Bank of Israel

Accounting, Payment and Settlement Systems Department

FINANCIAL STATEMENTS

FOR 2015

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Kost Forer Gabbay & Kasierer
8 Hartom st.
Jerusalem 9777508, Israel

Tel: +972-2-6471000
Fax: +972-2-6471012
ey.com

AUDITORS' REPORT

To the Governor and the Supervisory Council of

BANK OF ISRAEL

We have audited the accompanying Balance Sheets of Bank of Israel (hereinafter, "the Bank") as of December 31, 2015 and 2014, and the related statements of operations and changes in equity of the Bank for each of the years then ended (hereinafter, "the financial statements") featured on pages 6-35 below. These financial statements are the responsibility of the Bank's Supervisory Council, Governor, Director General and Director of the Accounting, Payment and Settlement Systems Department. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Israel, including those prescribed by the Auditors' Regulations (Auditor's Mode of Performance), 1973. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by the Bank's management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bank as of December 31, 2015 and 2014, and the results of its operations and changes in its equity for each of the years then ended, in conformity with accounting principles generally accepted in Israel ("Israeli GAAP"), adapted for principles applicable to central banks, as detailed in Note 1a.

Jerusalem
March 21, 2016

Kost Forer Gabbay & Kasierer
KOST FORER GABBAY & KASIERER
A Member of Ernst & Young Global

Balance Sheets

(TEVET 19, 5776)

As of December 31

	Note	2015	2014
Assets			
Foreign currency assets			
Foreign currency assets abroad	2		
Demand deposits		1,677	1,503
Short-term deposits		7,216	499
Tradable securities		336,985	316,639
Reverse repurchase agreements		3,502	9,628
Derivative financial instruments		1,379	1,932
Other assets		118	-
The International Monetary Fund	3	6,372	6,843
Total foreign currency assets abroad		**357,249**	**337,044**
Other foreign currency assets			
Credit to the government	4	129	128
Total foreign currency assets		**357,378**	**337,172**
Local currency assets			
Tradable securities	5	10,092	11,968
Other	6	79	83
Total local currency assets		**10,171**	**12,051**
Other assets			
International financial institutions	7	941	938
Fixed assets	8	386	378
Total other assets		**1,327**	**1,316**
Total		**368,876**	**350,539**

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

(NIS million, reported amounts)

	Note	As of December 31 2015	2014
Liabilities and equity			
Banknotes and coins in circulation	9	**73,487**	**63,194**
Foreign currency liabilities			
Foreign currency liabilities abroad	2		
Repurchase agreements		2,335	-
Derivative financial instruments		550	124
Other liabilities		941	2,072
Total foreign currency liabilities abroad		**3,826**	**2,196**
Other foreign currency liabilities			
Government deposits	10	9,775	8,400
Deposits of banking corporations	11	1,136	3,261
The International Monetary Fund and others	12	4,914	5,116
Total other foreign currency liabilities		**15,825**	**16,777**
Total foreign currency liabilities		**19,651**	**18,973**
Local currency liabilities			
Government deposits	10	12,766	7,247
Deposits of banking corporations	11	170,224	145,438
Makam	13	115,934	129,713
Other liabilities	14	6,243	*) 6,308
Total local currency liabilities		**305,167**	**288,706**
Total liabilities		**398,305**	**370,873**
Revaluation accounts	15	**26,710**	***) 27,734**
Equity			
Share capital and general reserve	16	3,985	3,985
Accumulated losses		(60,124)	*) (52,053)
Total equity (deficit)		**(56,139)**	***) (48,068)**
Total		**368,876**	**350,539**

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

*) Restated, see Note 1v.

Karnit Flug	Uri Galili	Kalo	Irit Mendelson
Dr. Karnit Flug	**Uri Galili**	**Hezi Kalo**	**Irit Mendelson**
Governor	Chairman of the Supervisory Council	Director General	Director of the Accounting, Payment & Settlement Systems Department

March 21, 2016.

STATEMENT OF OPERATIONS

(NIS million, reported amounts)

	Note	2015	2014
		FOR THE YEAR ENDED DECEMBER 31	
Interest income			
From assets in foreign currency abroad	18	1,539	1,345
From the government	19	605	642
Other	20	1	4
Total interest income		**2,145**	**1,991**
Interest expenses			
To banks and the public	21	510	1,793
To the government	22	233	396
Other	23	78	80
Total interest expenses		**821**	**2,269**
Interest income (expenses), net		**1,324**	**(278)**
Other financial income (expenses)			
Securities and derivative financial instruments	24	1,417	1,115
Exchange rate differentials	25	(9,986)	(1,158)
Miscellaneous	26	(29)	(22)
Total other financial (expenses)		**(8,598)**	**(65)**
Loss from financial transactions		**(7,274)**	**(343)**
Expenses of printing banknotes and minting coins		**(70)**	**(59)**
General and administrative expenses	27	**(673)**	***) (695)**
Other expenses	28	**(54)**	**-**
Loss for the year		**(8,071)**	***) (1,097)**

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

*) Restated, see Note 1v.

STATEMENTS OF CHANGES IN EQUITY (DEFICIT)

(NIS million, reported amounts)

	Share capital and general reserve	Accumulated losses	Total deficit in equity
Balance as of January 1, 2014	3,985	*) (50,956)	*) (46,971)
Loss for the year	-	*) (1,097)	*) (1,097)
Balance as of December 31, 2014	3,985	*) (52,053)	*) (48,068)
Loss for the year	-	(8,071)	(8,071)
Balance as of December 31, 2015	**3,985**	**(60,124)**	**(56,139)**

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

*) Restated, see Note 1v.

NOTES TO THE FINANCIAL STATEMENTS FOR 2015

1. Significant accounting policies

a. General

The financial statements are prepared in accordance with generally accepted accounting principles in Israel (Israeli GAAP), adapted for the special activity of a central bank and consistent with the practice of other central banks. The main items presented in accordance with generally accepted accounting principles of central banks are:

1) Revaluation accounts - as detailed in Section m below.
2) Statements of cash flows - as detailed in Section t below.

b. Definitions

In these financial statements:

1) **"The Bank"**—the Bank of Israel.
2) **"CPI"**—the Consumer Price Index as published by the Central Bureau of Statistics.
3) "**Adjusted amount**"—the historical nominal amount adjusted to the CPI in respect of December 2003, in accordance with the provisions of Opinions 23 and 36 of the Institute of Certified Public Accountants in Israel.
4) **"Reported amount"**—the adjusted amount at the transition date (December 31, 2003), with additional amounts in nominal values that were added after the transition date, less amounts subtracted after the transition date.
5) **"Nominal financial reporting"**—financial reporting based on reported amounts.
6) **"Fair value"**—the amount for which an asset can be acquired or sold (a liability assumed or settled) in a current transaction between independent willing parties.

c. Financial statements in reported amounts

1) In October 2001, the Israel Accounting Standards Board published Accounting Standard No. 12, "Discontinuance of Adjustment of Financial Statements". Pursuant to this Standard, and in accordance with Accounting Standard No. 17, which was published in December 2002, the adjustment of financial statements for the effect of inflation was discontinued as of January 1, 2004.
2) In the past, the Bank prepared its financial statements on the basis of historical cost, with no adjustment for changes in the purchasing power of the Israeli currency. In

the financial statements for 2005, comparative figures for the year ended December 31, 2003 were recalculated on a historical-cost basis, adjusted for changes in the CPI as required by Accounting Standard No. 12, for purposes of the transition to nominal financial reporting.

The adjusted amounts at December 31, 2003 served as a starting point for nominal financial reporting as of January 1, 2004. Any additions and disposals made during the period were included at their nominal values.

3) Amounts of nonfinancial assets do not necessarily reflect their realizable value or current economic value, but only the reported amounts of those assets.

4) The term "cost" in these financial statements denotes the reported amount of cost.

d. Reporting principles

1) Balance Sheet:
   a. Nonfinancial items (fixed assets and investments shown at cost) are stated in reported amounts.
   b. Financial items are stated in the Balance Sheet at their nominal values at the Balance Sheet date.
   c. The Balance Sheet is presented in the format generally accepted by central banks worldwide.

2) Statement of Operations:
   a. Income and expenses originating from nonfinancial items (such as depreciation, prepaid expenses and deferred income) or from provisions included in the Balance Sheet, are derived from the movement between the reported amount of the opening balance and the reported amount of the closing balance.
   b. All other items of the Statement of Operations (such as interest income and interest expenses) are stated at their nominal values.

3) Statement of Changes in Equity:

   In accordance with Section 76 of the Bank of Israel Law, 5770–2010, within three months from the end of each year the Bank will transfer its profits to the Government according to the following provisions:
   a. If the equity amounts to 2.5 percent or more of total assets, the Government will receive an amount equal to the net income, less any accumulated losses.
   b. If the equity amounts to more than 1 percent of total assets but less than 2.5 percent of total assets, the Government will receive 50 percent of the net income, less any accumulated losses.
   c. If the equity amounts to 1 percent or less of total assets, the Government will not receive any profits.

The Bank is permitted to record capital funds arising from accounting principles, provided that the balance of net income not transferred to the Government as aforementioned is added to retained earnings and not recognized as another capital item, unless agreed upon otherwise between the Governor and the Minister of Finance.

In accordance with these provisions, as of December 31, 2015 there is no obligation to transfer funds to the Government.

e. Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires the Bank's management to make estimates and assumptions regarding transactions or matters whose final effect on the financial statements cannot be determined with precision at the time the statements are prepared. Even though the estimates and assumptions are based on management's best judgment, the final effect of such transactions or matters may be different from the estimates and assumptions made in their respect.

f. Income recognition

Income and expenditures are charged to the Statement of Operations on an accrual basis.

Realized gains or losses from foreign currency and securities in local and foreign currency are transferred to the Statement of Operations. These gains or losses are calculated on the basis of average cost of the balances of that asset.

Unrealized gains are not transferred to the Statement of Operations but rather are charged to the "Revaluation accounts" line item in the Balance Sheet.

Unrealized losses are transferred to the Statement of Operations after offsetting unrealized gains of the same asset. These losses derive from the difference between the average cost of an asset and its fair value.

Unrealized losses from foreign currency securities, from local currency securities, or a specific foreign currency are not offset against unrealized gains from other securities or foreign currencies.

Losses recognized in the Statement of Operations are not offset against unrealized gains that will accrue in the future.

g. Securities

1) Foreign currency securities

Tradable foreign currency securities are stated in the Balance Sheet at their fair value as of the Balance Sheet date. The fair value of quoted securities is based on market prices. Unquoted securities are revalued on the basis of data obtained from outside sources.

The adjusted cost of securities is their par value plus the interest, indexation differentials and the balance of the premium or discount not yet amortized. The premium or discount is amortized over the period from the date of purchase until the date of redemption.

The difference between the original cost of the securities and their par value plus interest and the unamortized balance of the premium or discount in respect of each security is charged to the Statement of Operations.

Unrealized differentials from indexation to an index published abroad which accrued on the principal and the difference between the fair value of the securities and their adjusted cost in respect of each security are charged to the ″Revaluation accounts″ line item in the Balance Sheet.

Interest income and amortization of the premium or discount are charged to the Statement of Operations on an accrual basis, and are stated in the ″Interest income from assets in foreign currency abroad″ line item.

Income from the realization of securities is stated in ″Other financial income (expenses)—Securities and derivative financial instruments″.

The balance of unrealized loss, which is calculated separately in respect of each security, is charged to the Statement of Operations at the end of the year and stated under ″Other financial income (expenses)—Securities and derivative financial instruments″.

2) Local currency securities

Tradable government securities in local currency are stated in the Balance Sheet at their fair value as of the Balance Sheet date. The difference between the original cost of securities and their par value, plus interest and the unamortized balance of the premium or discount is charged to the Statement of Operations.

Unrealized indexation differentials accrued on the principal as well as the difference between the fair value of the securities and their adjusted cost are charged to the ″Revaluation accounts″ line item in the Balance Sheet.

Interest income from securities in local currency and amortization of the premium or discount are charged to the Statement of Operations on an accrual basis, and are stated in the ″Interest income from the government″ line item.

The balance of unrealized loss, which is calculated separately in respect of each security, is charged to the Statement of Operations at the end of the year and stated under ″Other financial income (expenses)—Securities and derivative financial instruments″.

h. International financial institutions

1) The International Monetary Fund

The International Monetary Fund (IMF) balances are managed in Special Drawing Rights (hereinafter, "SDR") and presented in New shekels using the representative exchange rates published by the Bank of Israel as of the Balance Sheet date (see Notes 3 and 12 below).

2) Balances in respect of international financial institutions

The Bank of Israel's participation in other international financial institutions is presented under assets in the "International financial institutions" line item according to the cost in the currency in which the participation was paid, translated according to the exchange rate on the transaction date with the necessary reporting adjustments to reported amounts pursuant to Accounting Standard No. 12. Liabilities to international financial institutions are presented under liabilities in the "The International Monetary Fund and others" line item.

i. Fixed assets

1) Fixed assets are stated at cost less accumulated depreciation. Cost includes expenses directly attributable to the purchase of the asset.
2) Improvements and enhancements are charged to the cost of the assets and depreciated over their useful lives, whereas maintenance and repair expenses are charged to the Statement of Operations as incurred.
3) Depreciation is calculated by the straight-line method on the basis of the estimated useful life of the asset:
   Buildings - 50–67 years;
   Motor vehicles - 6.5 years;
   Computers - 4 years;
   Equipment - 10 years.
4) Software that is not an integral part of the related hardware is shown under fixed assets at cost and depreciated by the straight-line method over four years.

j. Banknotes and coins in circulation

Banknotes and coins in circulation that were issued by the Bank reflect the Bank's liability to their holders. This liability is shown in the Bank's Balance Sheet at face value.

k. Short-term loan

The balance of short-term loans (called *makam*, their Hebrew acronym) in the Balance Sheet reflects the redemption price of the loan held by the public, less the balance of unamortized discount. *Makam* sold by the Government to the Bank of Israel but not yet sold to the public is not included in this balance.

Makam are issued for a period of up to one year. The discount is the difference between the redemption price of the *makam* and the proceeds from their sale to the public.

The discount is amortized over the period from the date of issuance of the *makam* to its date of redemption.

Expenses for amortization of the discount on the balance of the *makam* held by the public are shown in the Statement of Operations in "Interest expense to banks and the public".

l. Liabilities in respect of employee rights

All liabilities in respect of employer-employee relations have corresponding reserves in accordance with the law, relevant agreements, common practice and management's expectations.

Liabilities in respect of employee pensions and severance pay are calculated by an expert actuary using the method of estimation of cumulative benefits with probabilities taken into account on the basis of past experience. The discount rate applicable to the reserves is set in accordance with a discount rate which is based on the interest curve of government bonds in Israel, and the rate of future salary increases is estimated by management and based on past experience.

The provision for vacation pay is computed on the basis of the accrued vacation and the effective salary for vacation redemption days at October 31. The difference in the liability that derives from the accrual of vacation days between October 31 and December 31 is immaterial (see Note 14).

m. Revaluation accounts

The following are the types of revaluation accounts:

1) Revaluation accounts that include unrealized profits from exchange rate differentials on balances denominated in foreign currency and unrealized profits from indexation and the revaluation of tradable securities in local currency and foreign currency to their fair value.

   These revaluation accounts are maintained separately for each item (currency, security) and are recognized in the Statement of Operations when the item is fully or partially realized. No offsetting among different types of items is performed.

Revaluation accounts in respect of certain externally managed portfolios are managed at the individual portfolio level.

Accumulated loss in the revaluation accounts relating to each item (currency, security) that originates from indexation differentials and price differentials in securities in local currency and foreign currency and exchange rate differentials on foreign exchange reserves is charged to the Statement of Operations at the end of the year (see also Section f above).

2) Revaluation accounts that consist of unrealized gains or losses arising from changes in actuarial assumptions underlying the computation of pension accruals.

n. Foreign currency

Assets and liabilities denominated in or indexed to foreign currency are shown in New shekels according to the representative exchange rates published by the Bank of Israel at the Balance Sheet date.

Income and expenses in foreign currency are included in the Statement of Operations at the representative exchange rates in effect on the date of each transaction.

Exchange rate differentials arising from the adjustment of assets and liabilities due to changes in the exchange rate include realized and unrealized exchange rate differentials.

Realized gains or losses from exchange rate differentials are carried to the Statement of Operations. Unrealized exchange rate differentials are charged to revaluation accounts separately for each foreign currency.

A loss balance in the revaluation accounts at the end of the year is carried to the Statement of Operations and is not offset against future unrealized gains. Unrealized losses in one currency are not offset against unrealized gains in another currency.

Following are details of the shekel exchange rates against other key currencies:

	December 31			Rate of Change	
	2015	2014	2013	2015	2014
		(NIS)		(Percent)	
US Dollar	3.9020	3.8890	3.4710	0.3	12.0
Euro	4.2468	4.7246	4.7819	(10.1)	(1.2)
Pound Sterling	5.7840	6.0636	5.7419	(4.6)	5.6
Special Drawing Rights (SDRs)[a]	5.4071	5.6344	5.3561	(4.0)	5.2

[a] The SDR rate published by the IMF is determined according to a weighted basket of four currencies - the US dollar, euro, Japanese yen, and pound sterling.

o. Indexation

Assets and liabilities linked to the CPI are shown in accordance with the indexation terms determined for each balance.

The following are details of the CPI (based on the 2002 average):

		December 31			Rate of change	
		2015	2014	2013	2015	2014
		(Points)			(Percent)	
CPI	For November	123.2	124.3	124.4	(0.9)	(0.1)
	For December	123.1	124.3	124.6	(1.0)	(0.2)

p. Interest rates

Some of the local currency interest on the Government's and the banks' balances, which are collected or paid by the Bank of Israel, are based on the Bank of Israel interest rate or the prime interest rate.

The following are the interest rates as of December 31:

	December 31			Rate of change	
	2015	2014	2013	2015	2014
	(Percent)				
Bank of Israel interest	0.10	0.25	1.00	(60.0)	(75.0)
Prime interest	1.60	1.75	2.50	(8.6)	(30.0)

q. Financial instruments

The Bank uses derivatives in its monetary policy and foreign exchange activities, both in Israel and abroad.

1) Activity in financial instruments in Israel

NIS/USD forwards

These transactions are shown net in the Balance Sheet under "Other assets" or "Other liabilities": future receipt of US dollars less future remittance of shekels.

In the Statement of Operations, the results of the transactions are shown under "Interest income from assets in foreign currency abroad".

2) Activity in financial instruments abroad

a. Repurchase (Repo) and Reverse-Repurchase (R. Repo) Agreements

The Bank carries out repurchase (Repo) agreements. Such transactions are composed of the sale of securities under an agreement to purchase them in the future. The transactions are treated as a secured debt and accordingly the securities sold under its terms are not subtracted from the Bank's assets. The liability to purchase the securities is included in the "Repurchase agreements" item. In the Statement of Operations, the results of these transactions are shown in the "Interest income from assets in foreign currency abroad" item.

The Bank also carries out reverse repurchase (R. Repo) agreements. These transactions are treated as a secured debt, and are included in the "Reverse repurchase agreements" item. Securities purchased within the framework of these agreements do not appear in the Balance Sheet. In the Statement of Operations, the results of these transactions are shown in the "Interest income from assets in foreign currency abroad" item.

b. Foreign currency swaps and forwards

These transactions are included on the Balance Sheet as the sum of the differences between the foreign currency received and the foreign currency to be remitted in the future, with the addition of the balance of unamortized premium, and are shown in the "Derivative financial instruments" item. In the Statement of Operations, the results of these transactions are included in the "Interest income from assets in foreign currency abroad" item.

c. Futures

The balance of futures contracts at face value on the date of the financial statements is shown in Note 17 - "Commitments, financial instruments and contingent liabilities". In the Statement of Operations, the change in the value of the contracts is recorded under "Other financial income (expenses)—Securities and derivative financial instruments".

r. Offsetting financial balances

Financial assets and liabilities are presented on the Balance Sheet in net amount only when the Bank has a legal and enforceable offsetting right, and when it is intended to settle the asset or liability on a net basis or to realize the asset and settle the liability simultaneously.

s. Impairment of assets

The Bank applies Accounting Standard No. 15 (Revised), "Impairment of Assets" (hereinafter, "the Standard"), which establishes procedures that the Bank must apply to ensure that its assets in the Balance Sheet (to which the Standard applies) are not stated in an amount greater than the recoverable amount, i.e., the net selling price or value in use (the present value of the estimated future cash flows expected to derive from the use and realization of the asset), whichever is higher.

The Standard applies to all Balance Sheet assets, except for financial assets. The Standard also establishes presentation and disclosure rules for assets that have been impaired. Where the value of the asset in the Balance Sheet exceeds its recoverable amount, the Bank recognizes an impairment loss in the amount of the difference between the asset's book value and recoverable amount. A loss recognized in this manner is reversed only if changes occur in the estimates that were used to determine the recoverable amount of the asset from the date on which the last impairment loss was recognized.

t. Statements of cash flows

These financial statements do not include statements of cash flows because such statements provide no significant information beyond that presented in the financial statements; this practice corresponds with the general practice among some of the central banks worldwide.

u. Taxes

According to the Bank of Israel Law, 5770–2010, regarding the payment of taxes, municipal taxes, levies and other mandatory payments, the Bank has the same status as the State of Israel, and therefore is exempt from paying certain taxes such as income tax and capital gains tax.

v. Restatement

The Bank restated its financial statements as of December 31, 2014 and for the year then ended in order to retroactively reflect the effect of a change in the accounting recognition and presentation of pension accruals arising from changes in actuarial assumptions[1], and a change in the amount of pension accruals resulting from the change in the discount rate underlying the actuarial calculation of pension accruals. The Bank's actuarial obligation

1 Actuarial assumptions include the following:
a. Demographic assumptions on future characteristics of current and former employees such as mortality tables, early retirement rates, etc.
b. Financial assumptions such as discount interest rate, salary increase rate, expected inflation, etc.
c. Expected deviation based on experience in the reporting period compared to the former period's assumptions.

until 2014 was calculated on the basis of a discount rate of 4 percent pursuant to the public reporting directives issued by the Supervisor of Banks. Following the Supervisor of Banks' directive of December 15, 2014 issued to commercial banks regarding a change in the accounting treatment of employee rights, the Bank reviewed the accounting recognition and presentation policy and the discount rate underlying the calculation and adopted the generally accepted accounting method practiced by central banks.

1) A change in the accounting recognition and presentation policy—changes in the pension accruals resulting from changes in underlying actuarial assumptions will be carried to a revaluation account, whereas any other changes in the accrual balance will be carried to the Statement of Operations.
2) A change in the discount rate underlying the calculation—the Bank's actuarial obligation is calculated at the discount rate based on the government's yield curve.

The following tables present the changes in the financial statement items resulting from the restatement:

In the Balance Sheet	December 31, 2014		
	As previously reported	The change	As presented in these financial statements
		(NIS million)	
Other liabilities	4,606	1,702	6,308
Revaluation accounts	29,692	(1,958)	27,734
Accumulated loss	(52,309)	256	(52,053)
Equity	(48,324)	256	(48,068)

In the Statement of Operations	Year ended December 31, 2014		
	As previously reported	The change	As presented in these financial statements
		(NIS million)	
General and administrative expenses	684	11	695
Net loss for the year	1,086	11	1,097

In the Statement of Changes in Equity	December 31, 2014		
	As previously reported	The change	As presented in these financial statements
	(NIS million)		
Accumulated loss	52,309	(256)	52,053

	January 1, 2014		
	As previously reported	The change	As presented in these financial statements
	(NIS million)		
Accumulated loss	51,223	(267)	50,956

2. Foreign currency assets and liabilities abroad

Foreign exchange reserves

As presented in the explanatory remarks, the economic analysis refers to foreign exchange reserves which consist of the balance of the "Foreign currency assets abroad" item less the balance of the "Foreign currency liabilities abroad" item.

The Bank's investment policy relates to these balances.

The following is the composition of the foreign exchange reserves:

	December 31		December 31	
	2015[a]	2014	2015	2014
	(NIS million)		(USD million)	
Foreign currency assets abroad	357,249	337,044	91,555	86,666
Less: Foreign currency liabilities abroad	(3,826)	(2,196)	(980)	(565)
Total foreign exchange reserves	**353,423**	**334,848**	**90,575**	**86,101**

[a] This item includes balances in respect of collaterals on futures: on the assets side, an amount of NIS 118 million as of December 31, 2015 and on the liabilities side, a liability in respect of collaterals on futures totaling NIS 941 million as of December 31, 2015 and NIS 2,072 million as of December 31, 2014.

3. The International Monetary Fund (IMF)[a]

	December 31		December 31	
	2015	2014	2015	2014
	(NIS million)		(SDR million)	
IMF quota	5,738	5,979	1,061	1,061
Less: Liability for the quota	(4,218)	(3,882)	(780)	(689)
Reserve tranche	**1,520**	**2,097**	**281**	**372**
NAB loans	**261**	**338**	**48**	**60**
Special Drawing Rights (SDRs)	**4,591**	**4,408**	**849**	**782**
Total IMF balance	**6,372**	**6,843**	**1,178**	**1,214**

[a] The balances bear interest pursuant to the IMF's terms.

a. Bank of Israel participation in the IMF

Each member country of the IMF has a quota for its participation in the Fund's capital, a quota which is denominated in the SDR currency. The part of the quota that is paid in cash (the reserve tranche) is transferred to the IMF in foreign currency and may be withdrawn by the country, whereas the rest is deposited with the country's central bank in deposits and notes indexed to SDR.

In 2011, a reform was carried out in the quotas and in the IMF's voting rights. In the first stage, which came into effect in March 2011, Israel's quota was increased by about SDR 133 million to approximately SDR 1,061 million. After December 31, 2015, the IMF's approval for the second stage was obtained and on February 9, 2016, Israel's IMF quota increased by about SDR 860 million, to about SDR 1,921 million.

Since 1999, Israel has been part of the IMF's Financial Transaction Plan. This plan is a mechanism through which an IMF member country may exchange SDRs or foreign currency against its local currency and another country is asked to perform a counter exchange. Executing transactions in the context of the Financial Transaction Plan modifies the quota composition between the Reserve Tranche and the other tranche which consists of deposits and notes placed in the central bank (liabilities for the quota).

b. NAB loans

In 2010, Israel joined the IMF's arrangement known as NAB (New Arrangements to Borrow).

In accordance with this arrangement, countries, including Israel, provide a credit line to the IMF, in the context of which loans are extended with maturities of ten years. However, the loans may be repaid to Israel at an earlier date at its request, should it need the money.

As of December 31, 2015, the Bank has provided loans that bear interest at the IMF's terms in an aggregate of NIS 261 million (SDR 48 million).

The credit line which the Bank has provided as of the Balance Sheet date totals NIS 2,704 million (SDR 500 million), of which the IMF's outstanding balance for utilization, excluding loans provided in practice, amounts to NIS 2,444 million (SDR 452 million). In 2014, the balance for utilization amounted to NIS 2,479 million (SDR 440 million).

Simultaneously with the increase in Israel's IMF quota effective from February 9, 2016, the maximum credit line that the Bank is required to provide the IMF was reduced to SDR 340 million.

c. Special Drawing Rights (SDRs)

The balance includes SDRs allocated by the IMF to Israel. Against these allocations the Bank has a liability towards the IMF with no repayment date, which is shown in liabilities under the item of "The International Monetary Fund and others". The State is not required to hold all the SDRs allocated to it.

At the end of 2009, Israel joined another IMF plan, "Voluntary Arrangement for the Purchase and Sale of SDRs". Within the framework of this plan, the State of Israel may be asked to buy or sell some SDRs from other IMF members, as instructed by the IMF. These transactions are recorded in the balance of SDRs.

Under this Arrangement, Israel's SDR holdings may range from 50 percent up to a maximum of 145 percent of total SDRs allocated by the IMF to Israel (the total being SDR 884 million). The IMF has undertaken to consult with Israel before making any purchase or sale of SDRs in the context of the plan.

4. Credit to the government

Binational foundations

Credit on account of binational foundations was given to the government of Israel for investment, in conjunction with the United States government, in binational foundations involved in research, industrial development and science. The foundations deposited these sums with the Bank of Israel and they are shown in foreign currency on the Balance Sheet on the liability side under the item of "The International Monetary Fund and others". Both the credit and the fund deposits earn either fixed interest of 4–4.125 percent or interest on the basis of LIBOR.

5. Tradable securities in local currency

This item consists of tradable Government securities indexed to the last CPI level known on the Balance Sheet date, as well as unindexed securities. The securities are shown at fair value.

6. Other assets

	December 31	
	2015	2014
	(NIS million)	
Loans to employees	74	81
Other receivables	5	2
Total other assets	**79**	**83**

7. International financial institutions

	December 31	
	2015	2014
	(NIS million)	
Investment in BIS shares	282	282
Balance of other international financial institutions[a]	659	656
Total	**941**	**938**

[a] The balances are in respect of the following institutions:
i) The World Bank Group:
1. IBRD—International Bank for Reconstruction and Development
2. IDA—International Development Association
3. MIGA—Multilateral Investment Guarantee Agency
4. IFC—International Finance Corporation
ii) EBRD—European Bank for Reconstruction and Development
iii) IDB—Inter-American Development Bank
IIC—Inter-American Investment Corporation

In July 2015, the Bank decided to participate in the capital increase of the Inter-American Investment Corporation (IIC), in the context of which the Bank will purchase 197 paid-in shares at a total of approximately $3 million. The purchase and receipt of the shares are carried over a period of seven years from the fourth quarter of 2016.

In December 2011, the Bank decided to participate in the ninth general capital increase of the Inter-American Development Bank (hereinafter, "IDB"). In this framework, the

Bank will purchase 223 paid-in shares for approximately $3 million and 8,966 shares of callable capital for approximately $108 million. The purchase and receipt of the shares are spread over a period of five years, commencing from the first quarter of 2012.

The outstanding undertaking to purchase shares from international financial institutions as of December 31, 2015 amounts to approximately NIS 99 million ($25 million). In 2014, the balance available for use amounted to approximately NIS 173 million ($44 million).

When investing in international financial institutions, the Bank is generally required to assume additional undertakings toward these institutions beyond the actual callable capital, which may be exercised by the institutions only in times of need, a scenario which is relatively unlikely.

The balance of the above undertakings as of December 31, 2015 amounts to NIS 4,346 million (December 31, 2014 - NIS 4,326 million).

8. Fixed assets

	Land and buildings[a]	Equipment and furniture, computers, software and vehicles	Total
		(NIS million)	
Cost			
Balance as of January 1, 2015	284	335	619
Additions	68	33	101
Disposals[b]	(71)	(3)	(74)
Balance as of December 31, 2015	**281**	**365**	**646**
Accumulated depreciation			
Balance as of January 1, 2015	65	176	241
Additions	10	30	40
Disposals[b]	(19)	(2)	(21)
Balance as of December 31, 2015	**56**	**204**	**260**
Depreciated balance as of December 31, 2015	**225**	**161**	**386**
Depreciated balance as of December 31, 2014	**219**	**159**	**378**

[a] The Bank's property in Jerusalem, the cost of which, including the depreciated cost of the structures thereon, amounts to approximately NIS 192 million as of December 31, 2015 (approximately NIS 185 million as of December 31, 2014), is leased from the Israel Land Authority (ILA) through June 30, 2016. The Bank is currently negotiating the extension of the lease agreement with the ILA.

[b] The disposals are mainly a result of derecognizing items of fixed assets due to the renovation work on the Bank's building in Jerusalem, see also Note 28.

9. Banknotes and coins in circulation

	December 31, 2015		December 31, 2014	
	Quantity	NIS	Quantity	NIS
	(million)		(million)	
Banknotes and coins in circulation				
NIS 20	37.28	746	35.60	712
NIS 50	59.72	2,986	54.46	2,723
NIS 100	164.89	16,489	151.74	15,174
NIS 200	255.94	51,189	213.31	42,663
Coins in circulation		2,070		1,915
Other[a]		2		2
Commemorative banknotes and coins		5		5
Total		**73,487**		**63,194**

[a] The balance consists mainly of special coin items in circulation.

10. Government deposits

Government balances consist of balances in local currency and balances in foreign currency. All the government balances in the Bank of Israel (excluding several extraordinary balances) can be offset against each other.

	December 31		December 31	
	2015	2014	2015	2014
	(NIS million)		(USD million)	
In foreign currency[a]				
Current deposits	9,040	7,654	2,317	1,968
Other deposits	735	746	188	192
Total deposits in foreign currency	**9,775**	**8,400**	**2,505**	**2,160**
In local currency[b]				
Current deposits	12,766	7,247		
Total government deposits	**22,541**	**15,647**		

[a] **Government deposits in foreign currency**
The current deposits are used for financing budgetary activity. Some foreign currency government deposits bear interest at the rate paid on US Treasury bills with an average of six months to maturity. The average interest rate in 2015 was 0.14 percent (2014–0.06 percent).

[b] **Government deposits in local currency**
The current deposits and the balances used for bond lending are designated for financing budgetary activity. Local currency current deposits bear (when in debit) or are paid (when in credit) interest at the Prime rate. The average Prime rate in 2015 was 1.62 percent (in 2014–2.09 percent), other than that on government balances used for bond lending and on other government balances, for which a different interest rate is collected.

11. Deposits of banking corporations

	December 31		December 31	
	2015	2014	2015	2014
	(NIS million)		(USD million)	
Deposits in foreign currency[a] (*Pamach*)	**1,136**	**3,261**	**291**	**839**
Deposits in local currency[b]				
Time deposits	144,000	117,348		
Demand deposits	26,224	28,090		
Total deposits in local currency	**170,224**	**145,438**		
Total deposits of banking corporations	**171,360**	**148,699**		

[a] **Deposits in foreign currency**
Foreign currency demand deposits (known by their Hebrew acronym, *Pamach*) serve as a liquid asset against nonresidents' foreign currency deposits. The reserve liquidity requirement ranges from 0–6 percent, depending on the term of the deposit.

[b] **Deposits in local currency**

1. The Bank of Israel receives shekel time deposits from the banks. The deposits are allocated by auction for terms of one day, one week and one month. The deposits are not considered liquid assets with regard to the banking corporations' reserve requirements. In addition, deposits are received at the (overnight) deposit window available to the banking corporations at an interest rate of 0.1 percentage points below the Bank of Israel interest rate.
   The interest rate for deposits at the window on December 31, 2015 was 0 percent (on December 31, 2014 - 0 percent).
   The average interest rate for deposits at the window in 2015 was 0 percent (in 2014 - 0.27 percent).
   The average interest rate for time deposits by auction on December 31, 2015 was 0.1 percent (on December 31, 2014 - 0.25 percent).
   The average interest rate for time deposits by auction in 2015 was 0.12 percent (in 2014 - 0.59 percent).
2. The banking corporations' local currency demand deposits serve as a liquid asset against deposits in Israeli currency and Israeli residents' deposits in foreign currency. The reserve liquidity requirement ranges from 0 to 6 percent, depending on the term of the deposit.

12. The International Monetary Fund and others

	December 31	
	2015	2014
	(NIS million)	
Allocated Special Drawing Rights[a]	4,777	4,978
Liabilities to international financial institutions[b]	7	8
Binational foundations	130	130
Total	**4,914**	**5,116**

[a] Special Drawing Rights (SDRs) are sums of money that member countries in the IMF undertook to purchase from the Fund. No repayment date has been set for this liability and it bears interest according to the IMF's terms. The IMF allocates SDRs to its constituent countries commensurate with the size of their quotas.
As of December 31, 2015, Israel has been allocated approximately SDR 884 million.

[b] Liabilities in notes, deposits or letters of guarantee to the following institutions: IDB, IDA, IBRD, EBRD, MIGA, IMF (see Note 1h above).

13. *Makam*

	December 31	
	2015	2014
	(NIS million)	
Redemption value of short-term loans sold to the public	116,000	129,975
Less: Discount at time of sale to the public	(161)	(744)
Proceeds from sale of *makam* to the public	**115,839**	**129,231**
Plus amortization of discount difference for the period through the Balance Sheet date	95	482
Total balance of *makam*	**115,934**	**129,713**

The Short-Term Loan Law, 5744–1984, authorizes the government to issue short-term bills to be sold only to the Bank of Israel, with the Bank selling them to, and buying them from, the public in order to carry out its functions. The government must deposit all proceeds from sales of these bills with the Bank of Israel and may not use them for any purpose other than repayment of the loan taken under said Law, or payment of the yield thereon. The purchase of bills from the government by the Bank of Israel and the deposit of the proceeds from this purchase with the Bank of Israel are not reflected in the Bank's Balance Sheet.

The balance of *makam* shown in the Balance Sheet reflects the redemption value of bills held by the public, less the balance of the unamortized discount.

14. Other liabilities

	December 31	
	2015	2014
	(NIS million)	
Pension and severance pay liabilities	5,982	*) 6,034
Liability for employees' and other rights	187	212
Other payables[a]	74	62
Total other liabilities	**6,243**	***) 6,308**

[a] The balance mainly comprises accounts of statutory bodies that are managed at the Bank of Israel.
*) Restated, see Note 1v.

a. Pension and severance pay liabilities

The pension liability is calculated according to the pension agreements with the Bank's employees and pensioners who commenced their employment before September 2002 and their survivors (on December 31, 2015—271 employees and 695 retirees; on December 31, 2014—292 employees and 692 retirees). The pension liability includes future payment of benefits for Bank employees, former Bank employees whose pensions have been frozen, retirees, and survivors. It also includes obligations on account of the cash value of unused sick leave upon retirement and retirement grants.

The Bank's liability is calculated on the basis of salary and pension data for December 2015 and actuarial calculations. The calculation was performed using a method of estimating benefits which are accrued under various parameters: early retirement rates, pension rates for surviving spouses and orphans, employees' seniority and grade, relevant tax rates, etc.

The actuarial calculation is based on foreseen changes in white-collar mortality rates as well as other demographic tables, in accordance with pension circular 2013-3-1 published by the Capital Market, Insurance, and Savings Division of the Ministry of Finance regarding the preparation of actuarial calculations. The calculation assumes a real annual employee salary increase of 1.5 percent or 3 percent based on the employee's age.

The Bank's actuarial liability was previously calculated on the basis of a 4 percent discount rate, in accordance with the public reporting directives of the Supervisor of Banks and based on past experience.

The balance as of December 31, 2015 and December 31, 2014 was recalculated using the interest rate on Israeli government bonds as the discount rate.

For Bank employees who commenced their employment after September 2002, the Bank's liability for pension and severance pay is covered by regular deposits with a recognized pension and severance pay fund on behalf of the individual employee. Since sums deposited in said manner are neither controlled nor managed by the Bank, neither they nor the liabilities against which they were deposited are recorded in the Balance Sheet.

b. Liability for employees' and other rights

This item includes a liability for employees' vacation pay of approximately NIS 111 million (in 2014—approximately NIS 107 million). The liability at December 31 is calculated on the basis of the accrued vacation days due and the effective salary for vacation redemption at October 31. The difference in the liability that derives from the accrual of vacation days between October 31 and December 31 is immaterial.

15. Revaluation accounts

Revaluation accounts include unrealized profits from the revaluation of the following items (see Notes 1g, 1m and 1n above):

	December 31	
	2015	2014
	(NIS million)	
Balances denominated in foreign currency	23,025	22,680
Tradable securities in foreign currency	4,393	5,361
Tradable securities in local currency	1,231	1,651
Changes in actuarial assumptions for computing pension accruals	(1,939)	*) (1,958)
Total revaluation accounts	**26,710**	***) 27,734**

*) Restated, see Note 1v.

16. Share capital and general reserve in historical nominal values

Data on the Bank's share capital and general reserve appear in the financial statements in reported amounts (see Note 1c above).

The amount in historical nominal values is NIS 320 million at December 31, 2015 and 2014.

The general reserve served in the past to increase the Bank's capital in accordance with Section 6 of the Bank of Israel Law, 5714–1954.

17. Commitments, financial instruments and contingent liabilities

	December 31	
	2015	2014
	(NIS million)	
a. Commitments (off-Balance Sheet)		
Guarantees for government exports	4	8
Documentary credit	42	71
b. Financial instruments		
Currency swaps and forwards:		
Fair value	730	1,835
Future receipts of foreign currency	86,043	47,589
Future payments of foreign currency	84,950	45,743
Stock index futures - fair value:		
Purchase obligation in dollars	4	-
Purchase obligations in euros	35	-
Interest rate futures - fair value:		
Sale obligation in dollars	24	-
c. Contingent liabilities		

There are several claims pending against the Bank of Israel. However, no provision has been recorded in the Bank's books in respect of these claims as it is the Bank's opinion, based on the opinion of its Legal Department, that the probability of these claims being upheld is low, or that the sums involved are not significant.

18. Interest income from assets in foreign currency abroad

	For the year ended December 31	
	2015	2014
	(NIS million)	
Demand deposits	5	3
Short-term deposits	2	7
Tradable securities	1,279	1,398
Securities purchased under R.Repo agreements	(3)	6
Derivative financial instruments, net	253	(75)
The IMF	3	6
Total	**1,539**	**1,345**

19. Interest income from the government

	For the year ended December 31	
	2015	2014
	(NIS million)	
Binational foundations[a]	76	76
Securities in local currency	529	566
Total	**605**	**642**

[a] See Note 4 above.

20. Other interest income

This item consists of interest income from banks in respect of balances bearing the Bank of Israel interest rate.

21. Interest expenses to banks and the public

	For the year ended December 31	
	2015	2014
	(NIS million)	
Makam	362	1,205
Time deposits	148	588
Total	**510**	**1,793**

22. Interest expenses to the government

	For the year ended December 31	
	2015	2014
	(NIS million)	
Balances in local currency[a]	232	396
Balances in foreign currency	1	-
Total	**233**	396

[a] Interest expenses to the government are in local currency (see Note 10 above).

23. Other interest expenses

This item consists mainly of interest expenses in respect of deposits of the US-Israel Binational Industrial Research and Development Foundation, a deposit of the US-Israel Binational Science Foundation and international financial institutions.

24. Other financial income (expenses)—securities and derivative financial instruments

	For the year ended December 31	
	2015	2014
	(NIS million)	
Securities in foreign currency[a]	1,319	1,259
In Israeli currency	-	(2)
Total securities	**1,319**	**1,257**
Derivative financial instruments in foreign currency[b]	98	(142)
Total	**1,417**	**1,115**

[a] Dividend income, gain from sale of securities and loss from net impairment of securities at the end of the year.
[b] Including financial income (expense) from the realization of derivative financial instruments.

25. Other financial income (expenses)—exchange rate differentials

This item consists of exchange rate differentials in respect of balances denominated in foreign currency (see Notes 1f, 1m and 1n).

26. Other financial income (expenses)—miscellaneous

	For the year ended December 31	
	2015	2014
	(NIS million)	
In local currency	-	1
In foreign currency	(29)	(23)
Total[a]	**(29)**	**(22)**

[a] This item includes income (expenses) from commissions from the Bank's financial activities, from international financial institutions and from loans to employees.

27. General and administrative expenses

	For the year ended December 31	
	2015	2014
	(NIS million)	
Salaries and employees’ rights[a]	302	292
Pension and severance pay[b]	242	*) 267
General expenses	129	136
Total	**673**	***) 695**

[a] Salaries and provision for employees' vacation (754 employee posts on December 31, 2015 and 733 employee posts on December 31, 2014).
[b] Defined benefit pension payments to retirees and an update of the Bank's liability for pension payments (see Note 14 above).
*) Restated, see Note 1v.

28. Other expenses

As of December 31, 2015, this item mainly includes capital losses from the disposal of fixed assets.

EXPLANATORY REMARKS TO THE 2015 FINANCIAL STATEMENTS

1. The Principal Changes in the Financial Statements

1.1 Introduction

The Bank of Israel (hereinafter, "the Bank") performs its functions as a central bank and acts to achieve the objectives established for it pursuant to the Bank of Israel Law, 5770–2010 (hereinafter, "the BOI Law" or "the Law")—maintaining price stability and supporting financial stability and growth. The Bank's activity is not intended to yield profits. The actions taken by the Bank have significant implications for its financial statements, yet at the same time, the achievement of the Bank's objectives and the fulfillment of its functions have market-wide economic benefits, which inherently are not reflected in the financial statements.

1.2 The Bank's Balance Sheet

The scope of the Bank of Israel's Balance Sheet in 2015 expanded by NIS 18 billion, amounting to NIS 369 billion (an increase of about 5 percent compared to 2014). The main increase is attributed to the increase in balances of the foreign exchange reserves[1] by NIS 18.6 billion (approximately $4.5 billion) to NIS 353 billion (approximately $90.6 billion) at the end of 2015. This increase was mostly a result of foreign currency purchases by the Bank totaling approximately NIS 34 billion (approximately $9 billion), which were partly offset by the negative revaluation of the balances at year end by approximately NIS 11 billion, mainly due to the appreciation of the shekel vis-à-vis the euro which accounts for a material portion of the balances (Table 5).

Total liabilities in the Balance Sheet increased by NIS 26 billion as a result of several principal factors: (1) an increase in the net balance of monetary instruments—*makam* and time deposits—by approximately NIS 13 billion, to approximately NIS 260 billion, derived from the need to sterilize the excess liquidity injected into the markets, among other reasons due to said purchases of foreign exchange reserves; (2) an increase in

[1] In these explanatory remarks, the term "foreign exchange reserves" is used in its economic sense. The foreign exchange reserves are composed of the balance of "Foreign currency assets abroad" presented under assets in the Bank›s Balance Sheet, less the balance of "Foreign currency liabilities abroad" under liabilities in the Balance Sheet. The change in the balance of "Foreign currency assets abroad" in 2015 amounted to approximately NIS 20 billion and the change in the balance of "Foreign currency liabilities abroad" in 2015 amounted to approximately NIS 2 billion.

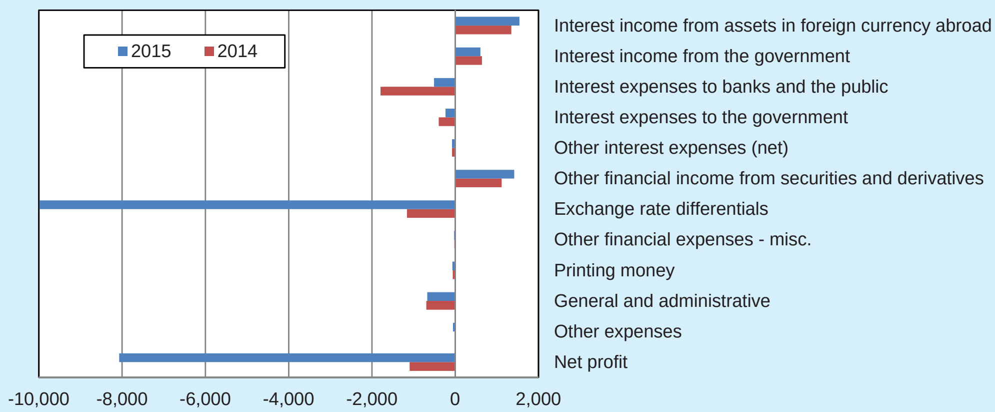
the money base in circulation, consisting of banknotes and coins in circulation and the banks' demand deposits in shekels, which amounted to approximately NIS 8 billion due to the decrease of the BOI interest rate to 0.1 percent during the year; (3) an increase in the government's deposits in the Bank by approximately NIS 7 billion.

The Bank's equity deficit in 2015 increased by about NIS 8 billion—the amount of the annual loss—with a deficit balance of NIS 56 billion at the end of the year (see Section 3.4, "Development of the Deficit in the Bank's Equity").

1.3 Statement of Operations

The loss in the current year amounted to NIS 8.1 billion, compared with a loss of approximately NIS 1.1 billion in 2014 (Figure 1).

Figure 1
The Bank's Profit and Loss Statement, 2014 and 2015 (NIS million)



SOURCE: Bank of Israel.

As indicated in Figure 1 above, the main increase in this year's loss derives from expenses in respect of exchange rate differentials, totaling approximately NIS 10 billion this year, most of which, as mentioned above, resulted from the appreciation of the shekel against the euro by about 10 percent this year. (In 2014, the accumulated exchange rate differentials were positive at approximately NIS 21 billion, the majority of which were carried to the revaluation account. The realized[2] expenses on exchange rate differentials in 2014 amounted to approximately NIS 1.2 billion, the result of a moderate appreciation of the shekel against the euro).

[2] In accordance with the Bank's accounting policy, gains derived from holding the reserves, as well as other gains, are classified as either realized gains, and are included in the Bank's income, or as unrealized revaluation gains. The latter are carried to the revaluation accounts in the Balance Sheet and are not reflected in the Bank's income for the relevant year. The accumulated losses in the revaluation accounts are carried to the Statement of Operations at the end of the year.

In contrast, interest expenses to banks and the public decreased by approximately NIS 1.3 billion, amounting this year to approximately NIS 0.5 billion only—the outcome of the continued lowering of the Bank's interest rate.

An increase in the Bank's income from investment of the foreign exchange reserves, consisting of interest and other financial gains and excluding exchange rate differentials, from NIS 2.4 billion in 2014 to NIS 2.9 billion in 2015, also contributed about NIS 0.5 billion to reducing the loss.

One of the more prominent factors leading to the increase in income from foreign exchange reserves is the contribution of the equities component in the reserves portfolio and foreign currency derivatives.

As for unrealized gains, the effect of the changes in the asset revaluation is expressed in the revaluation accounts in the Balance Sheet, and the effect is therefore not included in the Bank's income (see Note 1 to the Financial Statements). This year, the revaluation changes were negative, resulting in a decrease of about NIS 1 billion in the price revaluation account at year end, as opposed to an increase of about NIS 1.9 billion last year.

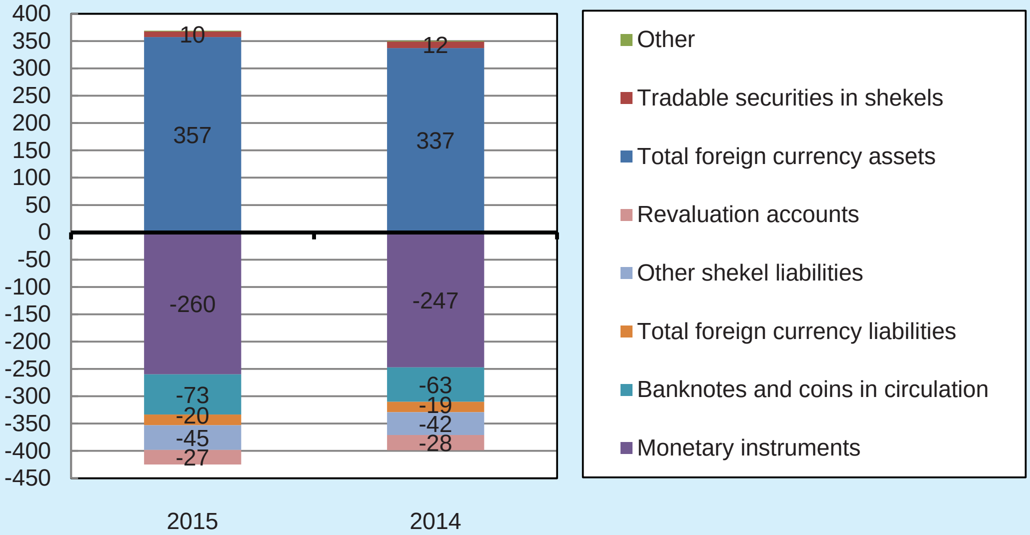
2. Analysis and Explanation of the Principal Changes in the Financial Statements

2.1 Structure of the Reports

The Bank's financial statements are characterized by considerable currency imbalance in the composition of the Bank's assets and liabilities. The vast majority of the Bank's assets are denominated in foreign currency (about 97 percent at the end of 2015), whereas the Bank's liabilities are mostly in New shekels, with foreign currency liabilities accounting for only about 5 percent of the total Balance Sheet (Figure 2).

Purchases of foreign currency in 2008–15 increased the foreign exchange reserves managed by the Bank, while at the same time increasing the scope of monetary instruments used to absorb the excess funds injected in return for the purchase of foreign currency. This increase in the Bank's Balance Sheet enhances the risk of a decline in the Bank's profits given a negative gap between the yield on the reserves and the expenses in respect of the monetary instruments which now address a larger base. Nevertheless, despite the Bank's foreign exchange purchases, this gap was markedly narrowed in recent years, and in the last two years the trend was reversed, whereby gains on the foreign exchange reserves have exceeded the expenses in respect of the monetary instruments.

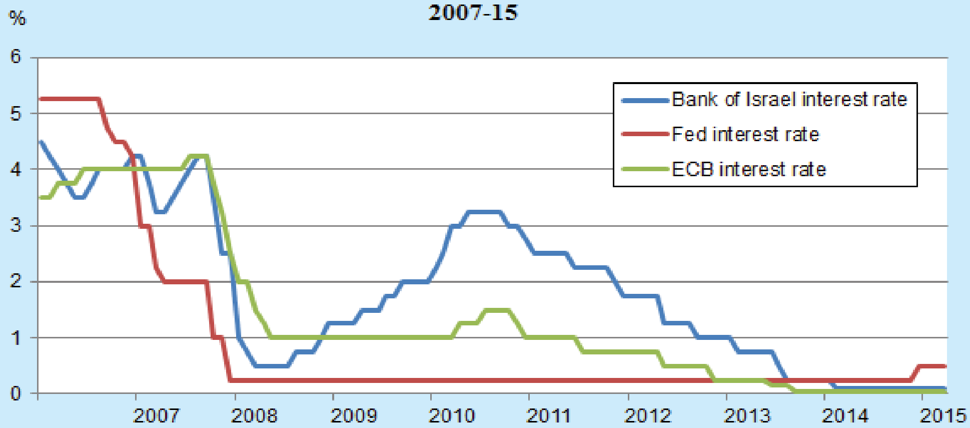
Figure 2
The Bank's Assets and Liabilities, 2014 and 2015 (NIS billion)



SOURCE: Bank of Israel.

The main reason for the reversal is the reduction of the interest rate gaps between Israel and the markets in which the reserves are invested. The interest rate gap between Israel and the United States, which in the late 1990s was in excess of 8 percent, declined significantly, and became positive toward the end of 2015 with the increase of the federal funds rate (Figure 3).

Figure 3
Short-term Interest Rates in Israel, the US and the Eurozone, 2007-15



* Year numbers on the X-axis indicate year-end.

SOURCE: Bank of Israel calculations.

The reduction of the gap was also supported by the sharp drop in yields and the gains from investments in equities which increased the yield on the foreign exchange reserves.

Another impact of foreign currency purchases derives from exchange rate differentials. As a result of the increased scope of foreign exchange reserves in the Bank's Balance Sheet, the rate of change in the exchange rate operates on a higher extent of reserves and therefore might enhance the volatility in the Bank's gains (losses) from this component.

Contrary to the trend of narrowing the gap between the gains on foreign exchange reserves and the cost of monetary instruments, the increased risk of exchange rate losses due to sharp appreciation is the main factor in the Bank's losses and accumulated deficit—a deficit that at the end of 2015 amounted to approximately NIS 56 billion (see more details in Section 3.4, "The Bank's Equity Deficit"). The balance of the revaluation account, which consists of unrealized gains at year end, amounted to approximately NIS 27 billion, so that when examining the deficit from a broader perspective while including the balance of the revaluation accounts, the deficit balance totaled only about NIS 29 billion.

2.2 Effect of the Economic Environment on the Financial Statements

In 2015, the extremely low interest rate environment worldwide was sustained due to the continued trend of monetary accommodation in numerous countries. In eurozone countries and in several other countries worldwide, the interest rate was negative. Low interest rates lead to low revenue on bonds which make up the majority of the Bank's reserve portfolio.

The trends of changes in interest rates and yields, however, were uneven. In the eurozone, additional declines in yields were noted over the year, while in the US, yields increased in the fourth quarter, following the repeated deferment of the expected increase of the federal funds rate throughout the year, until it was increased by 0.25 percent in December 2015.

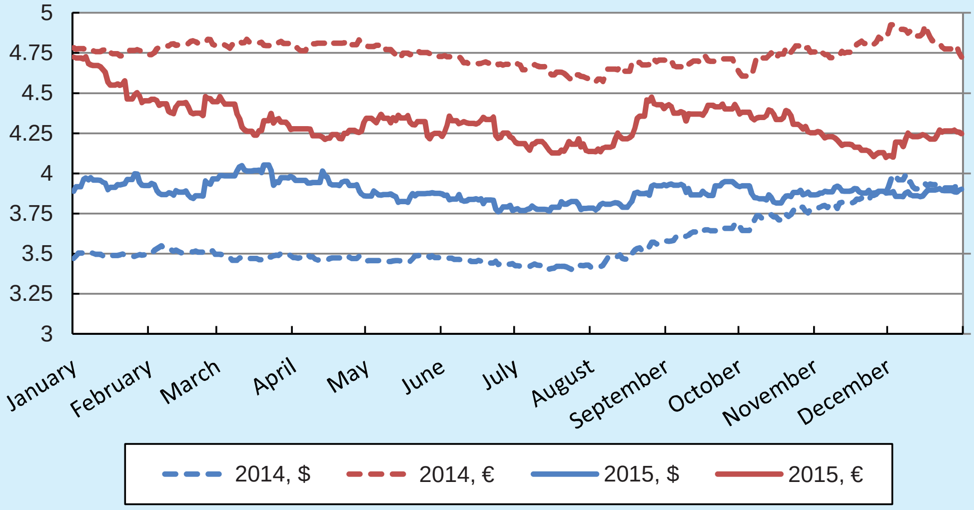
The increase in yields increases the Bank's interest income but reduces its capital gains. A decrease in yields will have the opposite effect.

This year, the shekel appreciated, mainly against the euro (Figure 4), by about 10 percent. The shekel's appreciation leads to recording exchange rate expenses, which, as noted, represented the main cause of the loss in the year.

In stock markets around the world, equity prices increased at the beginning of the year. Later, stock price volatility increased, with a tendency toward price declines. Overall, in 2015, equity investments positively contributed to the Bank's earnings.

The expansion of interest rate margins in foreign currency derivative transactions made these instruments more attractive, allowing growth in their scope and interest income therefrom.

Figure 4
Development of the NIS/$ and NIS/€ Exchange Rates, 2014 and 2015



SOURCE: Bank of Israel.

In Israel, as well, monetary accommodation continued this year with the Bank's interest rate for March reduced to an all-time low of 0.1 percent, in keeping with the reductions that began in late 2011, which contributed markedly to reducing the Bank's expenses in respect of the monetary aggregate. The inflation rate in Israel was negative 1 percent for the year, similar to the global trend of low, and even negative, inflation rates. The decrease was expressed in the decrease in the indexation component in the balance of the Bank's tradable securities in shekels.

2.3 Composition of the Balance Sheet

For the purpose of the economic analysis of the abovementioned changes, the Bank's Financial Statements are presented in Table 1 below in a different manner than in the Financial Statements for accounting purposes. The presentation herein is of the net balances in the Balance Sheet and the net operating results in the Statement of Operations in keeping with the Bank's functions.

Following is an analysis of Financial Statements data, in accordance with economic aggregates and the Bank's functions, in terms of their effect on the Financial Statements for accounting purposes.

Table 1
Aggregate Balance Sheet Balances and the Resulting Profit and Loss

	December 31		Year ended December 31	
	2015	2014	2015	2014
	Balances		Income (expenses)	
	NIS million			
Net assets				
Foreign exchange reserves[a]	353,423	334,848	2,924	2,435
Securities portfolio in shekels	10,092	11,968	529	564
Total	**363,515**	**346,816**	**3,453**	**2,999**
Net liabilities and equity				
Monetary aggregate[b]	259,934	247,061	(510)	(1,793)
Monetary base[c]	99,711	91,284	(69)	(55)
Government balances[d]	22,412	15,519	(157)	(320)
Deposits of banking corporations in foreign currency	1,136	3,261	-	-
Other[e]	9,751	*(10,025	(802)	*((770)
Revaluation accounts[f]	26,710	*(27,734	(9,986)	(1,158)
Bank's equity	(56,139)	*(48,068)	-	-
Total	**363,515**	***(346,816)**	**(11,524)**	***(4,096)**
Net loss			**(8,071)**	***(1,097)**

[a] Foreign exchange reserves consist of total "Foreign currency assets abroad" under assets in the Bank's Balance Sheet less total "Foreign currency liabilities abroad" under liabilities in the Balance Sheet.
[b] The balance of *makam* (central bank bills) and time deposits in local currency less monetary loans.
[c] The balance of banknotes and coins in circulation with the addition of the balance of the shekel demand deposits of banking corporations in the Bank. The expenses in respect of this item include money printing expenses and the income is from banks' local currency demand deposits.
[d] The balance of government deposits in foreign currency with the addition of the balance of government deposits in local currency less the outstanding credit to the government.
[e] The "Other" item consists of other balances in local currency with the addition of total other assets (fixed assets and international financial institutions) less the balance of other liabilities in local currency and other liabilities in foreign currency in respect of the IMF and international financial institutions.
[f] The gain (loss) in respect of this item consists of the exchange rate differentials on foreign exchange reserves. See Notes 1.f and 1.n. Capital gains are presented in accordance with the item from which they were generated.
*) Restated.

3. Select Items

3.1 Foreign Exchange Reserves[3]

One of the Bank's functions according to the Bank of Israel Law, 5770–2010, is to hold and manage the State's foreign exchange reserves.[4] In accordance with the BOI Law, the Monetary Committee has various authorities pertaining to the management of the reserves, and the Monetary Committee outlines the reserves' investment policy guidelines.

3.1.1 Changes in Reserves

The foreign exchange reserves account for the bulk of the Bank's assets, making up about 97 percent of the Bank's total Balance Sheet at the end of 2015. The reserves increased in 2015 by about NIS 18.6 billion (approximately $4.5 billion), reaching approximately NIS 353 billion (about $90.6 billion) at the end of 2015.

The main increase in reserves stems from foreign currency purchases, totaling approximately NIS 34 billion (about $9 billion) by the Bank (Table 2). About two-thirds of the purchases were made within the framework of the Bank's intervention in order to moderate exchange rate fluctuations that are not in line with fundamental economic conditions. The remaining third was purchased in the context of the program intended to offset the effects of natural gas production on the current account.

Interest income and capital gains from foreign exchange reserves, excluding exchange rate differentials, contributed approximately NIS 2.9 billion to the increase in reserves (as detailed below) against a negative revaluation of the reserves that decreased them by approximately NIS 11 billion. The majority of this amount arises from negative exchange rate differentials accrued on the reserves due to the appreciation of the shekel vis-à-vis the euro by about 10 percent this year.

Government and private sector transfers to abroad (net) totaled approximately NIS 7 billion (approximately $1.8 billion) in 2015.

[3] See details in the 2015 Investment of Foreign Exchange Reserves Report, which is published separately. In this report, the yield on holding the reserve portfolio is measured in currency basket terms—the numeraire. The numeraire represents the multicurrency composition of the basket which reflects the potential uses of the reserves.

[4] Foreign exchange reserves are comprised of the balance of "Foreign currency assets abroad" less the balance of "Foreign currency liabilities abroad" in the Bank's Balance Sheet (see Note 2). These balances are used to determine the Bank's investment policy and its reporting to various entities, and therefore form the basis for the analysis of trends in these explanatory remarks.

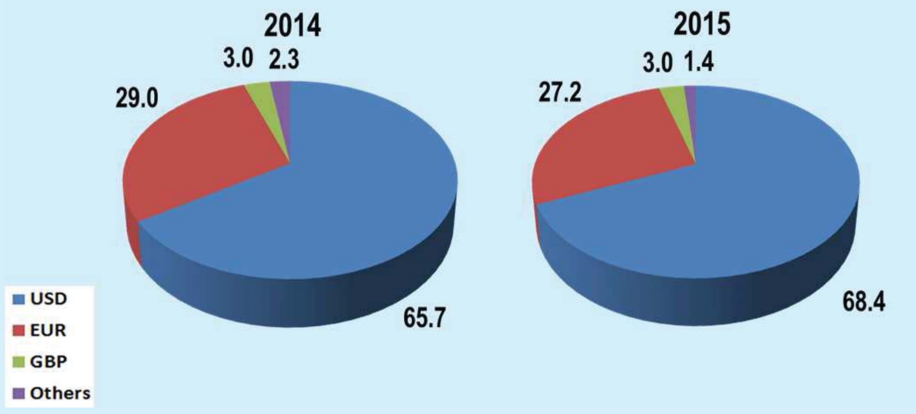
Table 2
Contribution to Foreign Exchange Reserves, by Sector

	2015	2014	2015	2014
	NIS million		USD million	
Change in foreign exchange reserves	**18,575**	**50,957**	**4,474**	**4,311**
Bank of Israel				
Purchases	33,842	24,632	8,770	7,000
Profits	2,924	2,435	748	674
Revaluation and other[a]	-11,153	23,921	-3,218	-3,362
Total Bank of Israel	**25,613**	**50,988**	**6,300**	**4,312**
The government[b]	**-5,056**	**-1,059**	**-1,310**	**-234**
The private sector[c]	**-1,982**	**1,028**	**-516**	**233**

[a] Includes the Bank's payments and receipts in foreign currency.
[b] Transfers from abroad by the Government and national institutions.
[c] Includes income tax payments of the sector in foreign currency.

The currency composition of the reserves in 2015 was principally similar to that of 2014 (Figure 5): The share of the main currencies in the portfolio—the US dollar, the euro and the pound sterling—remained similar. Nevertheless, the share of the other currencies in the reserves portfolio was reduced (from 2.3 percent in 2014 to 1.4 percent in 2015).

Figure 5
Currency Distribution of the Reserves Portfolio, 2015 and 2014
(percent, by end of year NIS)



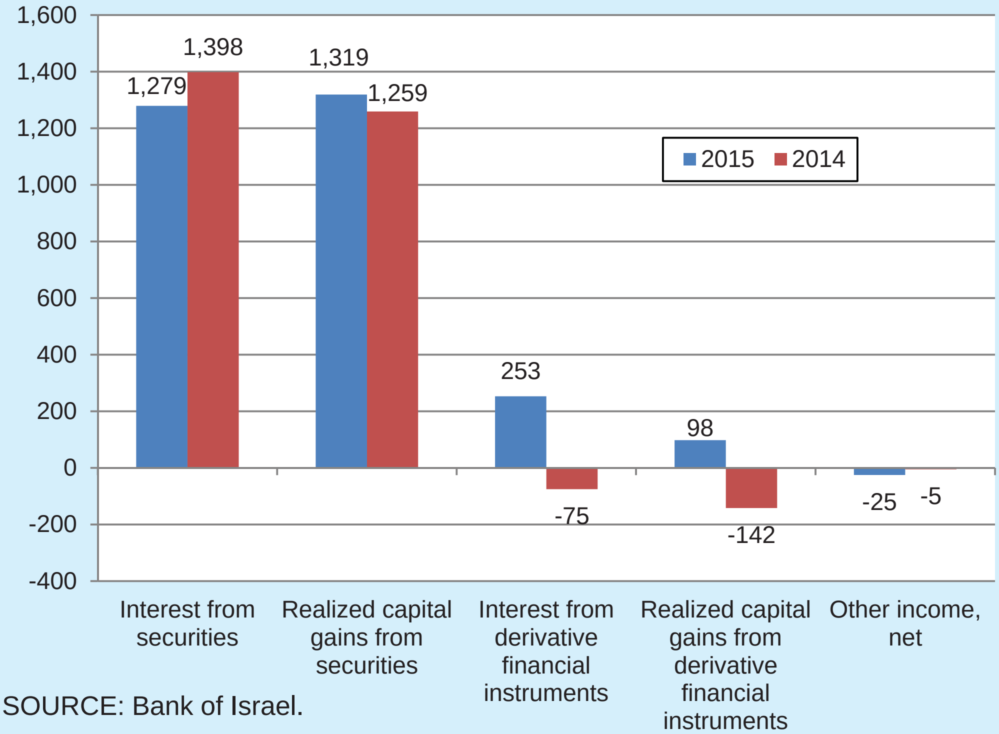
SOURCE: Bank of Israel .

This year, the share of investment in equities was increased, and was diversified into other stock markets. The share of investments in corporate bonds was also increased.

3.1.2 Rate of Return on the Foreign Exchange Reserves

The income from interest and capital gains[5,6] in respect of foreign exchange reserves, excluding exchange rate differentials, amounted to approximately NIS 2.9 billion in 2015, an increase of NIS 0.5 billion compared with 2014 (Table 3). Of this amount, interest income totaled approximately NIS 1.5 billion and capital gains and other income amounted to approximately NIS 1.4 billion (in 2014—NIS 1.3 billion and NIS 1.1 billion, respectively). Figure 6 presents the composition of gains based on the type and source of income.

Figure 6
Composition of Realized Gains from Foreign Exchange Reserves, 2015 and 2014 (NIS million)



SOURCE: Bank of Israel.

In 2015, derivative financial instruments made a positive contribution to gains from foreign exchange reserves. Interest income from derivative financial instruments stems from foreign-currency derivative gains of approximately NIS 253 million, which reflected

[5] Based on the Bank's accounting policy, gains deriving from holding the reserves are classified into gains that are defined as "realized" and included in the Bank's earnings, and unrealized revaluation gains. The latter are carried to the revaluation accounts in the Balance Sheet and are not expressed in the Bank's income for the year.

[6] Capital gains are included in the Financial Statements in "Other financial income".

attractive interest margins in these transactions during the year, and their volume increased.

Capital gains from foreign currency derivatives, totaling NIS 98 million, result from stock market index futures which, similar to equities, yielded a positive return this year.

Income from securities, interest and capital gains in 2015 was similar in scope to 2014. There were notable gains from the realization of equity investments, which were somewhat offset by the decrease in gains from bonds due to this year's low yield and interest rate environment.

The opposite trend was noted in the fair value revaluation component of the assets at year end, which is not realized and is not included in the Bank's earnings (Table 3). The change in the revaluation account balance due to the price differentials, reflecting changes in the prices of assets held by the Bank, was expressed in a decrease of NIS 968 million in revaluation in 2015, as opposed to an increase of NIS 1,918 million last year. The decrease in the revaluation account balances in the current year derives mostly from a more moderate increase in stock prices this year and partially from declines in bond prices due to the raising of the dollar interest rate toward the end of the year.

From an overall perspective of realized and unrealized gains from foreign exchange reserves, excluding exchange rate differentials, income declined by approximately NIS 2.4 billion, reflected in a decline in the interest yield and capital gains to 0.65 percent this year, compared with 1.29 percent in 2014 (Table 3).

Table 3 indicates that this yield is the lowest it has been in recent years, due to record low levels of yields to maturity in the countries in which the reserves are invested.

The yield on exchange rate differentials in shekel terms this year was negative at -3.12 percent and reflected the realized and unrealized negative exchange rate differentials accrued during the year.

In dollar terms as well, a similar trend of currency strengthening is evident and the overall yield in dollar terms at the end of 2015 was -2.78 percent.

Table 3
Foreign Exchange Reserves—Total Income, Exchange Rate Differentials and Returns

		2015	2014	2013*)
Total foreign exchange reserves:			USD million	
End of year		90,575	86,101	81,790
Annual average		87,389	85,973	78,693
Income (expenses) and exchange rate differentials - economic calculation:			NIS million	
Interest and capital gains		2,924	2,435	1,922
Unrealized price differentials[a]		(968)	1,918	2,258
Exchange rate differentials		(10,093)	22,088	(18,167)
Total		**(8,137)**	**26,441**	**(13,987)**
Income (expenses) and exchange rate differentials- economic calculation:			USD million	
Interest and capital gains		748	674	537
Unrealized price differentials[a]		(253)	386	674
Exchange rate differentials		(2,943)	(3,726)	667
Total		**(2,448)**	**(2,666)**	**1,878**
Rates of return[b]:			Percent	
In shekel terms				
	Interest and capital gains	0.65	1.29	1.56
	Exchange rate differentials	(3.12)	7.42	(6.28)
	Total	**(2.47)**	**8.71**	**(4.72)**
In dollar terms				
	Interest and capital gains	0.65	1.29	1.56
	Exchange rate differentials	(3.43)	(4.25)	0.88
	Total	**(2.78)**	**(2.96)**	**2.44**
In numeraire terms of foreign exchange reserves		**0.64**	**1.28**	**0.87**

[a] Unrealized price differentials express the annual change in the revaluation account of foreign currency tradable securities (see Note 15 to the financial statements).
[b] Rates of return, which are shown in annual terms, are based on daily calculations, and relate to income from the foreign exchange reserves, including gains or losses resulting from market price changes.
* Restated.

3.2 Revaluation Accounts

The revaluation accounts are composed of unrealized gains from exchange rate differentials on balances denominated in foreign currency and of unrealized gains from indexation and revaluation of tradable securities in local and foreign currency to their fair value.

Effective from 2015, this item also includes a revaluation account arising from changes in actuarial assumptions underlying the calculation of the pension allowance, see details in Section 3.2.4 below.

3.2.1 Revaluation Account of Balances Denominated in Foreign Currency

The balance of the revaluation account of balances denominated in foreign currency (in respect of exchange rate differentials) at year end amounted to approximately NIS 23 billion, similar to its level in 2014 (approximately NIS 22.7 billion).

In 2015, negative exchange rate differentials were accrued in respect of the adjustment of the balances denominated in foreign currency to the representative exchange rates, totaling approximately NIS 9.6 billion. This was a result of the appreciation of the shekel in relation to the major currencies in the foreign exchange reserves portfolio, mainly against the euro (Table 4). At the end of the year a negative revaluation balance was obtained in the euro and in several other currencies in the reserves portfolio, which depreciated. In line with the Bank's accounting policies, these losses are carried to the Statement of Operations, where losses totaling approximately NIS 10 billion from exchange rate differentials were therefore recorded. The remaining income/amount of NIS 0.3 billion was carried to the revaluation account.

The opposite trend was recorded in 2014, in which gains from exchange rate differentials totaling approximately NIS 21 billion were accrued, mainly as a result of the strengthening of the US dollar, the pound sterling and other currencies in relation to the shekel. Most of these exchange rate differentials were carried to the revaluation account. Realized losses from exchange rate differentials in 2014 amounted to approximately NIS 1.2 billion, also resulting from a decline of about 1.2 percent in the euro's exchange rate against the shekel, although the decline was much more moderate than in 2015.

Table 4
Exchange Rate Differentials due to Adjustment of Foreign Currency Balances to the Representative Exchange Rate

	2015	2014
	NIS million	
Assets		
Foreign currency balances	(10,093)	22,088
Credit to the government—binational foundations	-	14
Liabilities		
Government deposits	230	(662)
Foreign currency deposits of banking corporations	21	(131)
International financial institutions	201	(247)
Binational foundation deposits	-	(14)
Total	**(9,641)**	**21,048**
Realized exchange rate differentials	(9,986)	(1,158)
Unrealized exchange rate differentials	345	22,206

3.2.2 Revaluation Account of Tradable Securities in Foreign Currency

The balance of the revaluation account of tradable securities in foreign currency at the end of 2015 was approximately NIS 4.4 billion, compared with approximately NIS 5.4 billion in 2014. The decrease of approximately NIS 1 billion arises mainly from the decrease in the revaluation account in respect of investment in equities due to the price declines in global stock markets toward the end of 2015 and, to a lesser extent, the decline in bond prices due to the raising of the US federal funds rate by 0.25 percent at year end.

3.2.3 Revaluation Account of Tradable Securities in Local Currency

The balance of the revaluation account of tradable securities in local currency at the end of 2015 was approximately NIS 1.2 billion, a decrease of approximately NIS 420 million compared with 2014. The decrease is mostly due to the reduced scope of the portfolio due to redemptions, and due to the decline in the CPI-indexation component of the revaluation account following the decrease in Israel's CPI in the current year.

3.2.4 Revaluation Account of Changes in Actuarial Assumptions for Computing Pension Accruals

In 2015, the Bank modified the accounting policy underlying the recognition and calculation of the pension and severance liability.

Until 2014, the Bank's actuarial obligation was calculated based on a fixed discount rate of 4 percent in accordance with the public reporting directives previously issued by the Supervisor of Banks. These directives were repealed and superseded by new guidelines. Accordingly, the Bank studied the issue and decided to change the calculation method to one that uses a discount rate based on the government-interest yield curve.[7] In its financial statements for 2015, the Bank adopted this policy retroactively. The effect on the balance of the obligation for 2014 is an increase in pension and severance pay accruals of approximately NIS 1.7 billion (see Note 1v to the Financial Statements).

The Bank concurrently modified the accounting treatment of pension accruals and adapted it to generally accepted accounting principles for central banks worldwide. In the past, the increase in the balance of accrued payroll and employee benefits was entirely recorded in general and administrative expenses.

According to the new policy, changes in the accrual arising from changes in actuarial assumptions[8] are carried to the revaluation account in the Bank's Balance Sheet. Other changes are carried to the Statement of Operations. As opposed to the other revaluation accounts mentioned above, this account may have a debit balance recorded at year end.

This change was also adopted retroactively and its effect on the balance of the revaluation accounts in 2014 is a decrease in the revaluation balance of approximately NIS 2 billion. The effect on the Bank's retained earnings in 2014 is an increase of approximately NIS 0.3 billion.

[7] A series of yields to maturity of Israeli government bonds with different maturities.

[8] Actuarial assumptions consist of demographic assumptions on future characteristics of current and former employees such as mortality tables, early retirement rates, etc.; financial assumptions such as discount interest rate, and deviation of the reporting period's experience from the former period's assumptions.

3.3 The Monetary Base and Aggregate of Monetary Instruments[9]

In 2015, the monetary base, which is comprised of the total banknotes and coins in circulation and the demand deposits of the commercial banks in the Bank[10], increased by approximately NIS 8.4 billion, further to the growth of NIS 11.7 billion recorded in 2014. The monetary base is determined according to the liquidity demand at the Bank's given interest rate. In 2015, the monetary base increased, among other reasons due to the Bank's repeated lowering of the interest rate in recent years.

The monetary base is affected both by factors which are not under the control of the Bank, such as government accounts[11], and by factors which are controlled by the Bank, such as purchases of foreign currency and bonds with the aim of achieving the various objectives of monetary policy (Table 5). The Bank either absorbs liquidity from the markets or injects liquidity to the commercial banks to satisfy demand for the monetary base based on the BOI's interest rate. The Bank adapts the monetary base to the interest rate using monetary instruments—by issuing makam and by using auctioned interest-bearing deposits or loans of the banks, which are not included in the monetary base[12], in accordance with their liquidity needs.

In 2015, the Bank made the largest injection to the monetary base, totaling approximately NIS 34 billion, as a result of the Bank's intervention in the forex market (Table 5). The Bank absorbed the excess liquidity and offset the effects of its transactions on the monetary base to avoid the pressure of short-term interest being lowered to a lower level than that determined by the Bank. The main absorption was carried out through an increase in the banks' term deposits, reflected in an increase of approximately NIS 27 billion in their balance in 2015. The balance of makam decreased by approximately NIS 14 billion and consequently, the balance of the monetary aggregate increased by approximately NIS 13 billion.

Despite the increase in the balance of monetary instruments, as described above, the interest expenses in respect thereof ("Interest expenses to banks and the public") were reduced in the current year to about NIS 0.5 billion, less than one-third of their balance in the previous year (approximately NIS 1.8 billion) due to the reduction of the interest rate for March 2015 to a record low of 0.1 percent.

[9] The aggregate of monetary instruments consists of the balance of makam and term deposits in local currency less monetary loans. The balance of monetary loans at the end of 2015 and 2014 was zero.

[10] The public's demand deposits also form part of liquidity in the economy, yet the Bank can only influence their scope indirectly by imposing a reserve requirement on the commercial banks.

[11] The government's actions also affect the monetary base since the government's accounts are managed at the Bank (in conformity with the Bank of Israel Law, 5770–2010).

[12] Since they are not recognized for the purpose of compliance with the reserve requirement.

Table 5
The Monetary Base—Changes and their Sources

Year	Change in monetary base	Injection (+) / absorption (-) by the government and national institutions[a]	Injection (+) / absorption (-) by the Bank of Israel	Injection from foreign currency conversions at the Bank of Israel	Adjustments[b]
	(1)=(2)+(3)+(4)+(5)	(2)	(3)	(4)	(5)
	NIS million				
2010	11,509	1,418	(32,962)	43,752	(699)
2011	6,078	(2,142)	(7,494)	16,170	(456)
2012	748	(9,130)	10,047	-	(169)
2013	6,443	(10,452)	(2,414)	19,037	272
2014	11,699	1,171	(14,190)	24,632	86
2015	**8,427**	**(14,036)**	**(11,543)**	**33,842**	**164**

[a] The government's injection also includes injections by the National Insurance Institute and by the Postal Bank.
[b] Adjustments include transfers by the national institutions from abroad via the banks but which are defined through the end of 2012 as public sector injections (in column 2). Foreign currency domestic receipts and payments by the Bank of Israel and the government to the private sector, such as income tax receipts in foreign currency, do not change the monetary base as they are transferred directly from the private sector to the government; they are defined as government absorption, yet at the same time they are defined as the private sector contribution to the foreign exchange reserves.

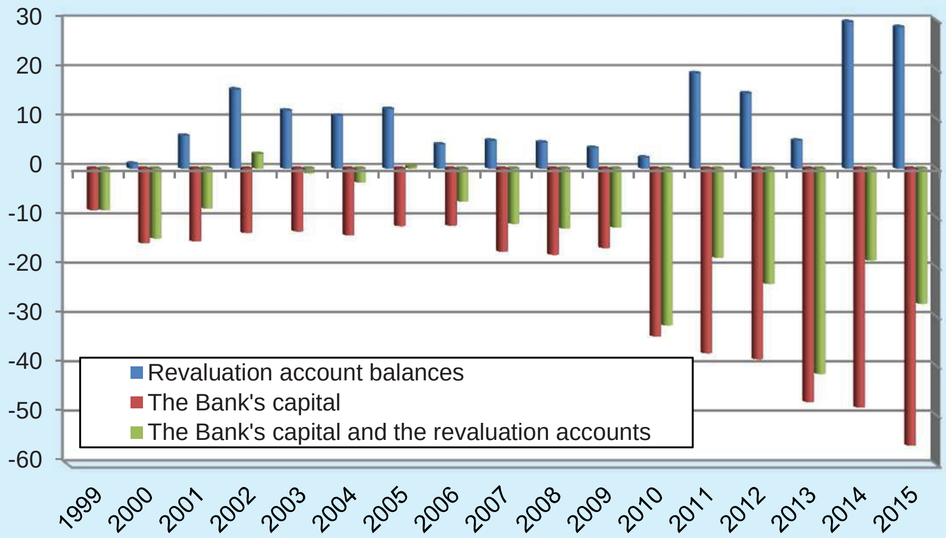
3.4 The Bank's Equity Deficit

Development of the Deficit in the Bank's Equity

At the end of 2015, the Bank has an equity deficit of approximately NIS 56 billion. The balance of revaluation accounts as of that date amounts to NIS 27 billion. Therefore, the Bank's overall equity balance, with the addition of revaluation accounts, amounts to only NIS 29 billion. Figure 7 demonstrates the development of the Bank's deficit simultaneously with the development of the balance of revaluation accounts and the overall underlying trend.

The Bank's equity deficit was initially sustained in 1999, after the Bank in 1998 had transferred to the government about NIS 9 billion in unrealized gains, the vast majority of which were from exchange rate differentials created by the shekel's depreciation against the dollar. The Bank ultimately recorded losses of NIS 8.8 billion in 1999, which partly offset the gains from exchange rate differentials recorded in the previous year. These losses represented the beginning of a deficit in the Bank's Balance Sheets which has continued to date.[13] The main component contributing to the Bank's deficit are losses on exchange rate differentials in an aggregate of NIS 42 billion during said years. The gains from foreign exchange reserves in those years amounted to NIS 67 billion, whereas expenses involving the use of monetary instruments amounted to NIS 76 billion, bringing the gap between the gains from foreign exchange reserves and expenses on monetary instruments, excluding the losses on exchange rate differentials, to approximately only NIS 9 billion.[14]

Figure 7
The Bank's Capital and the Revaluation Accounts, 1999–2015 (NIS billion)



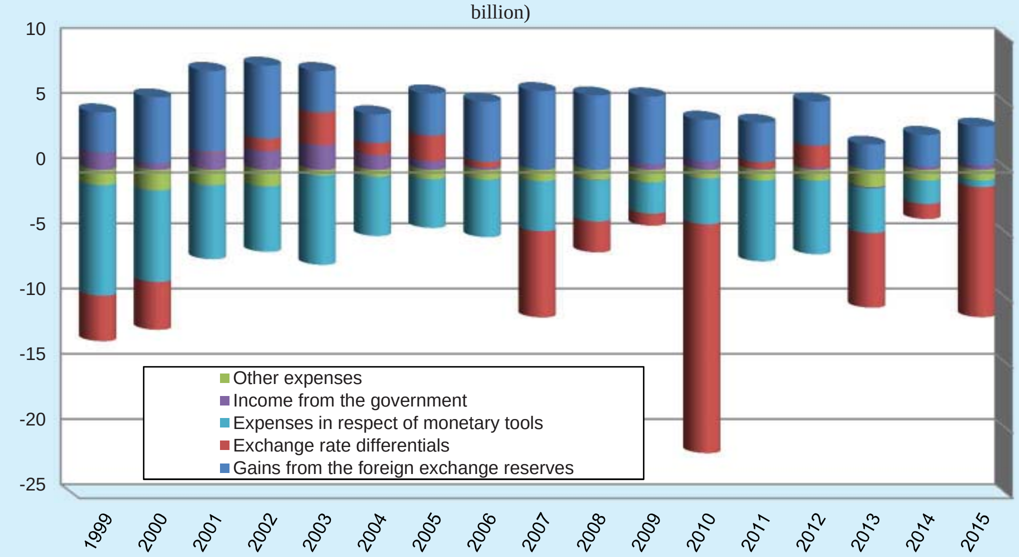
SOURCE: Bank of Israel.

"Other expenses", mainly comprised of various interest expenses, general and administrative expenses and banknote printing expenses, contributed approximately NIS 15 billion to the deficit. The government's income (bonds and deposits) mitigated the accumulated deficit by approximately NIS 10 billion. Figure 8 presents the development of the principal loss components of the deficit on an annual basis, from 1999 when the deficit was first created.

[13] In 2000, the Bank revised the method of recognizing its profit and loss by adding the use of revaluation accounts, which include unrealized gains. This method of recognition is likely to prevent the recurrence of the transfer of paper profits in the years in which the shekel depreciates sharply.

[14] The calculation mentioned here includes realized gains only. When taking into account the unrealized price revaluation differentials, the gap is reduced to NIS 5 billion.

Figure 8
Main Components of the Bank's Equity (Deficit) , 1999–2015 (NIS billion)

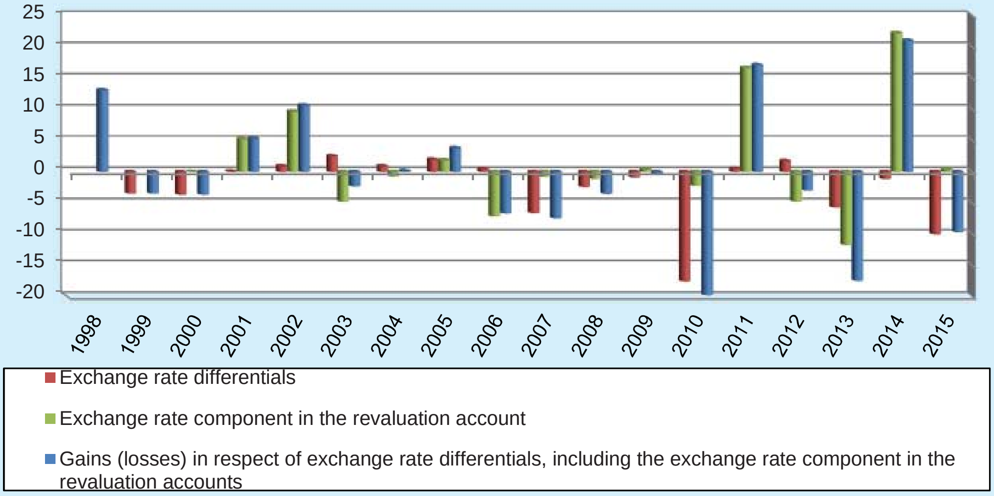


SOURCE: Bank of Israel.

It is evident that the difference between the component of gains on foreign exchange reserves and the cost of monetary instruments in the last two years was positive despite the growth in the portfolio's scope. The reason for this is the decrease in interest rate gaps between the Israeli market and the markets in which the reserves are invested; this until the trend is reversed and a positive interest rate gap is created for some of the currencies as a result of the accommodative monetary policy and the lowering of interest rates in numerous countries. The Bank's growing exposure to equities, whose expected return is higher, also contributed to reducing this gap.

In contrast, the effect of exchange rate differentials is highly volatile and large, and due to the appreciation of the shekel in 2015, it continued to contribute to increasing the Bank's deficit (Figure 9).

Figure 9
Gains (Losses) in Respect of Exchange Rate Differentials, Including the Change in the Revaluation Accounts, 1998–2015 (NIS billion)



SOURCE: Bank of Israel.