

CHAPTER IX

ACTIVITIES OF THE BANK OF ISRAEL

1. EXPLANATORY NOTES TO THE BANK OF ISRAEL BALANCE SHEET AS AT DECEMBER 31, 1986¹

The Bank of Israel's balance sheet at the end of 1986 stood at NIS16,003 million, compared with NIS14,580 at the end of 1985—an increase of 9.8 percent.

On the assets side, the major changes were an increase in foreign exchange reserves held by the Bank of Israel, and the shrinkage of its securities portfolio. Credit to the government—long-term loans linked to the first currency basket—remained unchanged, after expanding in previous years.

On the liabilities side, there were increases in the government's sheqel deposits and in banknotes and coins in circulation, while the banking institutions' Patam deposits (sheqel accounts denominated in foreign currency) declined.

2. MONETARY POLICY MEASURES IN 1986

Interest Rates

Early 1986 was characterized by a relaxation of the tight monetary restraint pursued since the initiation of the stabilization program in July 1985. Interest rates were accordingly cut three times during the first quarter of the year, both on liquid assets and on discount-window loans. The monthly interest rate on liquid assets was reduced from 3 percent to 1.25, and the rate on discount-window loans to an individual bank—from 5 to 2 percent. In view of the economic developments in the second half of the year, the Bank of Israel's raised its lending rate to the banks in mid-October by about a third of a percentage point. The detailed interest rates are shown in Table IX-2.

¹ This section already appeared in the Bank of Israel's Financial Statements for the Year 1986. The financial statements and their notes are appended at the end of this chapter.

Table IX-1
REQUIRED LIQUIDITY RATIOS ON SHEQEL DEPOSITS,
1985-February 1987
(Percent, by interest steps)

	1985		1986		1987	
	28.11	16.1	13.3	15.5	12.2	9.4
Demand deposits ^a	50	50	45	38	30 ^b	34 ^b
Step 1	14	14	9	7	10	10
Step 2	36	36	36	31	20	24
Time deposits						
1 week	45	45	45	38	30 ^b	34 ^b
Step 1	6	6	6	4	10	10
Step 2	39	39	39	34	20	24
2 weeks	43	43	43	30	30 ^b	34 ^b
Step 1	4	4	4	4	7	7
Step 2	39	39	39	26	23	27
1 month	38	25	25	20	20	20
Step 1	2	2	2	2	2	2
Step 2	36	23	23	18	18	18
2 months	35	35	15	15	15	15
Step 1	2	2	2	2	2	2
Step 2	33	13	13	13	13	13
6 months	30	10	10	10	10	10
Step 1	2	2	2	2	2	2
Step 2	28	8	8	8	8	8
CDs	43	43	43	38	30 ^b	34 ^b
Step 1	7	7	7	7	10	10
Step 2	36	36	36	31	20	24

(a) The required liquidity ratio on nondirected sheqel credit was reduced from 9 percent to 1 percent on 13.3.1986.

(b) The liquidity ratio on foreign currency deposits—residents' foreign currency demand and time deposits (Patam), and residents' foreign currency deposits from German restitution payments is 100 percent.

^aEffective liquidity ratio for banks who agreed to pay interest on demand deposits, after deduction of discount-window loans for demand deposits.

^bThe effective liquidity ratio was changed by permitting a recognized liquidity deficit, of 8 percent in February and 4 percent in April.

Liquidity Ratios

In January 1986 the Bank of Israel lowered the required liquidity ratios on the public's sheqel time deposits of a month and over in order to promote the marketing of such deposits. The large absorption by the government in the first half of the year made it possible, to reduce the liquidity ratios on credit (in March) and on all sheqel deposits (mainly in May). To some extent these measures offset the sharp raise of the required liquidity ratios subsequent to the introduction of the stabilization program in July 1985. The lowering of the liquidity ratios ranged from 5 percentage points on CDs, to 20 percentage points on time deposits of two months and over. The liquidity ratios and their changes are shown in Table IX-1.

Ceilings on Foreign Currency Credit

The exemptions from a ceiling of \$65 million were eliminated on 27.3.1986, and a new ceiling was set, of \$478 million on foreign currency credit, with a change in its allocation between the banks.

Ceilings on Loan Guarantees

The ceilings on guarantees for loans were revised as follows: from 26.9.1985 until 26.3.1986 there was no change in the ceilings, and from 27.3.1986 they were adjusted monthly according to the rise in the CPI. The ceiling on leasing guarantees was raised only once during the year—by 1.3 percent on 29.5.1986.

Open-Market Operations

Treasury bills

Limited use was made in 1986 of open-market operations in treasury bills as an effective instrument of monetary policy and as a means for affecting the size of the money base. The principal effect of treasury bills operations was on the banking system's borrowing rates, in order to narrow the spread between borrowing and lending rates.

The balance of treasury bills held by the public rose from NIS125 million at the end of 1985 to NIS160 million at the end of 1986. During the year the balance fluctuated between NIS70 and NIS160 million, and accounted for no more than 1-2 percent of the public's total liquid financial assets. The gross yield to maturity on treasury bills declined from a level varying between 30 and 38 percent in annual terms at end-1985 to 20-21 percent at the end of 1986.

Bonds

The Bank of Israel continued its policy not to intervene in the secondary bond market—a process initiated at the end 1982. The Bank's bond market operations in 1986, as in prior years, were directed only at ensuring a regular trade in bonds, according to the regulations of the Tel Aviv Stock Exchange, which requires bond issuers to

Table IX-2
THE BANK OF ISRAEL'S INTEREST RATES
 (Percent)

	Monthly interest rate				Annual interest rate				
	1985	1986			1987				
	28.11	9.1	20.2	13.3	1.4*	1.5*	16.10	12.2	9.4
Deposits with the Bank of Israel	3.0	2.5	1.75	1.25		15	19	31	28
Discount-window loans									
Demand deposits	3.0	2.5	1.75	1.25	15		19	31	28
Ordinary	3.5	3.0	2.0	1.5	18		22	34	30
Special	4.0	3.5	2.5	1.75	21		25	37	33
Individual bank	5.0	4.0	3.0	2.0	24		28	40	35

* Transition to quarterly debiting for interest.

Discount-window quotas:

Ordinary: NIS40 million
 Special: NIS40 million
 Individual bank: not subject to quota.

provide for regular trade in their paper. The Bank of Israel's activity in this area was no more than marginal, and amounted, in 1986, to an excess of sales over purchases of NIS0.3 million. The Bank's share in the turnover came to less than one percent.

In the initial period following the Bank of Israel's withdrawal from the bond market, the variation of bond prices increased considerably, but as the policy of making the internal public debt tradable induced institutional investors to buy tradable bonds and operate in the secondary market, the price fluctuations in this market became more moderate, and the standard deviation of the real monthly return fell to 1-2 percent, as against 4-6 percent in 1985, 7-8 percent in 1984, and 4-5 percent in 1983.

"Arrangement" Bank Shares

From September 1986, on instructions from the Ministry of Finance, the Bank of Israel, in its capacity of the government's broker, began to purchase "arrangement" bank shares, in order to reduce the amounts due for redemption in October 1988 and to spread the redemption over a longer period. The Bank's purchases of "arrangement" bank shares on the stock exchange from September until December 1986 totaled NIS3.1 million.

In addition to the Bank's operations on the Stock Exchange, the government purchased in July-October (through the Bank) 'arrangement' bank shares in an amount of \$69 million from Hevrat Haovdim (the holding company of the Histadrut enterprises), as part of the arrangement for extricating Solel Boneh, the Histadrut's construction company, from its financial difficulties.

3. FUNDING THE GOVERNMENT BUDGET

The Bank of Israel, in its capacity as the government's banker, raises funds on medium and long term for financing the government budget and for the recycling of the domestic debt, both through the issue of bonds and the receipt of deposits from financial institutions for the Ministry of Finance. These deposits originate in the public's accumulated savings in the various saving instruments.

The total gross amount of bond issues and deposits in 1986 was NIS4,560 million, of which 55 percent were tradable bonds acquired by the public and by financial institutions as cover for accumulated savings in provident funds and approved saving schemes; 21 percent were deposits of funds accumulated in saving schemes linked to the consumer price index or the dollar, 19 percent were special nontradable bonds issued to pension funds, and 5 percent were accounted for by deposits of insurance companies against life insurance.

In 1986 the balance of the government's borrowing turned negative, amounting to NIS -851 million. After deduction of redemptions from the Bank of Israel's portfolio, the net public borrowing of the government came to NIS-300 million. This reduction of public borrowing accorded with the government's intention to reform the capital market, primarily with a view to releasing funds for the financing of the private sector.

4. THE MANAGEMENT OF STATE LOANS

Redemptions of voluntary government loans in 1986 totaled NIS3,142 million (including interest and linkage differentials), compared with NIS1,422 million in 1985. During 1986, a total of 11,500 government bonds and interest coupons of voluntary loans were presented for redemption.

Disbursements of the redemption of the banking concerns' deposits against saving schemes (linked to the CPI or to the dollar), and withdrawal of deposits before their date of maturity amounted this year to NIS1,130 million, compared with some NIS807 million the year before.

The issue and distribution of bonds of the compulsory loans of the 1970s continued: the Defence Loans of 1970-74, the War Loan, and the Savings Loans of the years 1970 to 1979. Bond certificates issued and distributed numbered 7,700, with a nominal value of some NIS30,000.

In May 1986 the Bank of Israel began to distribute the bond certificates of the "Loan for Financing the Peace for Galilee Campaign."

5. DIRECTED BANK OF ISRAEL CREDIT

The average amount of export credit directed by the Bank of Israel totaled some \$1,840 million in 1986, as compared with some \$1,770 million in 1985, a 4 percent increase to be contrasted with an increase of 11.8 percent in total export financing.

The financing of exports, excluding diamonds, increased in 1986 by 1.5 percent over 1985, while the value of these exports increased by 8 percent. It should be noted that since August 1985, no changes were made in the terms of the export financing funds—neither in the financing ratios nor in interest rates.

6. FOREIGN EXCHANGE CONTROL

Changes in the General Permit

The General Permit is the legal framework that defines the transactions in foreign currency and with foreign residents in which Israeli residents may engage. The General Permit is subject to changes from time to time, according to economic and monetary developments and the policy of the government and the Bank of Israel. The main changes in 1986 were as follows:

A. In May 1986 Israeli residents were permitted to acquire social security rights from the social security institutions in Germany or Austria, even if they were not victims of Nazi persecution. This permit was given subject to the condition that the acquisition of such social security rights be financed from a foreign currency loan from a foreign corporation, repayable exclusively out of the benefits to be received, and that except for these benefits, no other guarantees and liens be given for the repayment of the loan. A further requirement is that the surplus of the benefits over the repayment of the loan be transferred to Israel.

• In August 1986 it was permitted:

A. To transfer abroad advances on imports of goods on the following conditions:

(1) The advance is not to exceed 15 percent of the f.o.b. value of the import goods, or \$50,000, whichever is lower, but advances not exceeding \$500 are transferable in any case.

(2) The advance is for the import of equipment of a kind for which the importer is entitled to receive credit out of deposits earmarked for loans from an authorized dealer,, provided the advance does not exceed 15 percent of the f.o.b. value of the goods to be imported.

(3) Advances on subscriptions to newspapers, periodicals or scientific publications.

B. Suppliers' credits were permitted to be repaid before the due date of such credits as recorded in the import documents, on condition that no interest shall be paid for the period subsequent to the actual repayment of the credit. It was also permitted to postpone the repayment of suppliers' credit, on condition that no guarantee be given or other obligation incurred by an authorized dealer, his subsidiary, an insurer or a corporation affiliated with the borrower in regard to the repayment of the credit on a date later than originally agreed between the parties. Such entities are therefore not allowed to guarantee or stand surety for the payment of suppliers' credit at a postponed date.

C. Transfers of gifts and support to beneficiaries residing abroad were made permissible, provided they do not exceed \$300 a year.

D. Travel allowances, in the case of business travel, were permitted to be taken out of the country in travelers' checks or cashier's checks drawn in favor of the traveler; this was in addition to cash withdrawals through credit cards, which were already permissible earlier.

E. The monthly allowance transferable to a student in an institution of higher learning abroad was increased from \$200 to \$300.

7. SUPERVISION OF BANKING CORPORATIONS

The changes in economic activity in the wake of the stabilization program introduced in July 1985 caused changes of trend in the activities of the banking system and led to considerable deterioration in its financial results for 1986. Preliminary data on the financial results in the first quarter of 1987 indicate that the decline in the banking system's profitability was halted in early 1987. Developments in 1986 required certain changes of emphasis in the activities of the Examiner of Banks Department. More attention was given to dealing with the various risks involved in banking transactions, with greater involvement of the Department in the management and control procedures of the banking system and its measures to attain higher efficiency.

The supervision and audit of banking activity, in particular of banking corporations engaged in high-risk activities, was extended in scope and intensified in 1986. At the same time the banks were given special instructions concerning their risk management, for example as regards the classification of doubtful debts and their public reporting. Much emphasis was put on strengthening the position of the boards of directors, external and internal auditors of the banks, and on their relationship with the Examiner of Banks Department. The follow-up was also tightened of the procedures for the activities of the boards of directors, as laid down by the Examiner in the fall of 1985.

In exceptional cases this required close surveillance by the Bank of Israel of the conditions of employment and retirement of senior managers. Intervention in the management system of the banks was also made necessary in order to implement the Bejski Commission's recommendations.

The importance attached to proper disclosure in the financial statements found expression in the requirements laid down by the Examiner in 1986 for the improvement of proper disclosure. Thus, guidelines were given for the disclosure of appropriations to the reserve for bad debts, and for the restructuring of problematic debts. This continued the process begun some years ago of improving and enhancing the published financial reports, as an instrument of supervision and control. In 1986 the Examiner of Banks Department set up a special audit committee to examine the financial statements of the banks and their conformity with the regulations.

The development of the financial results in recent years, against the background of the bank share "arrangement" required the Examiner of Banks to be more closely involved in the process of increasing the banks' efficiency, particularly in the year under review. Following the bank share crisis of 1983, the banking system embarked on an accelerated drive to save on inputs, but this process slowed down considerably in 1986.

Bank service to customers was given special attention: rules were laid down during the year for the proper disclosure of the bank's transactions with customers in the main areas of banking business, including investment counseling, and the banks set up management and organization systems charged with the responsibility of ensuring the implementation of these rules. The Examiner of Banks Department has set up a field audit team, with the task of tightening up the supervision of adherence to these rules, and the safeguarding of customers' rights in general.

8. ISSUE OF BANKNOTES, COINS AND MEMORIAL COINS

A half-sheqel coin was issued in 1986. The coin bears the likeness of the "Father of the Yishuv", Baron Edmond de Rothschild, which also appeared on the IS500 banknote that was withdrawn from circulation. The Bank of Israel's policy on coin issues is to commemorate the personalities whose likeness appeared on banknotes withdrawn from circulation. The likenesses are as those of the Herzl, Ben Gurion and Ze'ev Jabotinsky coins of IS10, 50 and 100, respectively. The value face and other technical characteristics are the same as those of the regular coins of the same denominations. A full series of Hanukka coins 5747-1986 was issued for the first time in 1986, and comprises all the coin denominations in circulation, from 1 agorah to NIS1. Of the total issue of about a million coins in each denomination, 14,000 were packed in a special transparent folder.

A new banknote of NIS100 was issued on 19.8.1986, bearing the portrait of Itzhak Ben-Zvi, Israel's second president (1953-63).

Table IX-3
VALUE OF BANKNOTES AND COINS IN CIRCULATION AT YEAR'S END, 1985-86

	1985		1986	
	NIS thousand	Percent	NIS thousand	Percent
Banknotes				
Banknotes of the IL series	43.2	0.0	43.2	0.0
Banknotes of the IS series	83,542.6	12.9	9,153.2	0.8
Banknotes of the NIS series				
NIS1	—	—	13,234.6	1.1
NIS5	17,209.9	2.6	25,268.2	2.1
NIS10	241,833.4	37.4	208,758.4	17.4
NIS50	274,953.6	42.5	666,502.3	55.6
NIS100	—	—	224,608.1	18.8
Total, NIS series	533,996.9	82.5	1,128,371.6	95.0
Total, all banknotes	617,582	95.4	1,147,568.0	95.8
Coins				
Coins of the IL series	19.6	0.0	19.6	0.0
Coins of the IS series	5,941.7	0.9	3,624.5	0.3
Coins of the NIS series				
1 agorah	313.1	0.0	988.3	0.0
5 agorot	585.4	0.1	1,713.3	0.1
10 agorot	3,162.2	0.5	8,528.0	0.7
half-sheqel	3,911.0	0.6	8,876.2	0.7
NIS1	15,998.4	2.5	26,400.6	2.2
Total, NIS series	23,970.1	3.7	46,506.5	3.9
Total, all coins	29,931.4	4.6	50,150.6	4.2
Total, banknotes and coins	647,514.1	100.0	1,197,718.6	100.0
Commemorative coins				
Of the IL series	15.5		15.4	
Of the IS series	8.5		8.5	
Of the NIS series			127.1	
Total	24.0		151.0	
Total currency in circulation	647,538.1		1,197,869.6	

9. FOREIGN CURRENCY OPERATIONS

The economic policy pursued by the government since July 1985 contributed to the stabilization of the foreign currency reserves, and the U.S. emergency aid increased them substantially by the end of 1985 and during 1986. The average balance of foreign currency reserves increased in 1986 by 34 percent, following a 16 percent decline in 1985.

10. ECONOMIC RESEARCH AND PUBLICATIONS

Publications and Studies

As every year, the Bank's *Annual Report* contains a substantial part of the current research on the economy carried out by the Bank's Research Department. Other studies carried out in 1986 by the Department's economists are the following:

1. *Two Reports on the Increase in the Money Supply*, by the Governor of the Bank of Israel (see below, Bank of Israel publications).
2. *Two Surveys of Recent Economic Developments*.
3. The National Budget for 1986, in cooperation with the Ministry of Finance and the Ministry of Economic Planning.
4. Internal surveys on monetary and macro-economic developments.
5. Position papers on policy in the money and capital markets, the foreign currency market and the labor market.
6. Main Israeli Economic Data (published weekly).

In addition to its current research, the Department carried out special studies, of which the following were published:

1. Reducing Inflation to the Level Prevailing in Western Countries.
2. An Estimate of the Public's Wealth, 1970–1980.
3. The Effect of the Public's Wealth and its Composition on Private Consumption.
4. The Educational Level of Jews, Population and Labor Force, 1950–1980.
5. Economic Indicators for the Israel Economy.
6. Monetary Announcements and Stock Prices in Israel.
7. Factor Use Intensity in Israel's Foreign Trade, 1965–1982.

The Research Department also publishes a series of discussion papers, presenting to the economic profession pre-publication drafts of economic studies. The series is published in order to bring studies on the Israeli economy to the knowledge of economists sooner than would be possible in the case of final publication, to initiate, before final publication, a fruitful discussion of the studies with the participation of economists outside the bank, and thus contribute to improving the research. The following discussion papers were published in 1985:

1. Financing Government Expenditure in Israel, 1960–1983.
2. Public Financing of Housing—Subsidies, Financing and Progressivity.
3. Monetary Announcements and Stock Prices in Israel.
4. The Contribution of Inflation to the Size of the Banking Sector in Israel.
5. Prices, Wages and Import Prices in Israel, 1970–1983.

6. The Economic Impact of Demographic Factors: Additional Aspects.
7. Wage Differentials in the 1970s between Jews from Different Countries of Origin.
8. Intensity of Labor Disputes under Unexpected Changes in the Rate of Inflation.
9. The Influence of the Domestic and Foreign Debt on Private Consumption in Israel, 1971–1984.
10. Mexico—Anatomy of a Foreign Debt Crisis.
11. An Estimate of Inflationary Expectations in Israel under the Disinflation Programs of 1984–85.
12. Labor Supply and Demand in Israel's Business Sector.
Many studies on diverse subjects are in preparation; the main topics are as follows:
 1. The Policy of Slowing Devaluations and Bubbles in the Market of Domestic Assets.
 2. The Effect of New Information on Securities Prices and the Efficiency of the Capital Market.
 3. The Real Interest Rate on the Public and Private Debt.
 4. An Econometric Model of the Israeli Economy.
 5. The Influence of National Saving and Capital Movements on Domestic Investment.
 6. The Relationship between Private and Public Saving.
 7. Demand for Liquid Assets.
 8. Interest Rates in Israel and their Term Structure.
 9. An Analysis of the Value-Added Tax.
 10. Transfer Payments in the Israeli Economy.
 11. Entry into the Labor Force in the 1980s.
 12. The Structure of Unemployment in Israel.
 13. Lessons from the Doctors' Strike and their Relative Wages.
 14. The Demand for Foreign Currency Reserves in Israel.
 15. Determining the Currency Basket Desirable for Exchange Rate Policy.
 16. Determinants of the Tariff Structure of the Israeli Industrial Sector, 1965–1977.
 17. Indexes of the Profitability of Exports.
 18. The Black Market for Foreign Currency in Israel.
 19. Subsidization and Financing of Housing and its Effect on the Demand for Housing.
 20. Technical Progress, Research and Development, and Productivity in Industry.

Capital Market Reform

An inter-departmental team was set up in 1986 to plan an extensive reform of the capital market (participating departments were: the Research Department, the Examiner of Banks Department, and the Office of the General Counsel). The reform focuses on reducing the government's intervention and on improving the economy's allocation of resources, and includes legal and institutional changes designed to contribute to improving the capital market while safeguarding the interests of savers.

The team deals with the entire complex of economic and institutional aspects of the

capital market; its work program is made up of the following chapters:

1. Financing the government deficit;
2. Financing of private sector investment;
3. Capital movements and foreign exchange control;
4. Alternative solutions for the problems arising from the bank share "arrangement;"
5. The structure of financial intermediaries in the money market and the composition of their activities;
6. The functions of the regulatory authorities and the conception of regulation.

In each of these areas the situation in Israel is reviewed in comparison with other industrialized countries, and recommendations for changes are submitted. Some of the chapters have already been completed, and work on the others continues.

11. BANK OF ISRAEL PUBLICATIONS

The following publications appeared in 1986:

Research Department

1. Annual Report, 1985 (Hebrew, English abridgement).
2. Main Points of the Annual Report 1985 (Hebrew and English).
3. Calendar of Economic Events, 1985 (Hebrew).
4. Recent Economic Developments, No. 39 and 40 (Bilingual: Hebrew and English).
5. Economic Developments in Judea-Samaria and Gaza District, 1983-84 (English).
6. Economic Review No. 61 (Hebrew).
7. National Budget for 1986 (Hebrew and English).
8. Governor's Report on the Increase in the Money Supply between 31.3.1985 and 30.9.1985 (Hebrew).
9. Governor's Report on the Increase in the Money Supply between 30.9.1985 and 31.3.1986 (Hebrew).
10. Industry and Industrial Policy in Israel, 1965-1985.
11. Main Israeli Economic Data (binder, weekly updates, Hebrew and English).
12. The Israeli Economy—Facts in Figures, 1986 (English).
13. Economic Review No. 58 (English).

Examiner of Banks Department

14. Annual Survey of Israel's Banking System, 1986 (Hebrew and English).
15. Annual Statistics of Israel's Banking System, 1981-85 (bilingual: Hebrew and English).
16. Banking Statistics (binder and monthly updates, bilingual: Hebrew and English).
17. Directory of Israeli Bank Branches on 1.1.1986 (Hebrew).

18. Regulations for the Bank Clearing House, Update (Hebrew).
19. The Mortgage Banks (Hebrew).
20. Israel's Banking System, Annual Survey, 1984 (English).
21. Banks in Israel—Selected Figures, 1985 (English).

Bank of Israel Comptroller

22. Financial Statements for the Year 1986 (Hebrew).
23. Financial Statements for the Year 1985 (English).

State Loans Administration

24. Explanatory Notes and Tables for Calculating /government Bond Redemptions (quarterly; Hebrew).
25. State of Israel Bonds—Coupon Bonds and Saving Certificates: List of Stop Payments (monthly and annual, Hebrew).

Currency Department

26. Annual Survey, 1985 (Hebrew).

General Counsel

27. Legislation and Updates (Hebrew).
28. Banking Legislation (Revised) (Hebrew).

Controller of Foreign Exchange

29. Foreign Currency Control Directives (updates and circulars of the Controller, Hebrew).
30. Foreign Currency Liabilities (quarterly, Hebrew).
31. Receipts and Payments in Foreign Currency (quarterly, Hebrew).

Monetary Department

32. Capital Market Developments, Annual Survey, 1985 (Hebrew).
33. Catalog of Securities (Hebrew).
34. Annual Yields on Treasury Bills (Hebrew).

Foreign Currency Department

35. Foreign Currency Exchange Rates in Israel, 1948–1985 (bilingual: Hebrew and English).
36. Representative Sheqel Exchange Rates (weekly, bilingual: Hebrew and English).

12. THE GOVERNOR'S OFFICE

On June 18, 1986, Prof. Michael Bruno was appointed Governor of the Bank of Israel in place of Dr. Moshe Y. Mandelbaum who resigned on June 8, 1986. On November 2, 1986, Yitzhak Rahav was appointed Director General of the Bank, and a senior executive board was set up, composed of the Examiner of Banks, Galia Maor, the Director of the Monetary Department, Victor Medina, the Director of the Research Department, Mordechai Fraenkel, and the Director-General, Itzhak Rahav. On March 1, 1987, Shmuel Bilitzki resigned from his post as General Secretary. On April 15, Freddy Wieder, Controller of Foreign Exchange, was appointed Director of the Foreign Department to replace Israel Igra who retired. Oded Hezroni replaced Freddy Wieder as Controller of Foreign Exchange, in addition to his tasks as Director of the Credit Control Department.

13. ADVISORY COMMITTEE AND ADVISORY COUNCIL

On March 29, 1987, the government appointed an advisory committee and an advisory council to the Bank of Israel, after these bodies had not functioned since March 1985. Mr. Shlomo Lorincz was appointed chairman of the advisory committee and council.

BANK OF ISRAEL BALANCE SHEET AS AT DECEMBER 31, 1986
(Millions of new sheqalim^a)

Notes	Dec. 31, 1986		Dec. 31, 1985	Notes	Dec. 31, 1986		Dec. 31, 1985
Foreign assets				Banknotes and coins in circulation		1,198	648
Gold, foreign exchange and foreign securities	6,990		5,576	Allocations of Special Drawing Rights	6	193	175
Other foreign assets	240	5,578	2	Accounts with the IMF and other foreign liabilities	7	29	26
	7,230			Deposits of the Government and National Institutions			
Government debt				Foreign currency deposits of the Government and National Institutions	872		1,066
Long-term debt	2	7,379	7,380	Deposits of the Government in local currency	1,748	2,620	1,369
Loans				Foreign currency deposits of banking institutions in Israel			
In foreign currency	3	237	294	Against resident deposits—restitution	4,785		4,198
In local currency		263	98	Against resident deposits—other	3,376		4,167
				Against nonresident deposits	817		793
Securities	4			Deposits of banking and financial institutions in Israel		1,689	1,498
Tradable		520	846	Other deposits	8	61	62
Nontradable		245	272	Other accounts	9	915	1,344
		765	1,118	Capital and general reserve	10	320	300
Other accounts	5	129	112				
		16,003	14,580			16,003	14,580

^a See note 1a.

The accompanying notes are an integral part of the financial statements.

**STATEMENT OF INCOME AND EXPENSES FOR
THE YEAR ENDED DECEMBER 31, 1986**
(Millions of new sheqalim^a)

	Notes	1986	1985
Income^b			
From investments abroad	12	723	2,809
From the Government		1,265	5,798
From loans		105	462
From banking institutions in respect of deviations from Bank of Israel regulations		3	10
From securities	13	189	747
Other income		24	47
Total income		2,309	9,873
Expenses^b			
On foreign currency deposits of banking institutions in Israel		981	6,855
On local currency deposits of banking and financial institutions in Israel		320	567
On foreign currency deposits of the Government and National Institutions		4	650
On other deposits and liabilities		45	181
Administrative and general expenses	14	48	36
Printing banknotes and minting coins		12	11
Total expenses		1,410	8,300
Net income	15	1,302	771
Appropriation statement			
Transfer to the general reserve		20	299
Transfer to the government		1,282	472
Total		1,302	771

^a See note 1a.

^b Includes differentials arising from the adjustment of assets and liabilities denominated in or linked to foreign currency for changes in the exchange rate for foreign currencies against the new sheqel.

The accompanying notes are an integral part of the financial statements.

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR ENDED DECEMBER 31, 1986

	Total assets and liabilities				Assets and liabilities in or linked to foreign currency				
	Balance on 31.12.86	Balance on 31.12.85	Balance on 31.12.86	Balance on 31.12.85	Change from preceding year		Balance on 31.12.86	Balance on 31.12.85	Change from preceding year
	(Millions of new sheqalim)		(Millions of adjusted new sheqalim ^a)		(%)		(\$ million)		(%)
Assets									
Foreign assets	7,230	5,578	7,230	6,677	29.6	8.3	4,864	3,720	30.8
Government debt	7,379	7,380	7,379	8,834	-	-16.5	4,964	4,921	0.9
Loans									
In foreign currency	237	294	237	352	-19.4	-32.7	159	196	-18.9
In local currency	263	98	263	117	168.4	124.8			
Securities	765	1,118	765	1,338	-31.6	-42.8			
Other accounts	129 ^b	112 ^b	125 ^c	213	15.2	0.9	63	69	-8.7
Total assets	16,003	14,580	16,089	17,531	9.8	-8.2	10,050	8,906	12.8
Liabilities									
Banknotes and coins in circulation	1,198	648	1,198	776	84.9	54.4			
Foreign liabilities	29	26	29	31	11.5	-6.5	20	17	17.6
Foreign currency deposits of the Government and National Institutions	872	1,066	872	1,276	-18.2	-31.7	586	711	-17.6
Deposits of the Government	1,748	303	1,748	363	476.9	381.5			
Foreign currency deposits of banking institutions in Israel									
Against resident deposits—restitution	4,785	4,198	4,785	5,025	14.0	-4.8	3,219	2,799	15.0
Against resident deposits—other	3,376	4,167	3,376	4,988	-19.0	-32.3	2,271	2,779	-18.3
Against nonresident deposits	817	793	817	949	3.0	-13.9	550	529	4.0
Deposits of banking and financial institutions in Israel	1,689	1,498	1,689	1,763	12.8	-5.8			
Capital and general reserve ^d	320	300	406	438	6.6	-7.3			
Other liabilities	1,169 ^b	1,581 ^b	1,169	1,892	-26.1	-38.2	282	294	-4.1
Total liabilities	16,003	14,580	16,089	17,531	9.8	-8.2	6,928	7,129	-2.8
Foreign exchange reserves held by the Bank of Israel ^e							4,153	3,190	30.2

^a See note 1a. The rate of change in the consumer price index between December 1985 and December 1986 was 19.7 percent.

^b Consists of sums in or linked to foreign currency and unlinked sums.

^c Includes NIS86 million difference between the inflation-adjusted cost of the non-monetary assets and their nominal cost.

^d The difference between the nominal and adjusted change is NIS52 million, the amount required to preserve the value at the end of 1986.

^e Defined as gold, foreign exchange and foreign securities, less deposits of foreign banks and foreign currency deposits of banking institutions in Israel against nonresident deposits.

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 1986

1. ACCOUNTING POLICIES

a. *Unit of measurement*

The financial statements are presented in new sheqalim—nominal values. In the Statement of Changes in Assets and Liabilities the data are also presented after adjusting for inflation (according to the consumer price index; the final index, for December 1986, stood at 163.1 points).

b. *Income and Expenses*

Income and expenses are recorded on the accrual basis.

Accrued interest and income receivable are included in *Other accounts* (assets), except for accrued interest and linkage differentials on securities denominated in local currency, which are included in the Balance Sheet in *Securities*. Accrued interest and expenses payable are included in *Other accounts* (liabilities).

c. *Foreign currency accounts*

Assets and liabilities in foreign currency are translated into new sheqalim (henceforth NIS) at the representative rates published by the Bank of Israel. The representative rate for the U.S. dollar was NIS1.4864 on December 31, 1986 and NIS1.4995 on December 31, 1985. Special Drawing Rights (SDR) are translated into new sheqalim on the basis of the SDR-U.S. dollar rate, i.e. NIS1.8137 per SDR on December 31, 1986 and NIS1.64315 on December 31, 1985.

d. *Gold*

Gold is stated at the rate of SDR35 per fine ounce.

e. *Foreign securities*

These are stated at their foreign currency cost (weighted average purchase price) or market value, whichever is lower, calculated separately for each type of security.

f. *Securities denominated in local currency*

These are stated in the Balance Sheet at their adjusted value (nominal value plus accrued interest and linkage differentials) or market value, whichever is lower, calculated separately for each type of security. Securities not quoted on the stock exchange are stated at their adjusted value, taking into account exposure draft No. 41 of the Institute of Certified Public Accountants in Israel. The adjusted value is calculated on the basis of the last consumer price index published before the Balance Sheet date.

g. *Premises and equipment*

Bank premises and equipment, included in *Other accounts* (assets), are stated at cost net of accumulated depreciation.

h. *Participation in international financial institutions*

The participation is included in *Other accounts* (assets) and stated at cost. The cost includes amounts required to maintain the value of the participation in foreign currency terms, in accordance with the terms of participation in the various institutions (for the participation in the IMF see note 7).

i. *Employee pensions and severance pay*

Provision for employee pensions and severance pay, actuarially computed and adjusted at the Balance Sheet date, is included in *Other accounts* (liabilities). Part of the domestic securities is held against the employee pension and severance pay liability. Income from these securities in excess of the current provision is set off against the increase in this liability in the Statement of Income and Expenses.

2. GOVERNMENT DEBT—LONG TERM

This item consists mainly of a NIS7,325 million debt linked to the basket of foreign currencies and bearing 8 percent interest linked to the same basket. The principal is renewable in annual instalments until 2010, with interest and linkage differentials payable on December 31 of each year (same balance on December 31, 1985).

3. LOANS IN FOREIGN CURRENCY

This item is presented net of NIS348 million—the participation of banking institutions in the credit funds (net of NIS298 million on December 31, 1985).

4. SECURITIES

Tradable securities consist of government bonds, wholly or partly linked to the consumer price index or the dollar; their market value is NIS520 million (NIS847 million on December 31, 1985).

Nontradable securities consist mainly of compulsory government bonds purchased from firms in accordance with the Government Loans (Sundry Provisions) Law, 5738–1977.

5. OTHER ACCOUNTS (ASSETS)

This item consists mainly of (a) accrued interest and other accrued income; (b) participation in the following international financial institutions: International Bank for Reconstruction and Development, International Development Association, International Finance Corporation, and Inter-American Development Fund; (c) premises and equipment net of accumulated depreciation.

6. SPECIAL DRAWING RIGHTS

Allocations of Special Drawing Rights amounted to SDR106 million (same amount on December 31, 1985). The item *Gold, foreign exchange, and foreign securities* includes SDR2000 (SDR65,000 on December 31, 1985).

7. ACCOUNTS WITH THE IMF AND OTHER FOREIGN LIABILITIES

Accounts with the IMF in the General Account are as follows:

	Dec. 31, 1986 (NIS million)	Dec. 31, 1985	Dec. 31, 1986 (SDR million)	Dec. 31, 1985
Quota	810	734	447	447
Liability	810	734	447	447

Other foreign liabilities consist of NIS25 million owing to international financial institutions and NIS4 million on account of trade agreements (on December 31, 1985—NIS24 million and NIS2 million respectively).

8. OTHER DEPOSITS

These consist mainly of deposits of the U.S.–Israel Binational Industrial Research and Development Fund and a deposit of the U.S.–Israel Binational Science Fund.

9. OTHER ACCOUNTS (LIABILITIES)

This item consists mainly of (a) income from the government subject to matched timing (see note 15); (b) accrued interest and amounts payable; and (c) provision for employee pensions and severance pay.

10. CAPITAL AND GENERAL RESERVE

In 1986, NIS20 million net income was transferred to the *General reserve*. The Bank's capital at the Balance Sheet date is NIS60 million and the *General reserve* NIS260 million (on December 31, 1985—NIS60 million and NIS240 million respectively).

11. CONTINGENT LIABILITIES

The contingent liabilities are as follows: (a) uncalled amounts on account of shares and participations subscribed to international financial institutions—NIS216 million (NIS210 million on December 31, 1985); (b) documentary credits—NIS40 million (NIS28 million on December 31, 1985); and (c) guarantees—NIS5 million (NIS31 million on December 31, 1985).

12. INCOME FROM INVESTMENTS ABROAD

In terms of U.S. dollars this amounted to \$520 million (\$417 million in 1985).

13. INCOME FROM SECURITIES

This item does not include income from securities held against the employee pensions and severance pay liability, which covered part of the increase in the liability (see note 1i).

14. ADMINISTRATIVE AND GENERAL EXPENSES

This item, excluding prior years' expenses and adjusted for the average rise in the consumer price index, calculated on a monthly basis, increased by 4 percent (in 1985 it declined by 15 percent).

15. TRANSFER TO THE GOVERNMENT—NET INCOME

Net income, which is the amount to be transferred to the government, is derived according to the matched-timing principle, i.e. income from the government is included in net income in the financial year of the Bank ending during the fiscal year in which such income is budgeted and is payable by the government. Income from securities held against the employee pensions and severance pay liability is not subject to the matched-timing principle (see note 1i).

In 1986 income subject to the matched-timing principle declined by NIS403 million (NIS629 million increase in 1985); this amount was added to the excess of income over expenses and included in net income. (In 1985, NIS802 million was deducted, of which NIS173 million was on account of 1984). The accumulated income subject to matched timing was NIS575 million (NIS978 million on December 31, 1985). This amount is included in the Balance Sheet in *Other accounts* (liabilities).