheap loans. This method creates numerous distortions, the most important of which is the unequal subsidization of export value added in the various branches.⁶ The method also limits the effectiveness of monetary policy,

⁶ For a full discussion of the distortions caused by subsidizing exports through directed credit, see the chapter on exports.

Table XVI-4

**PUBLIC SECTOR LIQUIDITY INJECTION, EXPENDITURE,
AND ESTIMATED DEMAND SURPLUS, 1978-79**

	Liquidity injection (1)	Net credit to the government ^a (2)	Injection due to demand surplus ^b (1+2) (3)	Tax revenues (4)	Estimated public sector payments (3+4) (5)
IL billion					
1978	10.7	10.3	21.0	98.9	119.8
First half	7.1	4.0	11.1	42.3	53.4
Second half	3.6	6.3	9.9	56.6	66.4
1979	14.8	24.1	38.9	196.4	235.3
First half	-3.3	13.0	9.7	81.1	90.8
Second half	18.1	11.1	29.2	115.3	144.5
Percent increase in 1979					
As against 1978	38.3	134.0	85.2	98.6	96.4
Second half as against first half	..	14.6	201.0	42.0	59.1

^a Net capital raised from the public and through savings schemes plus net bank credit to the government (including credit to the private sector in connection with development projects for which only annual data are available). The estimate also includes supplier credit to the government, for which no data are available.

^b The difference between total currency payments of the public sector (e.g. fiscal and financial operations) and total receipts, recorded on a cash basis. The demand surplus, as defined in Chapter X of this Report, is an estimate of the public sector's fiscal operations recorded at the time of implementation.

Source: Public sector liquidity injection—Table XVI-1; net credit to the government from sales of bonds—State Loans Administration; bank credit to the government—Examiner of Banks; tax Revenue—Chapter X.

since the size of the injection becomes dependent on the development of exports. In 1979 another factor made itself felt, which had been absent in 1978: the Bank of Israel extended credit to banking institutions so that they could cover their liquidity deficits. On the whole, however, this did not have an expansionary effect since the banks had to agree, in return, to limit the growth of nondirected credit in accordance with the ceilings set by the Bank of Israel.

The private sector's foreign currency purchases in 1979 were five times larger (in IL terms) during 1979 than in 1978 (see Table XVI-1), with most of the increase coming in the second half of the year. The main reason was the substantially enlarged basic deficit in the private sector's balance of payments. Additional factors were foreign debt repayment and purchases of foreign banknotes. It should be noted that despite the greater demand for foreign exchange during the second half of 1979, the real rate of exchange of the IL rose during this period in relation to a

representative basket of foreign currencies—and even more so as compared with the U.S. dollar.⁷ This happened even though the Bank of Israel acted throughout the year to prevent an upward real revaluation in the medium term, while permitting short-term fluctuations in order to reduce speculative capital movements.

(d) Credit Policy and the Interest Rate

The changing of the liquid asset base and liquidity ratios is supposed to determine the supply of liquid assets and credit. The commercial banks, however, do not abide by the liquidity regulations and they invariably run liquidity deficits, the size of which depends on their cost to the banks and on the demand for credit. Under its policy of monetary restraint the Bank of Israel decided in 1979 to restrict the expansion of credit and to make it prohibitive for the banks to exceed the ceilings set. In April 1979 it made loans available to the banks to cover their deficits, and in return the latter undertook to freeze nondirected foreign currency credit (in dollar terms) and to limit the growth of nondirected Israeli currency credit to approximately 3 percent a month.⁸ Since the average monthly rise in prices during this period was about 5 percent, this measure reduced the real volume of nondirected credit. At first the interest on the loans to the banks was set at 40 percent, but it was gradually raised until it reached 70 percent by the end of the year.⁹ A bank which deviated from its credit ceiling had its loan reduced by an identical amount. Since the interest was far below the going market rate, such deviations from the ceilings raised the cost of credit expansion prohibitively. Until August 1979 the banks adhered to these quantitative restrictions and even held small surpluses. Nevertheless, the banks' deficits grew rapidly—even in real terms—due chiefly to the nominal decrease in the liquidity injection, but also because the public continued to accumulate bonds and Patam deposits (see Table XVI-1).

In November 1979 the restrictions on nondirected credit were tightened further. The nominal volume of such credit was frozen at its June 1979 level, as part of a new policy and in view of the banks' exceeding the credit ceilings following a strike at Bank Leumi le-Israel. The freeze sharply raised the cost of extending credit, and the banks were consequently forced to reduce their nondirected credit, even in nominal terms. These developments indicate that restricting credit and increasing the cost of credit expansion proved effective in the final quarter of 1979, thus partly offsetting the expansionary effect of the government's liquidity injection.

⁷ The real rate of change in the IL exchange rate is defined as the change after adjusting for the difference between inflation in Israel and that abroad.

⁸ The actual arrangement was complicated. The monthly rate of expansion was fixed at about 4 percent until June and then reduced to 0-2 percent. The interval between changes in the ceiling was not uniform, ranging from two to four months.

⁹ The interest was computed on a quarterly basis, so that in annual terms it ranged from 46 to 91 percent.

Table XVI-5

**QUARTERLY CHANGES IN INTEREST RATES ON NONDIRECTED CREDIT,
THE EXCHANGE RATE, AND CONSUMER PRICE INDEX, 1978-79**
(Percentage changes at annual rates)

Period	Nominal interest			Indicators of increase in real interest				
	Average effective interest on overdraft accounts (1)	Interest on deviations from approved credit limits (2)	Interest on nondirected foreign currency credit (3)	Average increase in current and preceding quarter Consumer price index \$/IL rate (4)		Average effective interest on overdraft accounts (1/5)	Interest on deviations from approved credit limits (2/5)	Interest on nondirected foreign currency credit (3x4/5)
1978								
I	49	64	10	27 ^a	46 ^a	2	12	-4
II	49	64	11	28	48	1	11	-4
III	49	64	11	27	41	6	16	0
IV	52	64	14	17	50	1	9	-11
1979								
I	63	99	14	19	68	-3	18	-19
II	69	102	25	63	80	-6	12	13
III	93	129	26	88	99	-4	15	19
IV	132	175	29	88	129	1	20	6

^a The datum is for this quarter only in order to exclude the effect of the foreign currency reform.

As already mentioned, the central monetary measure implemented was the imposition of a 12 percent interest surcharge on foreign currency loans in April 1979. As a result, the effective interest rate on such credit rose from 14 percent at the beginning of the year to 25 percent in the middle of the year and 29 percent during the last quarter (see Table XVI-5). On the assumption that devaluation and inflationary expectations are formed in the light of current developments and of developments during the previous quarter,¹⁰ we find that the real interest on foreign currency credit decreased during the second half of 1978 and was even negative during part of this period. However, in the second quarter of 1979 the trend changed, and real interest began to climb steeply, reaching a fairly high

¹⁰ We have no clear-cut model for measuring the formation of devaluation and inflationary expectations. It should be noted, however, that an assessment of expectations based on various alternatives shows a similar trend in the movement of the real interest rate, although its level and the exact timing of the major fluctuations vary under the different methods used. It should further be stressed that, assuming that the public's devaluation expectations are zero and that real interest abroad has remained unchanged, a 12 percent surcharge will raise the real interest rate to the same extent.

positive level. In the last quarter it fell again but was still higher than before the imposition of the 12 percent surcharge.

The average effective interest on nondirected credit in the form of overdraft facilities also rose in real terms from the middle of 1979, but during most months of the year it remained negative. Interest on drawings in excess of authorized credit limits, however, soared from 64 percent at the end of 1978 to 175 percent at the end of 1979. This was largely due to the Bank of Israel's policy of limiting the growth of nondirected credit in Israeli currency. As a result, the real interest on Israeli currency credit rose, and such credit was actually rationed throughout most of the year. It should be noted that in the second quarter of 1979 the interest on deviations from IL credit quotas was similar to that charged on nondirected credit in foreign currency—an indication that the prices of the two types of credit was, on the margin, close to equilibrium. However, interest data and the comparisons between them should be treated with reserve, owing to the difficulty of estimating inflationary or devaluation expectations and to the differential degree of risk associated with the various types of credit.

The analysis of the movement of the real interest rate is based primarily on that applicable to foreign currency credit. The price of foreign currency credit can therefore be regarded as constituting the marginal price of credit in the economy. Support for this can be found in the fact that foreign currency credit subject to the interest surcharge accounts for roughly half the total volume of nondirected credit in Israel, and it seems that notwithstanding the surcharge its weight in total nondirected credit increased by 7 percent during 1979. Furthermore, the surcharge was imposed on foreign currency loans taken or renewed from the beginning of April; during the year 73 percent of the loans taken before the surcharge went into effect were repaid, and although it involved an extra interest charge, they were renewed (see Table XVI-A6).

In contrast to the raising of the price of nondirected credit, directed credit, which accounts for about half of total bank credit, became relatively cheaper. The interest on directed export credit was hiked by 2 percentage points during the year, while the world market interest rate on the dollar went up about 3 points. In the early part of 1980 such interest was raised by an additional 5 points, and in April 1980 it was set at 60 percent of the Eurodollar market interest rate. The interest charged on directed Israeli currency credit was also increased by 12 points at the beginning of 1979, bringing it up to 26 percent, but this still failed to match the rise in the market rate. In addition, foreign currency credit for financing the import of fodder and fuel, which accounts for 15 percent of total bank credit, and supplier credit were exempted from the interest surcharge.

3. INFLUENCE OF MONETARY DEVELOPMENTS ON ECONOMIC ACTIVITY

In 1979 monetary policy placed the stress, as stated, on credit. An interest surcharge was imposed on foreign currency credit, which brought up the real interest rate, and quantitative restrictions were put on nondirected credit in both foreign and Israeli currency. Consequently, the demand for financial assets decreased, as did demand for goods and services. The latter was one of the factors slowing economic activity during the last quarter of 1979 and particularly in the first quarter of 1980, when unemployment began to mount. It is reasonable to assume that this development was connected with the growing impact of the credit policy introduced in November 1979. The quantitative restrictions greatly increased the cost of expanding credit. As a result, the banks reduced their lending, and companies were therefore forced to make greater use of their own capital. Under the existing tax regulations the cost of using equity capital is incomparably higher than the net cost of credit.¹¹

Despite the stringent monetary policy, inflation grew much worse in the second half of 1979. This was probably due to the continued operation of the factors which boosted the inflation rate during the past two years—the abolition of subsidies on price-controlled products, higher fuel prices, and the awarding of substantial wage hikes during the first half of 1979. The effect of these three factors was magnified by the inflationary expectations. The dampening of demands led to the slowing of inflation at the beginning of 1980, for the November policy measures cut into real disposable income and probably altered the public's expectations regarding the future pace of price advance. But it is still too early to know whether this represented a change of trend, for some of the principal factors generating the upward thrust on prices are still at work, such as the growth of government spending and mounting costs. The operation of these factors, combined with the restriction of credit, is liable to depress economic activity without slowing inflation.

Among the factors that aggravated inflation during the last two years was the reshuffling of the public's assets portfolio following the liberalization of foreign currency control. Since November 1977 the public may invest in Patam deposits, a new, highly liquid linked asset. To be sure, highly liquid linked assets (indexed bonds) have been a regular feature of the money market for many years, but bonds are less marketable than Patam, as evidenced by the sizable gap between their

¹¹ Since the nominal interest on credit is recognized as a deductible expense for tax purposes, the escalation of inflation made credit financing increasingly more attractive than financing from equity capital (see section 5 for more details).

respective turnover velocities.¹² The creation of this new asset depressed demand for ordinary means of payment by more than was warranted by the faster rate of inflation. Government deficits are financed by “printing” money, which pushes up prices while reducing the real value of money held by the public (this is defined as an “inflationary tax”). Since the demand for money contracted sharply, the base on which the “inflationary tax” was levied narrowed. Consequently, in the long run every government deficit now causes a greater rise in prices than when fewer money substitutes were available. However, while the introduction of a new asset diminishes the demand for other financial assets, it also reduces the demand for real assets. It is therefore reasonable to assume that, together with the long-term inflationary effect which Patam deposits exerted through the contraction of the money supply, its short-term influence was to reduce the demand for goods and services.

The checking of monetary expansion during 1979 followed a period of rapid growth during the previous two years. The increased supply of liquidity in 1977-78 was mainly reflected by the larger volume of short- and medium-term financial assets held by the public, which increased by about 36 percent in real terms in these two years, while stocks of durable goods rose by only 14 percent over the same period. The much heavier demand for durable consumer goods in 1979, which was concentrated in the first quarter of the year, was probably also the result of an adjustment process,¹³ whereby the public reduced its holdings of short- and medium-term financial assets by 6 percent in real terms during the year, and simultaneously enlarged its stock of durable goods by 12 percent.¹⁴ That this occurred at the beginning of 1979 was apparently due to the real upward revaluation of the IL during the second half of 1978, which lowered the relative price of durables (most of which are imported).

In examining the effectiveness of a restrictive monetary policy based on the raising of real interest rates and the restricting of credit only, it turns out that this leads to a larger government liquidity injection, as firms cut their supplier credit to the government and even reduce or postpone tax payments. This is what actually

¹² The turnover velocity of bonds ranges between 1 and 2, whereas that for Patam demand deposits averaged approximately 20 during 1979, and for all types of Patam deposits it was about 7. These estimates exclude transfers between Patam accounts, one of the main ways in which the public has used Patam as a means of payment.

¹³ In order to correctly assess the influence of the public's wealth, one must add the capital stock of the private sector to its financial assets, and deduct private liabilities to the government and to the foreign sector. Most of the liabilities are owed to the government and were intended primarily to finance the private sector's capital stock. They are mostly unlinked, and it is reasonable to assume that disregarding the capital stock and liabilities imparted a downward bias to the estimated change in wealth that occurred in 1977 and 1978.

¹⁴ An examination of the short- and medium-term assets portfolio of the public in comparison with the stock of durable goods shows that the ratio between them tends to fluctuate in the short run, but the fluctuations offset each other to some extent in the long run.

Table XVI-6

SHORT- AND MEDIUM-TERM FINANCIAL ASSETS OF THE PUBLIC,^a 1977-79
(IL billion)

	Balance at end of period				Percent annual increase	
	1977	1978	June 1979	Dec. 1979	1978	1979
Liquid assets						
Money supply	18.7	27.2	29.1	35.4	45.5	30.2
Patam deposits	16.9	40.3	55.2	91.4	138.5	126.8
Bonds	35.7	48.5	67.0 ^b	87.8	35.9	81.0
Time deposits and negotiable certificates of deposit	5.2	5.9	8.0	7.9	13.5	33.9
Total liquid assets	76.5	121.9	159.3	222.5	59.4	82.5
Medium-term financial assets						
Shares	26.0	44.3	64.0	76.8	70.4	73.4
Restitution deposits	32.6	50.1	67.0	99.6	53.7	98.8
Saving schemes and linked deposits	37.5	66.0	96.8	154.0	76.0	133.3
Total medium-term assets	96.1	160.4	227.8	330.4	66.9	106.0
Total financial assets	155.3	255.8	369.1	509.3	64.7	99.1

^a The estimate was made by subtracting the financial assets in the portfolios of the Bank of Israel and the commercial banks from the outstanding balance of financial assets in the market, for each asset separately. It includes Patam deposits and bonds traded on the stock exchange which are owned by insurance companies and social insurance funds. The definition of "the public" in this table differs from that used last year, since it includes mutual funds and bonds owned by insurance companies as part of the public's assets portfolio. This definitional difference is reflected in the volume of assets; it has an insignificant effect on the rates of change.

^b Estimate base on beginning-of-year balance, net capital raised, and the index of yields for the first half of 1979.

Source: Based on the monthly balance sheet of the banking institutions, Department of the Examiner of Banks.

happened in the second half of 1979, and it greatly impaired the benefit of the measures introduced.

Such a policy also has repercussions on the economy's resources. The imposition of an interest surcharge raised the real interest rate to about 15 percent per annum, which is far above the usual rate in developed countries. If such a policy is pursued for a long time, it is liable to adversely affect investments and the economic growth potential. Thus the imposition of a heavy interest surcharge on foreign currency credit cannot constitute a desirable long-term solution, and it is necessary to adopt a monetary policy based chiefly on curtailing the government's demand surplus and the related liquidity injection.

Table XVI-7

**TURNOVER VELOCITY OF DEMAND DEPOSITS AND
MONETARY AGGREGATES, 1976-79**

Year	Average turnover velocity of demand deposits in IL ^a	Average annual turnover velocity of monetary aggregates relative to domestic uses		
		Money supply (1)	Money supply, time deposits in IL, C.D.s., and Patam (2)	Total liquid assets ^b (3)
1976	32.85	10.20	6.06	2.73
1977	34.75	9.87	5.58	2.97
1978	38.38	12.02	4.78	2.97
1979	66.25	17.26	5.52	3.29

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

^b 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 unlinked assets—Table XVI-A8; linked assets—Table XVI-A9; domestic uses (excluding direct defense imports)—Table II-1.

4. FINANCIAL ASSETS

The rapid acceleration of inflation and the availability of linked liquid assets have reduced the importance of the money supply in analyzing the economy's liquidity, and so it is necessary to examine broader monetary aggregates which include other types of liquid assets. For a sound analysis of monetary developments it would be useful to employ a combination of assets consisting of the money supply, foreign currency deposits of the public, bonds held by the public, and time deposits in IL. (It should be stressed, however, that this does not constitute a new definition of the money supply.) The monetary squeeze in 1979 was reflected chiefly by developments in the above-listed assets, which expanded in nominal terms by 83 percent (see Table XVI-6) but contracted in real terms by 14 percent, after having moved up at an annual 7 percent real rate in each of the preceding years. Thus the reduction of liquid assets in the course of 1979 took place against the background of a very high liquidity level in 1978, and on an annual average they rose at nearly the same rate as the general price level. Whereas domestic uses (excluding direct defense imports) increased by 8 percent in real terms, liquid assets declined, mainly due to the policy of hiking the cost of credit. Since the real rate of interest on credit was raised directly, without any corresponding change in interest rates on assets, a significant gap was created between the two types of interest. The public thus preferred to reduce its holdings of financial assets rather than accept

additional credit. The aggravation of inflation, which accelerates turnover velocities, was another factor depressing demand for liquid assets.

The development of liquid assets differed markedly in the first and second halves of 1979. During the first half they contracted by a moderate 4 percent in real terms, but in the second half they fell by 10 percent. Neither the change in the liquidity injection nor the development of the basic balance of payments deficit warranted such a sharp drop. It must be ascribed to the desire of the public to purchase foreign exchange in order to repay foreign debts and to increase its holdings of foreign currency. Throughout the year, but especially in the last quarter, the public stepped up its purchases of foreign currency owing to fears that the liberalization policy might be curtailed and a capital levy imposed. In the absence of reliable data concerning the size of such holdings, one can only assume that were it taken into account the observed contraction in the public's financial assets would be smaller. As in 1978, the proportion of unlinked assets in the public's financial portfolio continued to decline, while the composition of linked assets underwent a change. The money supply shrank sharply this year—by 38 percent in real terms. The declining demand for money is explained by the higher alternative cost of holding it due to the marked escalation of inflation. Since the Israeli pound is the country's only legal tender, the use of substitute linked assets is feasible only if there is a high turnover of Israeli currency deposits. And indeed, along with the real decrease in the money supply, the velocity of demand deposits jumped from 50 at the beginning of 1979 to 81 at the end of the year (at the beginning of 1970 it was only 20). On an annual average the velocity rose from 38 in 1978 to 66 in 1979 (see Table XVI-7).¹⁵ The velocity of Patam deposits also rose.

Credit cards likewise became more common during the year reviewed, partly because the banks promoted their use but also because it is worthwhile to use them under present conditions of rapid inflation. Although this further reduced the demand for money, the number of credit cards is still quite small. Another instrument widely used in 1979 was credit in the form of approved overdraft accounts of private persons, which constitutes a substitute for demand deposits.

Time deposits in IL also contracted in real terms, their place gradually being taken by negotiable certificates of deposit. These certificates were the only unlinked asset to expand rapidly, chiefly because in 1979 they were still a comparatively new asset, strongly promoted by the banks. Nevertheless, the weight of unlinked assets in the total liquid assets portfolio declined from 34 percent at the beginning of 1977 to only 19 percent at the end of 1979; in the portfolio of short-

¹⁵ Part of the rise in the velocity of demand deposits was due to the recording by certain banks of debits to overdraft accounts as debits to demand deposits. Since drawings in excess of the approved credit limits grew appreciably in 1979, the rise in the velocity of demand deposits is probably biased upward.

and medium-term assets their weight is even smaller now, accounting for no more than 9 percent.

During the year there was a net accumulation of linked liquid assets (Patam deposits and bonds). Since the relative price of these assets fell (as compared with the consumer price index), their market value rose about as fast as the consumer price index. Patam deposits expanded more rapidly than bond holdings—by 127 percent as against 81 percent—but part of the growth of Patam was due to the transfer in May 1979 of restitution deposits owned by heirs of the original recipients to the category of Patam, in accordance with a Bank of Israel directive. Less these transfers, the increase in Patam was 120 percent. Changes in the public's expectations concerning the real exchange rate, as well as anxiety over the possible imposition of capital gains tax and administrative restrictions, caused linked assets to develop in an erratic manner. In December 1978 Patam deposits swelled at an exceptional rate owing to jitters about a possible restoration of foreign currency control. For the most part, this represented the advancing of planned purchases of foreign currency, and so this item remained relatively stable throughout the first half of 1979, while the outstanding balance of linked bonds rose rapidly.

In August 1979 the public's demand shifted again. Fears of the deliberalization of foreign currency regulations and expectation of a real devaluation led to a steep increase in Patam deposits, while linked bonds plummeted. Another development worthy of note was the switch from Patam demand deposits to Patam time deposits: the former contracted during the year by 30 percent in real terms, while the latter rose 25 percent. This can apparently be ascribed to the raising of interest rates on foreign currency deposits and to the realization that time deposits of this kind are quite liquid.¹⁶

The less liquid components of the public's assets portfolio—shares and savings schemes—showed contrasting trends. Saving schemes and long-term linked deposits expanded by 10 percent in real terms as a result of the numerous concessions granted to those investing in such schemes during the year. The stock market, on the other hand, suffered from a serious slump, which sharply depressed the real market value of shares.

5. BANK CREDIT

The rapid monetary expansion of 1977-78 was reflected, above all, by a 47 percent real increase in bank credit to the public. This was one of the main reasons why the Bank of Israel concentrated in 1979 on making credit more expensive and restricting its growth by fixing limits for the commercial banking system. This

¹⁶ It should be remembered that the banks also pay interest on large Patam demand deposits.

Table XVI-8

CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1977-79^a
(IL billion)

	End-of-year balance			Percent increase			
				December levels		Annual average	
	1977	1978	1979	Average 1977-78	1979	Average 1977-78	1979
For financing domestic activities							
Nondirected credit in IL	12.8	19.9	29.6	52	48	54	42
Directed credit in IL	2.9	2.1	2.1	-6	0	8	-19
Nondirected credit in foreign currency	10.2	23.0	59.5	95	159	77	168
Total credit for the domestic market							
Including fuel	25.9	45.0	91.2	62	103	57	91
Excluding fuel	25.9	41.7	73.7	57	77	..	83
For financing exports							
Excluding diamonds	11.3	19.7	47.5	81	142	79	106
For the diamond industry	7.6	15.0	33.2	132	120	139	71
Total export credit	18.9	34.7	80.7	99	132	100	90
Total bank credit							
Excluding fuel	44.8	76.5	154.4	..	102	..	86
Including fuel	44.8	79.7	171.8	76	116	72	90

^a For definitions and sources see Tables XVI-A4, XVI-A5, and XVI-A6

helped to stabilize such credit (in real terms) during the year, although on an annual average it was 7 percent larger in 1979 than in 1978 (see Table XVI-8). The effectiveness of this policy is much more evident in the composition of credit. The Bank of Israel sought to check the general expansion of credit without reducing that provided for preferred purposes (exports and imports of fuel and fodder); it therefore curbed credit for the domestic market while substantially enlarging that for preferred purposes. In analyzing the availability of total credit an examination of the various component items is not of major importance, but a discriminatory policy does affect the structure of domestic uses, particularly with respect to those companies producing exclusively for the local market.

There is a case, however, for excluding credit for fuel imports¹⁷ when analyzing the total volume of credit. Following the Iranian crisis the world price of fuel rose steeply, and as a consequence the Israeli government decided to build up a large

¹⁷ There can be no doubt, however, that credit for fuel purchases must be included in the total volume of credit. Moreover, the additional financing of fuel stocks in 1979, as compared with 1978, should be regarded as an increase in credit to the government.

reserve stock. Imports of fuel thus expanded appreciably, and with them the amount of finance allocated for this purpose. Excluding this item, the volume of credit increased by 102 percent in 1979, a real decrease of 5 percent. It should be noted, however, that the more sluggish expansion of credit in 1979 followed its acceleration in 1978, so that excluding fuel, total credit increased by 4 percent on an annual average, while domestic uses (excluding direct defence imports) grew by 8 percent during the year reviewed.¹⁸

At the same time the demand for credit was influenced by several other factors operating in opposite directions. On the one hand, the much larger liquidity injection in the second half of the year depressed demand; but two factors had an opposite effect: the burgeoning of domestic uses and the prevailing tax regulations which encourage borrowing in time of inflation. Under the income tax law nominal interest on credit is recognized as a deductible expense for tax purposes, while inflationary gains in the form of the appreciation of the market value of linked bonds, shares, and real estate are not regarded as taxable income. Consequently companies can earn a tidy sum by taking loans to purchase such assets. The acceleration of inflation in 1979 might have been expected to bolster the demand for credit and for assets of this type, but in fact both the share and real estate markets were depressed and the public's net bond purchases were close to zero. These data demonstrate that the quantitative restrictions on credit were highly effective, permitting no more than the normal expansion of real activity.

(a) Credit for the Domestic Market

The tightening of credit for the domestic market was achieved through measures affecting both its cost and supply. A 12 percent interest surcharge was imposed on credit in foreign currency, while the Bank of Israel placed quantitative limits on the expansion of credit by banking institutions, to which it gave loans. Moreover, directed credit in IL for the domestic market was frozen in nominal terms. These three factors helped to raise the real interest rate on nondirected credit and to reduce its volume in real terms.¹⁹ As a result of this policy, credit for the domestic market (excluding fuel imports) expanded during January-October 1979 at approximately the same rate as inflation, with only slight monthly fluctuations. In October, following the strike at the Bank Leumi le-Israel, the commercial banking system deviated sharply from the credit ceilings. Since Bank of Israel loans for the purpose of covering the banks' liquidity deficits were made conditional upon their adhering to the credit ceilings, the banks were forced to drastically cut their nondirected credit. In November its average volume contracted in nominal terms,

¹⁸ The restriction of credit may have encouraged greater direct borrowing from abroad, which was exempt from the 12 percent interest surcharge. Owing to insufficient data, however, it was impossible to examine whether the growth of much finance compensated for the limitation of bank credit discussed here.

¹⁹ For full details see the chapter on exports.

Table XVI-9
ASSETS AND LIABILITIES OF BANKING INSTITUTIONS,^a 1978-79
 (IL million)

End-of-year balances	1978			1979		
	Israeli currency	Indexation differentials	Foreign currency	Israeli currency	Indexation differentials	Foreign currency
Assets						
Liquid IL assets at the Bank of Israel ^b	11,584			10,999		
Foreign currency deposits with the Bank of Israel			83,508			175,352
Loans and deposits abroad	10		65,568			152,339
Nondirected credit	19,922	1,919		29,566	4,990	
Participation in directed credit	3,784	311	51	6,286	388	141
Nondirected foreign currency credit to local residents			22,966			59,530
Foreign currency credit to local residents from approved earmarked deposits			10,365			26,409
Credit to the public from earmarked deposits	22,651	24,513		40,116	62,911	
Credit to the public from government deposits	10,048	304		15,943	925	
Securities of Israeli companies and institutions	22,228	22,103	234	27,659	67,086	440
Premises and equipment	2,117			3,612		
Loans to the government from the banks' own means	6,309	3,087	6,400	11,092	13,719	9,624
Loans to the government from earmarked deposits	38,952	45,029	7,270	57,933	134,003	16,561
Government bonds ^c	3,593	3,047		11,971	9,442	
Cash items in process of collection and banking institution deposits	2,984	1,534	5,562	4,046	4,066	14,135
Negotiable certificates of deposit	634			733		
Other accounts	14,229	1,594	2,079	40,699	4,543	2,025
Sundry accounts ^d	5,625 ^e	384 ^e	35,471 ^f	10,089 ^e	378 ^e	84,744 ^f
Contingent accounts ^g	13,452	946	26,030	22,680	1,983	67,712
Total assets	178,119	104,771	265,507	293,422	304,433	609,011

Liabilities						
Equity capital and capital notes	12,504	131	2,544	16,830	596	4,615
Foreign deposits ^h			95,083			228,878
Rediscounts	51			3,365		
Demand deposits	18,374			23,380		
Time deposits	5,133	13		3,397	10	
Negotiable certificates of deposit	1,411			5,202		
Approved savings schemes	32,332	31,400		58,881	86,018	
Linked long-term deposits	1,694	622		5,162	3,961	
Foreign currency deposits of local residents			90,339			191,050
Approved earmarked deposits	58,029	71,934	1,920	89,166	201,356	3,986
Earmarked government deposits ⁱ	12,258	44	4,426	21,334	305	9,325
Government accounts ^j	233		192	378		6
Banking institution deposits and cash items in process of collection	2,332	883	5,760	3,813	2,141	14,149
Other accounts	14,639	16	1,842	35,759	26	5,466
Sundry accounts	6,357 ^k	384 ^k	35,477 ^l	10,726 ^k	378 ^k	84,774 ^l
Contingent accounts	13,452	946	26,030	22,680	1,983	67,712
Total liabilities	178,410	106,373	263,614	300,133	296,773	609,961

^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 IL deposits with the Bank of Israel treated as a liquid asset, treasury bills, and vault cash.

^c Including the Short-term Loan

^d Includes the adjustments made in the balance sheet to conform to the definitions of credit and deposits used in this chapter.

^e IL rediscounts for the public.

^f Foreign currency rediscounts for the public, rediscounts for the Jewish Agency, and Patach and Patal (deposits against loans received

directly from abroad) funds redeposited with the Bank of Israel (as reported by the banking institutions).

^g Acceptances, guarantees, and documentary credits.

^h Deposits of foreign banks and overseas branches of Israeli banks, nonresidents, new immigrants, and temporary residents, less deposits with the Bank of Israel.

ⁱ Utilized earmarked deposits.

^j Demand, time, and unutilized earmarked government deposits.

^k As in note e, plus deposits against liabilities, and demand deposits of the public in the Israel Bank of Agriculture.

^l As in note f, but with Patach funds according to Bank of Israel data.

while credit for the domestic market (excluding fuel imports) in these two months declined by 17 percent in real terms (see Table XVI-A4). Over the year as a whole there was a 77 percent nominal increase in domestic credit (excluding fuel imports), while the consumer price index went up 111 percent. But in view of the very rapid expansion of credit in 1978, in 1979 the annual average level moved up 83 percent nominally, or 2 percent in real terms.

The measures introduced by the Bank of Israel also affected the various components of nondirected credit for the domestic market. The interest surcharge on foreign currency loans had a contractionary effect on its relative share, but quantitative restrictions were imposed on the expansion of total credit, in both Israeli and foreign currency, and this made the growth of local currency credit very expensive, especially during the last quarter of 1979. As a result, the weight of the foreign currency credit component rose.

(b) Directed Export Credit

Along with the limitation of credit for the domestic market, directed export credit expanded rapidly, as in the two previous years. The balance of credit for nondiamond commodity exports averaged 37 percent higher in 1979 in dollar terms, while exports of goods (other than diamonds) advanced only 28 percent. The financing of the diamond industry was likewise stepped up. Although the dollar value of diamond exports (net) dipped in 1979 by 7 percent, outstanding credit to the industry rose 12 percent.

The reasons for the growth of export credit vary from fund to fund. In the Export Shipments Fund it was due to the inclusion of the Citrus Marketing Board, which previously had not received financing from this fund. The increased utilization of the export funds is explained by the swelling of the subsidy element in such credit. The interest rate on directed export credit was upped by only 2 percentage points, while rates abroad went up much faster. What is more, the interest surcharge on nondirected foreign currency credit substantially widened the gap between the interest rate on directed export credit and the alternative free-market interest rates. Since the various credit frameworks are highly integrated, it is not surprising that borrowers increasingly turned to directed credit. It should be noted that in April 1979 the rate of financing from the Export Shipments Fund was raised from 85 to 90 percent, but it was lowered again in September. At the same time the interest charged by the various export funds was increased; since then the growth of exports has lagged behind the growth of export financing.

As already mentioned, the credit policy of the Bank of Israel clearly favors exports over domestic marketing with respect to the supply and price of credit. Although such a policy spurs exports at the expense of production for the home market, to subsidize foreign sale in this manner causes many distortions thus casting doubt on its efficiency.²⁰

²⁰ For a detailed discussion see the chapter on exports.

Table XVI-10**NET FOREIGN CURRENCY ASSETS OF THE BANKING SYSTEM, 1977-79**
(\$ million)

End of period	Net assets in Bank of Israel	Net assets in banking institutions			Net assets in banking system
		Assets	Liabilities	Net assets	
1977	1,427	2,470	3,519	-1,049	378
1978	2,368	3,448	5,000	-1,552	815
1979	2,427	4,310	6,475	-2,165	262
March	2,671	3,260	5,022	-1,762	908
June	2,719	3,653	5,537	-1,884	836
September	2,699	3,496	5,656	-2,160	539
December	2,427	4,310	6,475	-2,165	262

Source: Table XVI-A11.

APPENDIX TABLES

Table XVI-A1

THE MONEY BASE BY COMPONENT, 1977-79
(IL million)

End of period	Currency in circulation (1)	Liquid assets of banking institutions (2)	Narrow money base (1+2) (3)	Liquidity exemptions (4)	Recognized liquidity deficiencies (5)	Broad money base (3+4+5) (6)	Percent increase in broad money base (7)
1977	6,319	9,578	15,897	1,363	210	17,471	45.9
1978	8,777	11,584	20,361	2,215	92	22,668	29.8
1979	12,055	10,999	23,054	4,761	29	27,844	22.8
January	9,150	13,654	22,804	2,236	153	25,193	11.1
February	9,318	11,163	20,481	2,269	198	22,948	-8.9
March	9,562	10,271	19,833	2,296	58	22,187	-3.3
April	10,318	12,429	22,747	2,734	91	25,572	15.3
May	10,381	12,084	22,465	2,901	27	25,393	-0.7
June	10,835	10,573	21,408	3,052	18	24,479	-3.6
July	10,816	9,974	20,790	3,391	103	24,284	-0.8
August	11,730	11,975	23,705	3,996	108	27,809	14.5
September	11,995	8,407	20,402	4,211	33	24,646	-11.4
October	12,305	6,046	18,351	4,566	2,254	25,171	2.1
November	11,968	9,821	21,789	4,570	978	27,336	8.6
December	12,055	10,999	23,054	4,761	29	27,844	1.9

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

Table

INDICATORS OF THE BANKING INSTITUTIONS'
(IL)

	Required liquidity on ordinary deposits ^a (1)	Required liquidity on time deposits ^b (2)	Required liquidity on nondirected credit (3)	Total gross required liquidity ^c (4)
1977	9,027	1,057	613	10,927
1978	13,068	1,008	940	15,536
1979	13,736	672	1,351	17,575
January	12,536	951	946	15,417
February	11,944	929	1,013	15,101
March	13,125	825	1,078	15,838
April	13,062	836	1,101	16,513
May	13,801	828	1,147	17,198
June	13,350	803	1,205	16,931
July	13,636	748	1,275	17,169
August	14,341	775	1,239	17,802
September	14,485	706	1,431	18,284
October	12,907	665	1,632	17,255
November	13,419	652	1,433	17,921
December	13,736	672	1,351	17,575

^a Demand deposits and deposits against liabilities in Israeli currency.

^b Includes time deposits withdrawn before maturity.

^c Required liquidity against such other items as savings, directed credit, and unutilized balance of earmarked deposits.

XVI-A2^aLIQUIDITY IN ISRAELI CURRENCY, 1977-79
(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)
9,354	-496	-1,033	-11.6	-9.9
13,229	-2,803	-916	-7.6	-6.4
12,786	-3,325	-3,824	-47.8	-32.3
13,028	-645	-1,224	-9.6	-8.1
12,635	-2,675	-1,155	-8.8	-7.4
13,484	-3,996	-2,391	-19.1	-16.1
13,687	-2,600	-1,251	-9.0	-7.6
14,269	-3,224	-1,398	-10.8	-8.9
13,860	-4,423	-3,134	-22.8	-18.7
13,675	-5,210	-4,440	-30.4	-24.9
13,698	-2,979	-3,499	-25.1	-19.8
14,041	-6,842	-4,585	-31.9	-24.7
10,436	-6,095	-5,255	-40.3	-29.9
12,380	-4,176	-5,401	-47.1	-31.5
12,786	-3,325	-3,824	-47.8	-32.3

^d Free reserves 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 data from the banking institutions' monthly balance sheet presented in Table XVI-A1.

^e Gross required liquidity before the deduction of liquidity exemptions and recognized liquidity deficiencies; the net required liquidity is after reduction of these items.

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

Table

**SOURCES OF COMPONENTS OF
(IL)**

	Jan.	Feb.	Mar.	Apr.
1. Total basic				
public sector injection	-910	421	-468	50
Thereof: Government	-1396	-137	-871	-331
2. Total Bank of Israel injection	1,419	1,199	574	4,032
Thereof:				
Directed IL credit	-17	-14	-80	966
Directed foreign currency credit	1,005	783	310	407
Credit to banks	—	—	—	1,911
Other factors ^b	431	430	344	748
3. Total exogenous injection (1+2)	509	1,620	106	4,082
4. Foreign currency sales of the private sector	1,017	-813	-493	479
5. Change in narrow liquid asset base (3+4)	1,526	807	-387	4,561
6. Liquidity exemptions and recognized deficiencies	81	78	-113	472
7. Change in broad liquid asset base (5+6)	1,607	885	-500	5,033
Thereof:				
Change in broad money base	2,524	-2,245	-761	3,385
Increase in Patam, time, and demand deposits	1,333	679	-1,381	-21
Increase in bond holdings	-2,250	2,451	1,642	1,669
8. Change in liquidity deficits	2,157	-2,030	-1,320	1,395

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

XVI-A3

CHANGES IN THE LIQUID ASSET BASE,^a 1979

(million)

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.
1,036	-1,175	246	4,775	2,283	-1,103	5,473	5,315
736	-1,576	-182	4,355	1,725	-1,675	4,760	4,389
270	2,084	2,765	2,603	255	2,701	3,988	2,461
527	668	780	768	358	-73	127	2,160
69	732	320	803	675	1,984	1,001	3,248
88	409	470	-15	467	-939	955	1
-414	275	1,195	1,047	-1,245	1,729	1,905	-2,948
1,306	909	3,011	7,378	2,538	1,598	9,461	7,776
-1,674	-2,251	-495	-4,117	-3,194	-4,920	-4,937	-6,136
-368	-1,342	2,516	3,261	-656	-3,322	4,524	1,640
103	142	424	610	139	2,576	-1,272	-758
-265	-1,200	2,940	3,871	-517	-764	3,252	882
-179	-915	-194	3,525	-3,164	525	2,166	642
101	445	387	-286	3,017	37	4,270	2,352
-187	-730	2,747	638	-370	-1,308	-3,184	-2,112
-623	-1,199	-787	2,231	-3,863	747	1,920	851

Table

OUTSTANDING CREDIT TO THE PUBLIC^a
(IL)

	For financing exports				For financing	
	Credit in IL ^b (1)	Foreign currency credit, excl. diamonds ^c (2)	Diamond Fund (3)	Total (1+2+3) (4)	Directed IL credit ^d . (5)	Non- directed IL credit ^{e,f} (6)
1977	4,588	6,668	7,630	18,885	2,936	12,793
1978	7,335	12,330	15,072	34,737	2,061	19,922
1979	14,734	32,788	33,163	80,684	2,053	29,566
January	7,311	13,111	15,474	35,895	2,030	19,502
February	7,381	13,778	15,800	36,959	2,031	20,603
March	6,793	15,526	17,597	39,916	2,024	23,039
April	8,436	17,041	18,818	44,294	1,960	22,314
May	9,058	18,530	19,586	47,174	1,919	23,836
June	9,732	19,956	20,522	50,210	1,861	26,025
July	10,648	21,069	20,864	52,581	2,073	26,644
August	11,791	22,238	22,454	56,483	2,092	25,514
September	12,559	23,466	24,888	60,913	2,082	30,340
October	13,539	24,939	27,464	65,942	2,165	32,551
November	13,907	28,125	30,083	72,114	2,048	28,677
December	14,734	32,788	33,163	80,684	2,053	29,566

^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 Mostly working capital funds for industry and agriculture, supervised agricultural credit, and the Employers Loan Fund. Part of this credit was replaced during 1979 by the early redemption of Employers Loan Certificates, which reached IL1 billion at the end of 1978.

^e Excludes linkage increments on credit linked to the consumer price index. Linkage increments on nondirected credit in Israeli currency totaled IL1,919 million at the end of 1978, rising to IL4,990 million at the end of 1979. Linkage increments on directed IL credit in connection with the Employers Loan Fund totaled IL384 million at the end of 1978 and IL378 million at the end of 1979.

^f Includes linked long-term loans, which in 1979 increased to IL4,320 million, including linkage increments.

XVI-A4

FROM THE BANKING SYSTEM, 1977-79
million)

domestic activities						
Non-directed foreign currency credit (7)	Total excl. fuel (8)	Total (5+6+7) (9)	Credit from earmarked foreign currency deposits ^h (10)	Credit from earmarked nongovt. deposits (11)	Credit from govt. deposits for tax payments, etc. (12)	Credit from other earmarked govt. deposits (13)
10,195	..	25,924	6,242	15,352	1,817	5,059
22,966	41,716	44,949	10,365	22,651	2,777	7,271
59,530	73,686	91,149	26,409	40,116	4,155	11,788
24,238	42,367	45,769	10,640	23,338	2,686	7,373
25,663	45,026	48,296	10,955	24,279	2,822	7,590
28,073	49,472	53,135	12,506	25,830	3,473	7,967
31,047	51,540	55,321	13,243	25,917	3,417	8,105
34,474	55,229	60,229	14,574	26,791	3,560	8,430
37,056	57,772	64,943	15,622	28,019	3,783	8,852
39,418	60,891	68,135	16,713	29,356	4,245	9,148
42,713	60,906	70,320	18,067	31,272	4,139	9,690
49,239	69,156	81,662	19,460	32,629	4,343	9,947
53,325	75,068	88,042	20,353	34,154	4,573	10,311
56,555	72,962	87,280	23,197	38,155	4,435	10,682
59,530	73,686	91,149	26,409	40,116	4,155	11,788

^g Excludes shipments financed from the banks' own foreign currency resources.

^h Following the foreign currency liberalization the item "Approved foreign currency credit" was reclassified, with part being defined as "Nondirected foreign currency credit" and part as "Credit from earmarked foreign currency deposits". The latter consists chiefly of long-term credit and is not discussed in this chapter. In addition, certain loans were transferred from "Nondirected foreign currency credit" to "Credit to nonresidents" (about IL2 billion in October 1977) and from "Credit from earmarked foreign currency deposits" to "Credit to nonresidents" (about IL1.8 billion in December 1977). "Credit to nonresidents" is listed as a foreign currency asset of the banking institutions in Tables XVI-8 and XVI-A11.

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

Table

OUTSTANDING CREDIT TO THE PUBLIC^a

For financing exports					
	In IL ^b (1)	In foreign currency excl. diamonds ^c (2)	Total, excl. diamonds (1+2) (3)	Diamond Fund (4)	Total (5)
Annual averages (IL million)					
1977	4,353	3,637	7,990	4,598	12,588
1978	5,888	9,365	15,253	12,996	28,248
1979	10,491	20,880	31,371	22,226	52,597
Percent annual increase					
1977	76	59	68	102	79
1978	35	158	91	183	124
1979	78	123	106	71	90
End-of-period balances (IL million)					
1977	4,588	6,668	11,256	7,630	18,885
1978	7,335	12,330	19,665	15,072	34,737
1979	14,734	32,788	47,521	33,163	80,684
Percent annual increase					
1977	51	127	88	172	115
1978	60	85	75	98	84
1979	101	166	142	120	132
Percent quarterly increase					
1979 I	-7	26	13	17	15
II	43	29	33	17	26
III	29	18	21	21	21
IV	17	40	32	33	32

^a Excludes credit to the government and the National Institutions. For monthly data, component sub-items, and changes in classification see Tables XVI-A4 and XVI-A6.

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

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

XVI-A5

FROM THE BANKING SYSTEM, 1977-79

For financing domestic activity					Total credit to the public excl. fuel and diamonds (3+10) (11)	Total credit to the public (5+9) (12)
Nondirected IL credit ^{d,e} (6)	Directed IL credit ^{e,f} (7)	Nondirected foreign currency credit ^g (8)	Total (6+7+8) (9)	Total excl. fuel (10)		
10,606	2,621	7,453	20,680	..	..	33,268
18,104	2,518	14,967	35,589	..	..	63,837
25,718	2,028	40,111	67,857	59,506	90,877	121,454
39	28	57	43	..	..	55
71	-4	101	72	..	..	92
42	-19	168	91	..	..	90
12,793	2,936	10,195	25,924	..	..	44,809
19,922	2,061	22,966	44,949	41,716	61,381	79,685
29,566	2,053	59,530	91,149	73,686	121,207	171,833
49	33	67	53	..	..	74
56	-30	125	73	..	..	74
48	-0	159	103	77	97	116
16	-2	22	18	19	17	17
13	-8	32	22	17	22	24
17	12	33	26	20	20	24
-3	-1	21	12	7	15	21

^d Includes long-term linked loans; the balance of such loans rose by IL4,320 million during 1979 (including linkage differentials).

^e Excludes linkage differentials on credit linked to the consumer price index. Linkage differentials on nondirected credit in Israeli currency totaled IL1,919 million at the end of 1978 and IL4,990 million at the end of 1979. Linkage differentials on the Employers Loan Fund totaled IL384 million at the end of 1978 and IL379 million at the end of 1979.

^f Mostly working capital funds for industry and agriculture, supervised agricultural credit, and the Employers Loan Fund. Part of this credit was replaced during 1979 by the premature redemption of Employers Loan certificates, which amounted to IL1 billion at the end of 1978.

^g Excludes the financing of shipments from the banks' own foreign currency resources.

Source: Tables XVI-A4 and XVI-A6.

Table XVI-A6

NONDIRECTED FOREIGN CURRENCY CREDIT SUBJECT TO THE INTEREST SURCHARGE, 1979
(Percentages)

	Temporarily exempt from interest surcharge ^a	Subject to 9 ½% interest surcharge ^b	Subject to 12% interest surcharge	Total credit subject to interest surcharge
1979 March	41.4	58.6	—	100
April	32.3	34.1	33.6	100
May	28.8	25.5	45.7	100
June	27.3	16.9	55.8	100
July	25.7	12.7	61.6	100
August	24.3	9.2	66.5	100
September	23.5	7.3	69.2	100
October	22.7	6.9	70.4	100
November	22.1	6.5	71.4	100
December	23.0	3.6	73.4	100

^a Foreign currency credit received before the imposition of restrictions and the interest surcharge and which had not yet fallen due.

^b Foreign currency credit received after the introduction of obligatory import deposits but before the imposition of the 12 percent interest surcharge; such credit was subject to a lower surcharge.

Table XVI-A7
COMPOSITION OF DIRECTED CREDIT TO THE PUBLIC, 1978-79

	End-of-year balance				Annual averages			
	IL million		Percent increase		IL million		Percent increase	
	1978	1979	1978	1979	1978	1979	1978	1979
1. Directed IL credit for domestic activities	2,061	2,053	-30	-0	2,518	2,028	-4	-19
Working capital funds	1,587	1,706	-31	7	1,937	1,613	-1	-17
For industry	657	706	-33	7	827	678	9	-18
For agriculture	206	318	-47	54	333	192	-18	-42
Supervised agricultural credit	327	472	78	45	196	465	6	137
Employers Loan Fund	398	210	-46	-47	581	278	-5	-52
Other	473	347	-27	-27	581	415	-12	-29
2. IL export credit	7,335	14,734	60	101	5,888	10,491	35	78
Export Production Fund	6,066	12,150	74	100	5,000	9,056	44	81
Citrus and Cotton Funds	930	2,133	34	129	579	1,042	7	80
Indirect Export Fund	339	450	-15	33	308	393	-9	27
3. Export credit in or linked to foreign currency	26,976	65,203	93	142	22,022	42,568	177	93
Credit for export shipments in IL, linked to foreign currency ^a	7,387	21,117	70	186	5,465	12,522	148	130
Diamond Fund (in foreign currency)	15,072	33,163	98	120	12,996	22,226	183	71
Imports for Export Fund (foreign currency)	4,517	10,923	123	142	3,561	7,790	208	119
4. Foreign currency rediscounts outside the funds	426	747	42	75	339	539	22	59

^a On January 1, 1978 the financing of shipments from credit lines was terminated.
Source: Monthly balance sheet and the monthly liquidity report of the banking institutions.

Table XVI-A8

OUTSTANDING IL CREDIT TO THE GOVERNMENT FROM THE BANKING SYSTEM, 1977-79
(IL million)

	From the Bank of Israel			From banking institutions				
	Credit to the govt. ^a (1)	Deposits of the govt. and National Institutions ^b (2)	Net Bank of Israel credit (1-2) (3)	Credit to the govt. ^c (4)	Govt. securities ^d (5)	Less govt. deposits ^c (6)	Net credit from banking institutions (4+5-6) (7)	Total net IL credit to the govt. (3+5) (8)
1977	23,031	3,724	19,307	2,638	1,714	296	4,057	23,364
1978	30,366	9,816	20,550	6,309	3,593	233	9,669	30,219
1979	53,668	35,756	17,912	11,092	11,971	379	22,684	40,596
January	26,935	9,131	17,804	5,949	3,793	257	9,485	27,289
February	24,355	8,878	15,477	6,283	4,099	214	10,167	25,644
March	16,601	4,462	12,139	6,435	4,559	228	10,765	22,904
April	13,230	4,270	8,960	6,945	5,095	225	11,815	20,775
May	11,874	2,915	8,959	7,736	6,081	235	13,582	22,541
June	10,310	2,681	7,449	8,378	6,411	888	13,901	21,350
July	3,519	1,315	2,204	8,582	7,266	220	15,627	17,831
August	6,580	767	5,813	8,814	7,353	291	15,877	21,689
September	8,115	-1,879	9,994	9,013	8,563	255	17,321	27,315
October	5,824	-2,321	8,145	9,120	9,467	280	18,306	26,451
November	7,890	-5,660	13,550	9,505	10,317	362	19,460	33,010
December	53,668	35,756	17,912	11,092	11,971	379	22,624	40,596

^a Includes the monthly credits to the government's accounts 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 substantial growth of credit to the government stemmed from long-term linked deposits of the banking institutions with the Accountant General, which constitute the use of the freely loanable savings schemes

funds.

^d Excludes treasury bills and the banks' Short-term Loan holdings.

^e The government's Israeli currency deposits, its participation in the working capital funds, and the difference between its deposits for loan purposes and the credit actually granted therefrom.

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

Table XVI-A9
MONEY SUPPLY AND UNLINKED DEPOSITS OF THE PUBLIC, 1977-79
 (IL million)

End of period	Money Supply			Seasonally adjusted data Total (4)	Unlinked deposits			Total	
	Original data				Negotiable certificates of deposit (5)	Pazak time deposits in IL (6)	Deposits against liabilities in IL (7)	IL million (3+5+6+7) (8)	Percent increase from end of previous period (9)
	Currency in circulation (1)	Demand deposits (2)	Total (1+2) (3)						
1977	6,319	12,399	18,718	18,441	0	5,152	663	24,609	38.5
1978	8,777	18,374	27,151	26,671	777	5,133	538	33,610	36.6
1979	12,055	23,380	35,435	34,946	4,469	3,397	666	43,967	30.8
January	9,150	17,823	26,973	27,552	1,536	4,806	570	33,895	0.8
February	9,318	17,111	26,429	26,968	1,723	4,702	536	33,400	-1.5
March	9,562	17,860	27,422	26,937	1,807	4,167	792	34,196	2.4
April	10,318	17,928	28,246	28,303	2,549	4,260	649	35,710	4.4
May	10,381	18,836	29,217	28,956	3,126	4,207	819	37,368	4.6
June	10,835	18,227	29,062	28,381	3,911	4,112	752	37,837	1.3
July	10,816	18,768	29,584	29,913	3,728	3,843	607	37,762	-0.2
August	11,730	19,626	31,356	31,046	4,070	3,766	815	40,008	5.9
September	11,995	19,667	31,662	31,133	4,275	3,694	952	40,583	1.4
October	12,305	20,420	32,725	33,599	4,341	3,479	1,005	41,551	2.4
November	11,968	21,463	33,431	34,148	4,779	3,370	854	42,434	2.1
December	12,055	23,380	35,435	34,946	4,469	3,397	666	43,967	3.6

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
(IL

End of period	Approved savings schemes deposits			Patam	
	Total (1)	Principal (2)	Net deposits ^a (3)	Linked long- term deposits ^b (4)	Total (5)
1977	36,790	18,359	897	689	32,631
1978	63,733	30,515	873	2,316	50,081
1979	144,899	57,208	629	9,123	99,607
January	66,578	31,930	265	2,647	49,583
February	69,983	33,480	-136	2,890	50,584
March	73,134	35,252	1,382	3,189	55,646
April	78,010	37,019	746	3,606	59,057
May	87,543	41,452	2,556	4,054	61,787
June	92,231	43,169	25	4,555	67,047
July	95,828	44,812	114	4,868	67,926
August	101,232	46,169	214	5,150	71,399
September	112,641	49,813	2,315	5,799	80,738
October	120,816	51,612	-863	6,385	82,290
November	131,619	54,584	954	7,836	90,737
December	144,899	57,208	-24	9,123	99,607

^a The annual data are for net average monthly deposits over the year.

^b The principal amounted to IL523 million at the end of 1977, IL622 million at the end of 1978, and IL3,961 million at the end of 1979.

XVI-A10

IN THE BANKING SYSTEM, 1977-79

(million)

restitution deposits	Patam deposits ^c		Total deposits	
	Devaluation and exchange rate differentials (6)	Total (7)	Devaluation and exchange rate differentials (8)	Total (1+4+5+7) (9)	Devaluation and exchange rate differentials (6+8) (10)
16,396	17,050	7,123	87,160	23,519
11,237	40,258	5,532	156,387	16,769
47,851	91,443	36,828	345,072	84,679
-675	39,584	-90	158,392	-765
617	42,090	369	165,547	986
5,179	43,938	4,380	175,906	9,559
2,129	46,886	2,286	186,559	4,416
3,688	51,506	3,171	204,890	6,859
4,761	55,152	2,912	218,986	7,673
2,259	56,155	1,588	224,777	3,847
3,781	59,348	2,799	237,129	6,580
8,638	66,436	4,934	265,613	13,571
623	71,086	1,778	280,577	2,401
9,663	81,396	6,373	311,587	16,037
7,188	91,443	6,326	345,072	13,514

^c Includes foreign currency valuation adjustments due to changes in the external value of the various currencies. After the foreign currency reform Pazak restitution and Tamam deposits were classified as "Patam restitution", while all other foreign currency deposits were classified as "Patam".

Source: Monthly balance sheet of the banking institutions.

Table XVI-A11

ESTIMATED CONVERSION OF PATAM RESTITUTION DEPOSITS,^a 1977-79
(IL million)

	Personal restitution receipts (1)	Accrued interest (2)	Exchange rate and devaluation differentials (3)	Total poten- tial increase (1+2+3)		Amount converted to IL (4-5) (6)	Conversion rate (%)	
				Actual increase (5)			A ^b (6/4) (7)	B ^c (6/[1+2]) (8)
1977	3,616	1,032	16,396	21,044	17,432	3,612	17	78
1978	6,414	1,821	11,237	19,472	17,450	2,022	10	25
1979	11,451	3,315	47,851	62,617	49,526	13,091	21	89
January	764	201	-675	289	-497	787	272	82
February	730	110	617	1,457	1,001	456	31	54
March	722	159	5,179	6,060	5,061	999	16	113
April	741	439	2,129	3,310	2,411	899	27	76
May	841	115	3,688	4,644	3,730	914	20	96
June	835	106	4,761	5,702	5,261	442	8	47
July	938	499	2,259	3,696	878	2,817	76	196
August	930	144	3,781	4,855	3,474	1,381	28	129
September	1,006	513	8,638	10,157	9,338	818	8	54
October	1,188	281	623	2,091	1,552	539	26	37
November	1,327	144	9,663	11,134	8,447	2,687	24	183
December	1,429	604	7,188	9,222	8,870	351	4	17

^a The data relate to Pazak restitution funds and Tamam, but not to other Pazak accounts.

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

^c This calculation assumes that the recipients treat exchange rate 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 XVI-A12

**FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM,
1977-79**
(\$ million)

End of period	Bank of Israel			Net foreign currency assets (1-2-3) (4)	Banking institutions			Net foreign currency assets (5-6-7) (8)	Net foreign currency assets in banking system (4+8) (9)
	Foreign currency assets (1)	Liabilities			Foreign currency assets ^c (5)	Liabilities			
		Patach deposits ^a (2)	Other ^b (3)			Patach deposits ^d (6)	Other ^c (7)		
1977	1,827	202	198	1,427	2,470	1,474	2,045	-1,049	378
1978	2,970	396	206	2,368	3,448	2,066	2,935	-1,552	816
1979	3,169	519	223	2,427	4,310	2,910	3,565	-2,165	262
January	3,289	401	274	2,614	3,242	2,130	2,820	-1,708	906
February	3,316	414	285	2,617	3,268	2,257	2,759	-1,748	869
March	3,366	418	277	2,671	3,260	2,282	2,741	-1,762	908
April	3,324	406	192	2,726	3,250	2,447	2,597	-1,794	931
May	3,281	405	183	2,693	3,293	2,463	2,662	-1,832	862
June	3,326	414	193	2,719	3,653	2,535	3,001	-1,884	836
July	3,482	437	198	2,847	3,413	2,561	2,852	-2,000	847
August	3,368	451	199	2,718	3,368	2,623	2,789	-2,043	675
September	3,339	450	190	2,699	3,496	2,703	2,952	-2,160	539
October	3,163	465	212	2,487	3,518	2,747	2,878	-2,108	379
November	3,229	483	226	2,519	3,723	2,836	3,109	-2,221	298
December	3,169	519	223	2,427	4,310	2,910	3,565	-2,165	262

^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, residents, 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.