

Chapter IX

ACTIVITIES OF THE BANK OF ISRAEL

1. EXPLANATORY NOTES TO THE BANK OF ISRAEL BALANCE SHEET AS AT DECEMBER 31, 1987¹

The Bank of Israel's balance sheet at the end of 1987 totaled NIS 18,912 million, compared with NIS 16,003 million at the end of the previous year—an increase of 18 percent.

On the assets side, the major changes were increases in the foreign exchange reserves held by the Bank of Israel and in local currency loans. Credit to the government—long-term debt linked to the first currency basket²—remained the same as in 1986.

On the liabilities side, there was an increase in the government's foreign currency deposits, as against a decline in its sheqel deposits; an increase in the banks' deposits in both foreign and local currency; and an increase in banknotes and coins in circulation.

2. MONETARY POLICY MEASURES IN 1987

Interest rates

In 1987 the Bank of Israel took action to loosen the formal link between the interest rates it charges in its transactions with the banks, and the interest rates which the latter charge the public. In April 1987 the Bank abolished the direct link between the lending rate and the entitlement to discount-window loans. Instead of using interest rates as the principal instrument of monetary policy, the Bank began to set quantitative targets.

This new framework of monetary policy required the adaptation of the various policy instruments in order to give the Bank control over monetary absorption or injections, while the price would be determined in the money market. This policy

¹ This section already appeared in the Bank of Israel's Financial Statements for the Year 1987. The financial statements and their notes are appended at the end of this chapter.

² The first currency basket, as defined until August 1, 1986, consisted of the following currencies (weights in brackets): US\$ (0.35), £ (0.1295), DM (0.515), Ffr. (0.6832), and Fl. (0.2187). The basket was equal to US\$1.1688 at the end of 1987, compared with US\$1.0127 at the end of 1986.

expressed itself in the manner of use of the instruments of open-market operations—bonds, Treasury bills, and discount-window lending on the Bank's initiative.

Discount-window lending by tender

In addition to the quotas of discount-window loans which the banks may take up at their discretion, the Bank of Israel offers the banks fixed-term discount-window loans, at varying prices. The prices of fixed-term discount-window loans are determined by tender (the first three tenders were at a uniform price; subsequently, the tenders were at differential prices). In order to reduce the banks' uncertainty with regard to the resources that will be at their disposal, the Bank of Israel pre-determines the average volume of the discount-window loans offered each month, but retains, against special circumstances, the discretion to change the volume of the loans offered by tender during the month. Loans given by tender are usually for one week (i.e., 4–5 tenders per month), in order to facilitate the determination of their prices and allocation among the banks in accordance with the changing circumstances of each bank and of the system as a whole.

Treasury bills

The Bank has taken various steps to expand the market for Treasury bills and to improve its trading procedures. The previous computerized trading system was substituted by public multi-lateral trading, similar to that of other securities traded on the Tel Aviv Stock Exchange. In public trading, prices are determined by all participants and not, as previously, by the Bank of Israel alone as 'market-maker'.

Legislation was introduced to permit raising the outstanding balance of Treasury bills from NIS1 billion to NIS3 billion and to lengthen their term to six months.

New issues for 6-month bills were floated by tender, in which the bank undertakes to sell a specified amount at a yield set by the tender; in addition, issues of 'sales offers' for three months, tradeable on the Tel Aviv Stock Exchange, were placed by tender.

The banks were permitted to hold Treasury bills, in an amount of up to 10 percent, as part of their required reserves, and as excess reserves.

During 1987 the Bank of Israel used Treasury bills to absorb and to inject liquidity, in accordance with current requirements of monetary policy. These activities are reflected in the changes in the balance of Treasury bills held by the public.

Indexed bonds

The Bank of Israel also used operations in the secondary bond market, in the framework of its open market operations, as an instrument of monetary policy.

CHANGES IN THE INSTRUMENTS OF MONETARY POLICY, 1986–February 1988

Table IX-1a
RESERVE REQUIREMENTS ON SHEQEL DEPOSITS
(Percent, by interest steps)

	1986	1987		
	15.5	12.2	9.4	30.4
Demand deposits ^a	38	30 ^b	34 ^b	38
Step 1	7	10	10	10
Step 2	31	20	24	28
Time deposits				
1 week	38	30 ^b	34 ^b	38
Step 1	4	10	10	10
Step 2	34	20	24	28
2 weeks	30	30	30	30
Step 1	4	7	7	7
Step 2	26	23	23	23
1 month	20	20	20	20
Step 1	2	2	2	2
Step 2	18	18	18	18
2 months	15	15	15	15
Step 1	2	2	2	2
Step 2	13	13	13	13
6 months	10	10	10	10
Step 1	2	2	2	2
Step 2	8	8	8	8
CDs ^c	38	30 ^b	34 ^b	38
Step 1	7	10	10	10
Step 2	31	20	24	28
According to the new classification as of 25.2.1988		Up to 6 days	1 week to 3 months	3 months or more
Total		33	20	10
Step 1		8	4	2
Step 2		25	16	8

^a The effective liquidity ratio for banks who agreed to pay interest on demand deposits, after deduction of discount-window loans for demand deposits. On August 6, 1987, this arrangement was substituted by a reduction of the formal liquidity ratio on demand deposits.

^b The effective liquidity ratio was changed by permitting a recognized liquidity deficit.

^c The previous CDs were abolished in August, and the new SROs (self-renewing overnight deposits) were introduced. The liquidity ratios were changed, from 10 to 7 percent in the first step and from 28 to 31 percent on the second step. The separate classification of CDs and the special regulations applicable to them were eliminated in February 1988.

Table IX-1b
BANK OF ISRAEL BORROWING AND LENDING RATES, 1986-March 1988
(Annual rates, payable quarterly)

	1986				1987				1988	
	16.10	12.2	9.4	30.4	4.6	23.7	6.8.	26.11	7.1	17.3
On deposits with the Bank of Israel										
On required reserve deposits	19	31	28	21	17	14		14		14
On deposits in excess of required reserves	19	31	28	21	17	14		12		11
Discount-window loans										
Demand deposits	19	31	28	21	17	14		abolished		
Regular	22	34	30	23		20		20		18
Special	25	37	33	25		22		abolished		
To individual bank	28	40	35	28		25		abolished		
Special loan									35	33
Additional loan								50		48

Table IX-1c
DISCOUNT-WINDOW LENDING QUOTAS
(NIS million)

Until 25.11.1987					
Regular loans	40				
Special	40				
To individual bank	no quota				
From 25.11.1987					
Regular discount-window loan, monthly quota			26.11.87	9.12.87	7.1.88
Maximum utilization ^d			360	540	360
Additional discount-window loan			660	720	720
Maximum utilization ^d			-	-	720
			-	-	540

^d Maximum daily utilization, provided that the cumulative utilization from the beginning of the month does not exceed the average monthly quota.

Table IX-1d
FIXED TERM DISCOUNT-WINDOW LOANS BY TENDER
(NIS millions, annual interest rates)

Term of loan:	1987				1988				
	October	November		Dec. ^e	Monthly average				
	18-29	15-22	15-29		Jan. ^e	Feb. ^e	March ^e	April ^e	
Actual average amount	300	250	250	541	750	661	295	274	
Average annual interest rate	23.0	21.0	20.0	24.8	19.2	16.9	17.3	15.2	
Closing rate	- ^f	- ^f	- ^f	23.6	18.5	16.0	16.6	15.0	

^e Average monthly liquidity.

^f Tender at uniform price.

Table IX-1e
INCREASE IN CEILINGS FOR GUARANTEES AGAINST SHEQEL CREDIT
 (Percent of ceiling in the previous period)

1987							1988
29.1	26.2	26.3	23.4	28.5	30.7	29.10	25.2 ⁸
1.5	2.1	1.0	1.3	2.2	1.0	2.3	10

⁸ The two frameworks of guarantees—guarantees for credit and for leases— were combined in February 1988, and the combined ceiling is to be raised by 10 percent a month until October 1988.

Changes in reserve requirements

Together with the shift to quantitative targets, the Bank acted towards the end of the year in various ways to constrain significant fluctuations in short-term borrowing rates.

As part of the change in the system of managing required reserves, the averaging period for the purpose of complying with the reserve regulations was extended from three to 4–5 weeks—a time span that accords with monthly economic cycles.

The weekly reserve deficit which can be averaged over a complete accounting period (formerly 3 weeks, and now 4–5 weeks) was raised from 2 to 10 percent.

The setting of quantitative targets requires that discount-window lending be restricted quantitatively. The Bank of Israel in fact did so at the end of 1987, but in order to prevent fluctuations in the interest rate due to temporary liquidity deficits, permitted the banks a flexible utilization of the quotas allotted to them during the month.

Narrowing the gap between borrowing and lending rates in unindexed sheqel intermediation

The gap between borrowing and lending rates in unindexed sheqel intermediation arises, among other things, from the liquidity requirements and the interest on required liquidity deposits. The Bank took several steps to narrow this gap:

(a) The banks were permitted to hold up to 10 percent of their required liquidity and excess liquidity deposits in the form of Treasury bills, and obtain the commercial yields on these deposits.

(b) The reserve requirements on most sheqel deposits were reduced in February 1988, by about 4 percent.

(c) Although the Bank of Israel's lending rate, and the interest rates of the commercial banks, declined at the end of 1987 and early 1988, the Bank did not reduce the interest rate on required liquidity deposits, thus raising it relatively.

Narrowing interest rate differentials on various types of credit

Financial intermediation by the banks has in the past been subject to restrictions due to expansionary fiscal policy, among them volume ceilings, high liquidity ratios in certain types of financial intermediation, and even absolute prohibitions on engaging in some parts of financial intermediation. These regulations considerably restricted the areas subject to the influence of monetary policy, and created differential interest rates in the various segments of financial intermediation. In 1987, the Bank took steps to reduce the administrative restrictions:

(a) The obligatory investment in government bonds as cover of CPI-indexed saving schemes was reduced, as part of the capital market reform. This helped to enhance the direct and competitive flow of such resources from savers to investors.

(b) Similarly, the obligatory investment as cover for dollar-linked saving schemes was reduced so as to permit the granting of loans out of these funds. To this purpose, the volume ceiling on foreign-currency credit was lifted with regard to credit linked to foreign currency. Foreign-currency linked credit, unlike CPI-indexed credit, is not limited to two years, as laid down in the Interest Ordinance, and can therefore serve as a close substitute for unindexed sheqel credit, thereby helping to narrow the disparities between various interest rates.

(c) The Bank has announced that the ceiling on guarantees against credit will be raised significantly in the course of 1988. This will establish a closer link between the financial intermediation via the banks and that outside the banking system, and will reduce the disparities between interest rates on different credit categories in the banks' intermediation, which have their origin in administrative restrictions.

(d) At the same time, futures transactions began to develop in the banking system's intermediation. These transactions create assets and liabilities within the private sector, both indexed and unindexed, without creating a net position vis-à-vis the public sector, which takes no part in these transactions.

Current activities of monetary policy

During 1987 the Bank used all the available instruments of monetary policy for the conduct of its current monetary policy and for the introduction of basic changes in the structure of the money market and the policy instruments themselves, as described above—as regards reserve requirements, the Bank of Israel's interest rates, quotas of discount-window lending, short-term loans offered by tender, the ceiling on guarantees against credit, Treasury bills, and indexed bonds on the secondary market.

3. THE BANK OF ISRAEL AS THE GOVERNMENT'S FISCAL AGENT

A. 'Arrangement' bank shares

In 1987 the Bank of Israel, in its capacity as the government's banker, and in implementation of a policy laid down by the Ministry of Finance since October 1986, purchased on the government's behalf 'arrangement' bank shares in the amount of NIS376 million, in order to reduce the amounts due for redemption in October 1988. Most of these purchases were made in January and February, after the January 1987 devaluation (NIS184 million), and in October–November, after the world-wide stock exchange crash (NIS117 million).

In addition to the Bank's purchases on the stock market, the government acquired off the floor, through the Bank of Israel, 'arrangement' shares held by the commercial banks—NIS64 million from Bank Hapoalim, as part of the financial assistance to Hevrat Ha'ovdim (the holding company of the Histadrut's economic enterprises) and NIS8 million from the General Bank, in the framework of a rights issue to the shareholders of that bank.

The dollar-yields to maturity of the Bank's share purchases on behalf of the government were between 14 and 18.5 percent per annum.

B. Funding the government budget

In 1987 the Bank of Israel raised funds on medium and long term from the public and saving institutions for the recycling of the domestic debt and for financing the government deficit, both through the issue of bonds and the receipt of deposits from financial institutions for the Ministry of Finance.

The public sector deficit in 1987, as in the previous year, stood at a low level, and the government's borrowing requirements were therefore limited. Net public borrowing (the excess of bond issues over redemptions, excluding interest payments) amounted in 1987 to NIS1,240 million, as compared to NIS1,042 million in 1986.

The negotiable bonds issued by tender to the public and the savings institutions amounted in 1987 to NIS3,725.7 million—a 49 percent increase over 1986.

The policy of commercializing the domestic debt continued in 1987. The issue of special non-negotiable bonds to the provident funds was suspended already in 1986, and since then these institutions have bought negotiable bonds. A first issue of CPI-indexed 12-year bonds, with interest payments due once a year, was made in July. In August, negotiable 15-year bonds were also placed. The negotiable bonds issues amounted to 54 percent of the government's total gross borrowing on the capital market—a proportion similar to that of the previous year.

The deposits by savings institutions and pension funds in 1987 were NIS2,462 million. In May, the Ministry of Finance ceased to authorize special bank issues to the

pension funds, which instead acquired special 20-year bonds issued by the Bank of Israel.

4. THE MANAGEMENT OF STATE LOANS

The redemptions of voluntary loans amounted in 1987 to NIS2,979 million (including interest and linkage differentials), as against NIS3,142 million in 1986. Disbursements of the redemption of the banking concerns' deposits against saving schemes (linked to the CPI or the dollar or the currency basket), and withdrawals of deposits before their date of maturity amounted this year to NIS2,372 million, as compared with NIS1,130 million in 1986.

The final redemption of the 1970 Defense Loan amounted to NIS77 million (including interest, linkage differentials and payments for late redemption), as against NIS190 million in 1986. The amount of this year's redemptions of the Savings Loans of the years 1970 to 1979 was NIS157 million (including interest, linkage differentials and payments for late redemption), as compared to NIS133 million in 1986.

Disbursements for early redemptions this year were NIS98 million at the redemption value, as against NIS69 million in 1986. The number of bond certificates and interest coupons of compulsory loans presented for redemption in 1987 was 429,000, as against 617,000 in 1986.

5. THE DEPARTMENT OF CREDIT AND FOREIGN EXCHANGE CONTROL

In 1987, directed export credit stood at an average \$2,000 million, compared to \$1,815 million in 1986—an 11 percent increase, as compared to an increase of 21 percent in the exports financed.

The financing of exports, excluding diamonds, increased in 1987 by 9.6 percent over 1986, as against a 21 percent rise in exports, excluding diamonds. There was no change in the terms of the export credit funds, except for the 3 percent surcharge imposed in May 1987 on credit from the foreign currency credit funds and the marketing fund.

Foreign exchange control is implemented within the framework of the General Permit which defines the transactions in foreign currency and with foreign residents in which Israeli residents may engage, and by a range of special permits. In 1987 the Bank of Israel's Department of Credit and Foreign Exchange Control has introduced changes in the General Permit and the special permits in various areas subject to foreign exchange control, among them permits for investments abroad and for the establishment of companies abroad.

6. SUPERVISION OF BANKING CORPORATIONS

Israel's banking system has for long been operating within a framework of many and diverse restrictions which have tightly circumscribed the banks' freedom of action, both as regards the terms of financial intermediation in its various segments, and in the marketing of their services. A gradual process of removing part of these restrictions—which were imposed on the banks not necessarily for considerations of stability—has been underway in the last two years. This lifting of restrictions is part of a policy designed to reduce the involvement of the government and the Bank of Israel in the money and capital markets and in the activities of the banking corporations.

The process of eliminating restrictions broadens the banking concerns' freedom of action and holds out new prospects for their profitable commercial activity. At the same time, however, new risks are created which call for a thorough reappraisal of the banking corporations' risk management. In 1987 the Banking Supervision Department embarked on laying the appropriate foundations for dealing with this problem. Teams were set up in the department to examine systems and instruments for analyzing the state of the banking corporations, and to re-examine the substance of the information required from them and the manner in which it may be obtained, in order to make the supervision of the banks more efficient.

The Banking Supervision Department proceeded to further strengthen the control capability of other participants in the supervision of the banking concerns, such as the boards of directors, the certified public accountants, the internal comptrollers, and the banks' customers. The department took action to expand the participation of the public in the information on the activities of the banks, by instructions to the banks to publish more frequent and more exhaustive financial statements.

The department continued in 1987 to follow up on the banking system's restructuring, its efficiency measures and cost reductions—a process that reflected itself in the closure of banking institutions and cuts in the number of branch offices and manpower. This follow-up on the banks' progress towards higher efficiency will continue also in 1988.

7. ISSUE OF BANKNOTES, COINS AND MEMORIAL COINS

No need arose in 1987 to issue a higher-denomination banknote, as was frequent in the years of high inflation. In 1988, a banknote of NIS20 was nevertheless issued, which will facilitate the public's cash transactions and will help the Bank of Israel to save expenses in issuing and dealing with banknotes.

Currency in circulation amounted at the end of 1987 to NIS1,671 million, as compared to NIS1,197 million at the end of 1986—a nominal increase of 39.5 percent. The real-term increase (the change in total currency in circulation deflated by the Consumer Price Index) was 20.2 percent.

Mainly as a result of the lower inflation rate, which led to a drastic cut of the cost of holding cash, 1987 was the third consecutive year of a rise in the real value of the amount of currency in circulation.

8. FOREIGN CURRENCY OPERATIONS

The management of the foreign currency reserves has the objective of obtaining a reasonable return on investments together with maintaining a level of liquidity adequate for the economy's requirements, and at the same time to minimize risk to the value of the reserves. To this latter purpose, the reserves are held in a portfolio which accords, in principle, with the mix of currencies of the reserves' expected uses, i.e., the currency basket of imports, foreign debt service, etc. At times, there are cautious deviations from this composition of the reserves, when future trends in foreign cross rates can be reasonably assessed against the background of economic policy and macro-economic factors in the relevant economies.

Total income from the investment of the foreign currency reserves reached \$776 million this year, as compared to \$520 million in 1986 and \$417 million in 1985. It should be emphasized that the size of this income is affected by its denomination in U.S. dollars, the weakening of which has in the last three years increased the dollar value of the reserves invested in other currencies.

9. ECONOMIC RESEARCH AND PUBLICATIONS

As every year, the Bank's *Annual Report* contains a substantial part of the current research on the economy carried out by the Bank's Research Department. Other studies carried out in 1987 by the Department's economists are the following:

1. Two *Reports on the Increase in the Money Supply*, by the Governor of the Bank of Israel (see below, Bank of Israel Publications).
2. Two *Surveys of Recent Economic Developments*.
3. The National Budget for 1987, in cooperation with the Ministry of Finance and the Ministry of Economic Planning.

4. Internal surveys on monetary and macro-economic developments.
5. Position papers on policy in the money and capital markets, the foreign currency market and the labor market.
6. Main Israeli Economic Data (published weekly).

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

1. Inflation and Money Creation in the 1970s.
2. The Variance of Prices under Different Exchange Rate Regimes.
3. The Financing of Government Expenditure in Israel, 1960–83.
4. The Contribution of Inflation to the Expansion of the Banking Sector.
5. Financing, Subsidization and Progressivity
in Mortgages Granted by the Government, 1976–84.
6. The Influence of the Domestic and Foreign Debt on Private Consumption.
7. Demographic Factors in the Trend of Long-term Saving.
8. Wage Differentials between Male Jewish Workers
from Different Countries of Origin in the 1970s.
9. Inflation as an Equilibrating Mechanism between
Real Wages and Other Factors of Production.
10. The Government's Involvement in Israel's
Capital Market: A Review and Outline of Reform.
11. Expected Effects of Changes in the Minimum Wage Law.
12. Two Years After the Stabilization Program—a Survey.
13. Inflation and Growth in Israel.
14. The Government's Involvement in Industry.
15. Adjusting to High Inflation Rates: The Case of Israel.
16. Prices, Wages and Import Prices in Israel, 1970–83.

The Research Department also publishes a series of discussion papers, presenting the economic profession pre-publication drafts of economic studies. The following discussion papers were published in 1987:

1. Determinants of the Tariff Structure of the Israeli Industrial Sector, 1965–77.
2. Inflationary Expectation Formation in Israel: A Specification Test.
3. Trying to Cope with Large Government Deficits: The Israeli Experience.
4. Financing the Government Deficit: Foreign Debt versus Inflation.
5. Israel's Stabilization, a Two-Year Review.

Many studies on diverse subjects are in preparation, and a data bank covering all areas of economic activity is being constructed. The main studies that have already been discussed internally in draft form are the following:

1. The Current Rate of Inflation and Obstacles to Growth in Israel: A Proposed Solution.
2. The Effect of Government Policy on the Demand for Housing.
3. Determinants of Government Transfer Payments and How to Reduce them.
4. The Monetary Dynamics of Inflation in Israel.
5. Inflationary Expectations and the Efficiency of the Israeli Stock Market.
6. The Development of Wages, 1972–83: Temporary and Permanent Workers.
7. International Interest Rate Differentials, Credit Policy and Foreign Exchange Control.
8. Indexes of Export Profitability.
9. A Decade Ahead: The Desirable and the Possible.
10. The Influence of National Savings and Net International Capital Movements on Israel's Domestic Investment.
11. Labor Market Indicators.
12. The Intensity of Labor Conflicts under Unexpected Changes in the Inflation Rate.
13. The Logic of 'Ricardian Equivalence' and the Deficit–Inflation Debate
14. Seigniorage and Real Returns in a Banking Economy.

The following studies presented by members of the Research Department at the Sapir Forum (which opened this year) will be published:

1. Wage Policy During Disinflation.
2. Monetary Policy and Institutions in Israel: Past, Present and Future.
3. Short-Run Monetary Control in Israel.

10. BANK OF ISRAEL PUBLICATIONS

The following publications appeared in 1987:

Research Department

1. Annual Report, 1986 (Hebrew, English Abridgment).
2. Main Points of the Annual Report 1986 (Hebrew and English).
3. Calendar of Economic Events, 1986 (Hebrew).
4. Recent Economic Developments, No. 41 and 42 (Bilingual: Hebrew and English).
5. Economic Review No. 62 and 63 (Hebrew).
6. National Budget for 1987 (Hebrew and English).
7. Governor's Report on the Increase in the Money Supply between 31.5.1986 and 31.7.1986.

8. Governor's Report on the Increase in the Money Supply between 31.7.1986 and 31.3.1987.
9. Main Israeli Economic Data (binder, weekly updates, Hebrew and English).
10. The Israeli Economy—Facts in Figures, 1987 (English)
11. Economic Review No. 59 (English).

Banking Supervision Department

12. Annual Survey of Israel's Banking System, 1987 (Hebrew and English).
13. Annual Statistics of Israel's Banking System, 1982–86 (Bilingual: Hebrew and English).
14. Directory of Israeli Bank Branches on 1.1.1987 (Hebrew).
15. Banking Review No. 6 (Hebrew).
16. Ordinary and Special Banking Institutions, 1903–85
17. Publications on Banking Issues in Israel, 1987 (Hebrew).
18. Instructions for the Preparation of Annual Financial Reports by Mortgage Banks, Investment Banks and Financial Institutions (Hebrew).
19. Bank-Customer Relations, Legislation and Instructions.
20. Israel's Banking System, 1986 (English).
21. Banks in Israel—Selected Figures, 1986 (English).
22. Banking Review No.1 (English).

Bank of Israel Comptroller

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

State Loans Administration

24. Explanatory Notes and Tables for Calculating Government Bond Redemptions (Quarterly; Hebrew).
25. State of Israel Bonds—Coupon Bonds and Saving Certificates: List of Stop Payments (monthly and annual, Hebrew).
26. Procedure of Redemption in Israel of State of Israel Bonds and State of Israel Certificates (Hebrew).

Currency Department

27. Annual Survey, 1986 (Hebrew).

General Counsel

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

Controller of Foreign Exchange

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

Monetary Department

- 33. Capital Market Developments, Annual Survey, 1986 (Hebrew).

Foreign Currency Department

- 34. Foreign Currency Exchange Rates in Israel, 1986 (bilingual: Hebrew and English).
- 35. Representative Sheqel Exchange Rates (weekly; bilingual: Hebrew and English).

11. THE GOVERNOR'S OFFICE

In June 1987 Victor Medina resigned his post as Director of the Monetary Department and left the Bank of Israel.

On September 1, 1987, David Klein joined the senior executive board of the Bank, in charge of the Monetary Department and the Department of Credit and Foreign Exchange Control. On August 1, Avraham Ben-Bassat replaced Mordechai Fraenkel as Director of the Research Department, and Amnon Goldschmidt was appointed Supervisor of Banks in place of Galia Maor. These changes were made in order to enable the members of the senior executive board—Mordechai Fraenkel, David Klein, Galia Maor and Yitzhak Rahav—to concentrate on assisting the Governor in shaping the Bank's policy and managing the Bank.

On February 1, 1988, Menachem Raboy resigned his post as senior advisor to the Governor and director of public relations and information.

12. ADVISORY COMMITTEE AND ADVISORY COUNCIL

The Advisory Committee discussed the following issues: the substitution of SROs for CDs, the lowering of liquidity ratios on saving schemes, and changes in the liquidity regime of the banks. The Committee endorsed the changes proposed by the Bank of Israel.

The Advisory Council heard reviews by the Governor and the members of the Bank's management on issues of monetary policy and economic developments, and held discussions of these topics. The Council also discussed the Bank's Annual Report for 1986, and the structure of the banking system.

**STATEMENT OF INCOME AND EXPENSES FOR
THE YEAR ENDED DECEMBER 31, 1987**
(Millions of new sheqalim^a)

	Notes	1987	1986
Income^b			
From investments abroad	12	1,449	723
From the Government		1,758	1,265
From loans		147	105
From securities	13	108	189
Other income		62	27
Total income		3,524	2,309
Expenses^b			
On foreign currency deposits of banking institutions in Israel		1,631	981
On local currency deposits of banking and financial institutions in Israel		387	320
On foreign currency deposits of the Government and National Institutions		30	4
On other deposits and liabilities		72	45
Administrative and general expenses	14	115	48
Printing banknotes and minting coins		5	12
Total expenses		2,240	1,410
Excess of income over expenses		1,284	899
Plus income from the Government subject to matched timing	15	207	403
Net income		1,491	1,302
Appropriation statement			
Transfer to the general reserve			20
Transfer to the government		1,491	1,282
Total		1,491	1,302

^a See note 1a.

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

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

STATEMENT OF CHANGES IN ASSETS AND LIABILITIES FOR THE YEAR ENDED DECEMBER 31, 1987

	Total assets and liabilities						Assets and liabilities in or linked to foreign currency		
	Balance on 31.12.87	Balance on 31.12.86	Balance on 31.12.87	Balance on 31.12.86	Change from preceding year		Balance on 31.12.87	Balance on 31.12.86	Change from preceding year
	(Millions of new sheqalim)	(Millions of adjusted new sheqalim ^a)			(% Nominal Real		(\$ million)	(%)	
Assets									
Foreign assets	9,377	7,230	9,377	8,394	29.7	11.7	6,095	4,864	25.3
Government debt	7,380	7,379	7,380	8,567	-	-13.9	4,797	4,964	-3.4
Loans									
In foreign currency	263	237	263	275	11.0	-4.4	170	159	6.9
In local currency	943	263	943	305	258.6	209.2			
Securities	649	765	649	888	-15.2	-26.9			
Other accounts	300 ^b	129 ^b	432 ^c	276 ^d	132.6	56.5	118	63	87.3
Total assets	18,912	16,003	19,044	18,705	18.2	1.8	11,180	10,050	11.2
Liabilities									
Banknotes and coins in circulation	1,671	1,198	1,671	1,391	39.5	20.1			
Foreign liabilities	45	29	45	34	55.2	32.4	29	20	45.0
Foreign currency deposits of the Government and National Institutions	2,751	872	2,751	1,012	215.5	171.8	1,788	586	205.1
Deposits of the Government	719	1,748	719	2,029	-58.9	-64.6			
Foreign currency deposits of banking institutions in Israel									
Against resident deposits—restitution	5,689	4,785	5,689	5,555	18.9	2.4	3,698	3,219	14.9
Against resident deposits—other	3,315	3,376	3,315	3,920	-1.8	-15.4	2,154	2,271	-5.2
Against nonresident deposits	915	817	915	949	12.0	-3.6	595	550	8.2
Deposits of banking and financial institutions in Israel	2,479	1,689	2,479	1,961	46.8	26.4			
Other liabilities	1,008 ^b	1,169 ^b	1,008	1,357	-13.8	-25.7	301	282	6.7
Capital and general reserve ^e	320	320	452	497 ^d	-	-9.1			
Total liabilities	18,912	16,003	19,044	18,705	18.2	1.8	8,565	6,928	23.6
Foreign exchange reserves held by the Bank of Israel ^f							5,329	4,153	28.3

^a See note 1a. The rate of change in the consumer price index between December 1986 and December 1987 was 16.1 percent.

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

^c Includes NIS132 million difference between the inflation-adjusted cost of the non-monetary assets and their nominal cost (in 1986—NIS117 million).

^d The difference between the nominal and adjusted change is NIS45 million, the amount required to preserve the value at the end of 1987.

^e Revised.

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

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

NOTES TO THE FINANCIAL STATEMENTS DECEMBER 31, 1986

1. ACCOUNTING POLICIES

a. *Unit of measurement*

The financial statements are presented in new sheqalim—nominal values. In the Statement of Changes in Assets and Liabilities the data are also presented after adjusting for inflation (according to the consumer price index; the final index, for December 1987, stood at 189.4 points).

b. *Income and Expenses*

Income and expenses are recorded on the accrual basis.

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

c. *Foreign currency accounts*

Assets and liabilities in foreign currency are translated into new sheqalim (henceforth NIS) at the representative rates published by the Bank of Israel. The representative rate for the U.S. dollar was NIS1.5386 on December 31, 1987 and NIS1.4864 on December 31, 1986. Special Drawing Rights (SDR) are translated into new sheqalim on the basis of the SDR-U.S. dollar rate, i.e. NIS2.1640 per SDR on December 31, 1987 and NIS1.8137 on December 31, 1986.

d. *Gold*

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

e. *Foreign securities*

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

f. *Securities denominated in local currency*

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

g. *Premises and equipment*

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

h. *Participation in international financial institutions*

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

i. *Employee pensions and severance pay*

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

2. GOVERNMENT DEBT—LONG TERM

This item consists mainly of a NIS7,325 million debt linked to the basket of foreign currencies (as defined until August 1, 1986) and bearing 8 percent interest linked to the same basket. The principal is renewable in annual instalments until 2010, with interest and linkage differentials payable on December 31 of each year (same balance on December 31, 1986).

3. LOANS IN FOREIGN CURRENCY

This item is presented net of NIS314 million—the participation of banking institutions in the credit funds (net of NIS348 million on December 31, 1986).

4. SECURITIES

Tradable securities consist of government bonds, wholly or partly linked to the consumer price index or the dollar; their market value is NIS461 million (NIS520 million on December 31, 1986).

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

5. OTHER ACCOUNTS (ASSETS)

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

6. SPECIAL DRAWING RIGHTS

Allocations of Special Drawing Rights amounted to SDR106 million (same amount on December 31, 1986). The item *Gold, foreign exchange, and foreign securities* includes SDR91,000 (SDR2,000 on December 31, 1986).

7. ACCOUNTS WITH THE IMF AND OTHER FOREIGN LIABILITIES

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

	Dec. 31, 1987	Dec. 31, 1986	Dec. 31, 1987	Dec. 31, 1986
	(NIS million)		(SDR million)	
Quota	966	810	447	447
Liability	966	810	447	447

Other foreign liabilities consist of NIS41 million owing to international financial institutions and NIS4 million on account of trade agreements (on December 31, 1986—NIS225 million and NIS4 million respectively).

8. OTHER DEPOSITS

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

9. OTHER ACCOUNTS (LIABILITIES)

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

10. CAPITAL AND GENERAL RESERVE

The Bank's capital at the Balance Sheet date is NIS60 million and the *General reserve* NIS260 million (same amounts on December 31, 1986).

11. CONTINGENT LIABILITIES

The contingent liabilities are as follows: (a) uncalled amounts on account of shares and participations subscribed to international financial institutions—NIS441 million (NIS216 million on December 31, 1986); (b) documentary credits—NIS62 million (NIS40 million on December 31, 1986); and (c) guarantees—NIS18 million (NIS5 million on December 31, 1986).

12. INCOME FROM INVESTMENTS ABROAD

In terms of U.S. dollars this amounted to \$776 million (\$520 million in 1986).

13. INCOME FROM SECURITIES

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

14. ADMINISTRATIVE AND GENERAL EXPENSES

Administrative expenses, excluding prior years' expenses and adjusted for the average rise in the consumer price index, calculated on a monthly basis, increased by 5 percent (in 1986 they increased by 4 percent). General expenses include a NIS 57 million provision for possible losses in connection with the North American Bank; this sum does not take into account that bank's tax refund claims.

15. TRANSFER TO THE GOVERNMENT—NET INCOME

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

In 1986 income subject to the matched-timing principle declined by NIS207 million (NIS403 million increase in 1986); this amount was added to the excess of income over expenses and included in net income. The accumulated income subject to matched timing was NIS368 million (NIS575 million on December 31, 1986). This amount is included in the Balance Sheet in *Other accounts* (liabilities).