CHAPTER XV

MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. Main Monetary Developments

Monetary expansion was rapid in the year reviewed, but not as rapid as in 1967. The deceleration was accompanied by a structural change: the increase in the money supply accounted for a much smaller percentage of the total monetary expansion as compared with the preceding year, while other financial assets of the public—less liquid deposits with banking institutions, bank-negotiated bill credits (bill brokerage), and the Government Short-Term Loan—accounted for a larger share.

The more sluggish monetary expansion and the change in its structure were important factors in keeping the economy on an even keel, despite the vigorous growth of activity.

The money supply rose by IL 360 million, or 14.2 percent, in 1968, as contrasted with 26.4 percent the year before.[1] Other financial assets of the public increased by approximately IL 1,000 million, or 28.0 percent, compared with 27.7 percent in 1967.[2] The total increase in the money supply and other financial assets amounted to 22.3 percent in 1968, as against 27.2 percent in the preceding year.

The rapid growth of other financial assets during the year surveyed brought up the weight of this component in the total increment, while that of the money supply fell precipitately—from 40.7 percent in 1967 to 26.5 percent.

During the first four months of the year monetary expansion was exceptionally strong, but thereafter the tempo slackened appreciably.[3] The factors slowing down

[1] Part of the additional means of payment in 1967 was absorbed by the inhabitants of the administered areas and East Jerusalem. Even assuming that this amounted to IL 100 million (see Bank of Israel, *Annual Report 1967,* pp. 395–98), the growth rate still came to about 21 percent in 1967. The flow of currency to the administered areas was apparently much smaller in 1968.

[2] The rapid monetary expansion in 1967 reflected to some extent the revaluation of the banking system's foreign currency assets and liabilities after the devaluation. Revaluation increments totalled some IL 227 million in November 1967, but apparently their full effect was not felt in 1967 owing to the lag in adjusting the asset portfolios of economic units affected by the devaluation.

[3] The slower expansion of the money supply from May 1968 onward was not of a seasonal nature only. Seasonally adjusted data likewise point to a sharp deceleration beginning in May (see section 4 below).

the growth as from May were the contractionary effects of the heavy drain on the country's foreign currency reserves and of the policy of monetary restraint introduced by the Bank of Israel.

Table XV-1

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC, BY SOURCE AND COMPONENT, 1966–68[a]

(IL million)

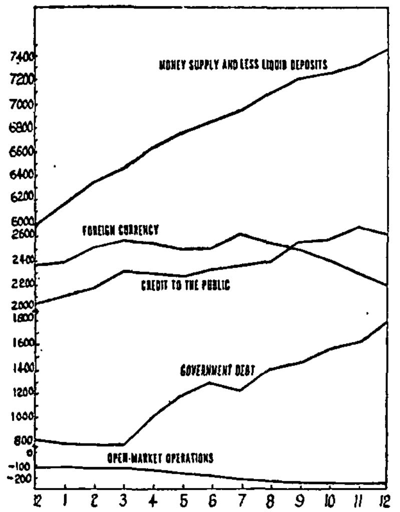
	1966	1967[b]	1968	Percent increase or decrease (–) as against preceding year		
				1966	1967	1968
Sources						
Foreign currency assets						
With the Bank of Israel	–61.6	596.5	–164.9	–3.2	32.3	–6.7
With banking institutions	–8.4	72.1	–8.5	–5.7	46.0	–9.9
Total	**–70.0**	**668.6**	**–173.4**	**–4.0**	**39.5**	**–7.3**
Credit from the Bank of Israel						
Net credit to the Government	165.2	189.3	900.9	170.8	72.3	267.9
Credit and advances[c]	*83.4*	*702.4*	*366.8*	. .	. .	. .
Less: Govt. and National Institution deposits[d]	*–81.8*	*513.1*	*–534.1*	. .	. .	. .
Rediscounts and loans	122.2	147.2	41.5	87.8	56.3	10.1
Open-market operations	–15.1	–108.2	–130.1	—	716.6	105.5
Total, net	**272.3**	**228.3**	**812.3**	**115.4**	**44.9**	**130.7**
Credit from banking institutions						
To the Government	23.5	151.6	66.2	22.0	116.1	23.5
To the public	174.7	370.8	547.6	16.3	29.7	33.8
Total	**198.2**	**522.4**	**613.8**	**16.8**	**37.9**	**32.3**
Other factors, net	6.6	53.2	85.6	7.8	69.5	94.7
Total sources	**407.1**	**1,472.5**	**1,338.3**	**13.1**	**42.0**	**26.9**
Components						
Money supply	108.9	530.7	360.0	5.7	26.4	14.2
Less liquid deposits	298.2	941.8	978.3	24.9	63.0	40.1
Total financial assets	**407.1**	**1,472.5**	**1,338.3**	**13.1**	**42.0**	**26.9**
Bill brokerage	247.4	–278.7	–96.4	32.0	–27.3	–13.0
Short-Term Loan[e]	80.7	109.2	115.6	42.7	40.5	30.5

[a] The Yaad Agricultural Development Bank has been reclassified in this year's Annual Report, being shifted from the banking institutions to the financial institutions sector. The tables in this chapter therefore exclude this bank, apart from its demand deposits, which constitute means of payment. Data for previous years have been revised accordingly.
[b] Including revaluation increments due to the devaluation.
[c] Excludes the change in the Government debt stemming from transactions in Government securities with the public and banks (e.g. sales of the Government Short-Term Loan in the open market).
[d] In 1966 Government deposits only.
[e] Revised data.

Diagram XV-1

FINANCIAL ASSETS, BY SOURCE AND COMPONENT, 1968

(IL million)



The decrease in the volume of foreign currency assets was partly due to seasonal and random factors, but in the main it reflects the marked widening of the adverse balance in the country's goods and services account, which was not accompanied by an increase in capital imports from abroad. The Bank of Israel initiated a restrictive money policy in May 1968, following the swelling of the money supply in the early part of the year, in order to prevent the undermining of economic stability. The policy measures included the raising of liquidity ratios for ordinary and time deposits in Israeli currency, and the mopping-up of excess liquidity through sales of the Government Short-Term Loan in the open market.

Table XV-2

ANNUAL INCREASE IN THE MONEY SUPPLY, 1966–68[a]

(IL million)

	Balance at end of year	Change in end-year balance		Average annual balance	Change in average annual balance		Composition of money supply (percentages; average annual balances)
		IL m.	%		IL m.	%	
				Currency			
1966	751.1	93.7	14.3	716.7	69.6	10.8	36.4
1967	965.8	214.7	28.6	920.9	204.2	28.5	38.9
1968	1,091.2	125.4	13.0	1,059.6	138.7	15.1	37.6
				Demand deposits			
1966	1,256.7	15.2	1.2	1,250.7	64.4	5.4	63.6
1967	1,572.7	316.0	25.1	1,445.5	194.8	15.6	61.1
1968	1,807.3	234.6	14.9	1,755.3	309.8	21.4	62.4
				Money supply			
1966	2,007.8	108.9	5.7	1,967.4	134.0	7.3	100.0
1967	2,538.5	530.7	26.4	2,366.4	399.0	20.3	100.0
1968	2,898.5	360.0	14.2	2,814.9	448.5	19.0	100.0

[a] As from August 1967, the data include demand deposits of Israeli banks operating in the administered areas. These deposits totalled IL 2.6 million in December 1967 and IL 7.1 million in December 1968.

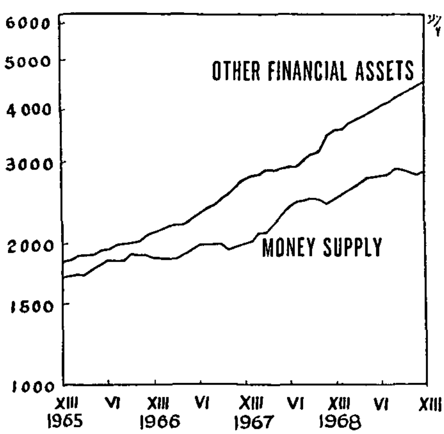
The last quarter of the year witnessed a tight money market. Short-term credit became somewhat dearer, and it was more difficult to obtain bank credit. Interest rates on local-currency time deposits and on bill brokerage transactions likewise rose.

The circulation velocity of the money supply held steady in 1968, but the turnover rate of all financial assets declined as compared with 1967. These indicators reflect a greater preference for near-money, which was one of the major factors in preserving price stability in 1968.

The greater demand for financial assets can be ascribed to the steep rise in income from domestic sources, the changes in the income structure, the increase in personal restitution receipts from West Germany, the larger capital transfers of new immigrants and returning residents, and the stable yields on financial assets.

Diagram XV–2

FINANCIAL ASSETS HELD BY THE PUBLIC, 1965–68



Semi-logarithmic scale.
[a] Less liquid deposits, Short-Term Loan, and bills purchased through banks (bill brokerage).

Less liquid deposits of the public continued upward at a rapid rate in 1968. Saving scheme deposits increased by IL 276 million, time deposits in Israeli currency by IL 349 million, Pazak balances by IL 241 million, and Tamam balances by IL 92 million.

The sources of the big increase in the money supply and less liquid deposits of the public during 1968 were the huge rise of IL 967 million in net credit received by the Government from the banking system and the growth of bank credit to the public. The decline in the banking system's foreign currency assets and the open-market operations of the Bank of Israel offset part of the monetary expansion resulting from the large increment of credit to the Government and the public.

Bank credit to the public expanded by IL 589 million in 1968, compared with IL 518 million the year before. Only a relatively small percentage of the 1968 increase was at the expense of bill brokerage; it was the heavy demand for such credit, which accompanied the growth of economic activity, that was responsible for much of the additional borrowing. The incremental demand was satisfied by the banking institutions, which possessed liquidity surpluses until the last quarter of the year. The outstanding balance of the bill brokerage trade declined during the first nine months of the year, increasing only in the last quarter when money became tight.

2. The Effect of Monetary Expansion on the Economy

Even though the expansion of financial assets slowed down in the course of 1968, their average annual level was up 26.6 percent, compared with 23.8 percent in 1967.

The 1968 increment consisted of a rise of 19.0 percent in the average annual money supply (as against 20.3 percent in 1967), and of 32.6 percent in the average annual level of other financial assets (26.7 percent in 1967).[1]

The sizable growth of aggregate demand in 1968 was accompanied by a steep rise in the economy's liquidity, and these two factors together led to an unprecedented expansion of 13 percent in real GNP. They also resulted in an enormous growth of imports and the import surplus, the latter by as much as 53 percent, but they did not undermine the stability of prices which had persisted since the second half of 1966. The continued stability of prices in 1968, despite the much larger volume of financial assets, requires an explanation.

The nonfinancial factors keeping prices stable in 1968, despite the big increase in demand and liquidity, were treated at length in Chapter VI. The principal reasons given were the existence of a reserve of idle factors of production, the available supply of labor from the administered areas and East Jerusalem, and the substantially larger import, which satisfied much of the incremental demand.[2] This chapter will discuss the special character of the monetary expansion and the demand for financial assets which helped to preserve stability in 1968.

The indicators presented in Table XV–3 point to a slight rise in the circulation velocity of the money supply in 1968 and a decline in the velocity of other financial assets.[3] The latter development, together with the increased weight of these assets (which have a lower velocity than does the money supply) brought down the velocity of total financial assets in 1968 as compared with the previous year. This reflects, at one and the same time, the greater preference for holding financial assets, the weakening of demand in the commodity and service markets, and the checking of upward pressures on prices.

The increased preference for financial assets in 1968 is explained by a number of factors:

(a) The marked growth of incomes from domestic sources generated a stronger demand for financial assets. It is reasonable to assume that the desire to hold financial assets largely depends on the income level, and the rise in the

[1] It should be borne in mind that the high average annual level of financial assets in 1968 was affected *inter alia* by the big growth of such assets during 1967.

[2] See Chapter VI, "Prices".

[3] The circulation velocity of the money supply was calculated from data unadjusted for the flow of currency to the administered areas in 1967 and 1968. But adjusting for this factor would not change the picture to any significant extent.

Table XV-3

INDICATORS OF THE TURNOVER VELOCITY OF FINANCIAL ASSETS, 1966–68

	Average velocity of demand deposits[a]	Average annual velocity relative to GNP[b]		
		Money supply	Other financial assets[c]	Total financial assets
1966	21.8	5.84	4.75	2.62
1967	18.5	5.01	3.87	2.18
1968	17.8	4.84	3.35	1.98
		Average annual velocity relative to the economy's resources[d]		
1966		6.68	5.43	2.99
1967		5.76	4.45	2.51
1968		5.81	4.02	2.38

[a] Total debits to local-currency demand deposit accounts in banks, divided by the average annual volume of these deposits. Deposits with cooperative credit societies are not included.
[b] The gross national product at current prices (based on the effective exchange rate), divided by the average annual volume of the three types of financial assets.
[c] Less-liquid deposits of the public with banking institutions, bill brokerage, and Short-Term Loan certificates held by the public.
[d] The gross national product at current prices plus the import surplus (both based on the effective exchange rate), divided by the average annual volume of the three types of financial assets.

latter led to a greater preference for holding such assets. The strong upswing in incomes in 1968 was accompanied by some change in saving patterns induced by the preceding period of economic slowdown, and together they augmented the demand for financial assets.[1]

(b) The changes in income distribution likewise strengthened the demand for financial assets. Economic conditions in 1968 apparently led to an appreciable growth of financial asset holdings of business firms. The reference is to those firms which showed a striking improvement in profitability after the recession and did not yet require external capital for financing development or expansion. Such enterprises tend to invest their liquidity surpluses in liquid interest-bearing financial assets (mainly local-currency time deposits), besides enlarging their cash and demand deposit balances.[2] The growth of local-currency time deposits of over IL 50,000 lends indirect support to this assumption, as it may reasonably be

[1] It should be noted that the big increase in financial asset holdings in 1968 occurred simultaneously with a sharp rise in voluntary bond purchases by the public ("purchases" of certificates of the Absorption and Defense Loans, which are largely compulsory in nature, fell off compared with 1967). See Chapter XIX, "The Securities Market".

[2] This very likely applied to some self-employed as well. It will be recalled that the earnings of self-employed likewise rose appreciably in 1968.

assumed that a considerable percentage of these deposits were made by business enterprises. The outstanding balance of such deposits soared from IL 162 million at the end of 1967 to IL 345 million at the end of 1968—i.e. by some IL 183 million as against IL 104 million in 1967.[1]

(c) Besides the larger income from domestic sources, the year 1968 witnessed a substantial increase in unrequited personal remittances from abroad. Personal restitution from West Germany reached $ 143 million in 1968, compared with $ 123 million the year before. There was also a change in the composition of such income, the proportion of nonrecurrent receipts rising. Personal transfers in cash totalled $ 128 million, as against $ 85 million in 1967. The appreciable increase here presumably reflects the transfer of property by new immigrants and returning residents, most of whom came from affluent countries. Some of these transfers were apparently invested in financial assets during 1968.

The effect of the increase in personal restitution receipts is clearer. According to studies of saving patterns of families receiving restitution, a considerable proportion of such income is invested in liquid assets during the first year of their receipt.[2] Consequently, a rise in personal restitution receipts can be expected to drive up the demand for financial assets. Moreover, it was found that the propensity to save from lump-sum restitution receipts is greater than that from current transfers, and since the weight of the former went up in 1968, this too explains the greater preference for financial assets.

(d) Another factor was the continued stability of prices in 1968, which encouraged the holding of financial assets, most of which are not linked to the consumer price index. The levelling-off of nominal yields on interest-bearing financial assets, after a sharp decline in 1967, likewise stimulated the demand for such assets.

From the foregoing, it is obvious that part of the incremental demand for financial assets in 1968 was of a temporary nature only and did not reflect any permanent change in liquidity preference. This applies particularly to businesses, immigrants, returning residents, and restitution recipients, since it is reasonable to assume that these groups enlarged their financial asset holdings for an interim period—until implementation of planned investments (residential or otherwise) or an increase in consumption spending.

Nevertheless, the decline in the velocity of total financial assets—relative both to the product and to available resources—suggests that if the random factors increasing the propensity to hold financial assets be discounted, there was still

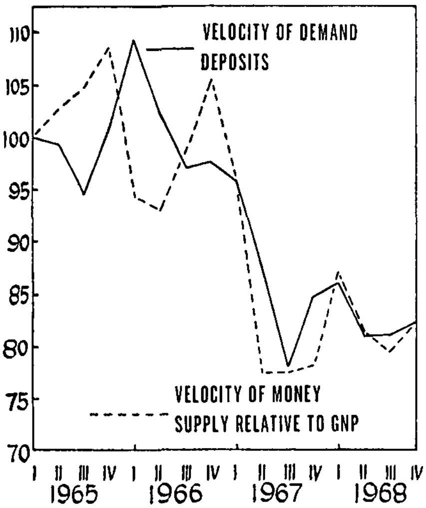
[1] Provisional data.

[2] See M. Landsberger, "The Effect of Pazak and Tamam Arrangements on the Saving of Restitution Recipients", *Bank of Israel Bulletin,* No. 29, December 1967.

some deceleration in 1968.[1] The decline in the adjusted velocity may be regarded as an indication of an increased preference for financial assets on the part of the public, induced by the change in saving habits developed during the recessionary period and by the stable return on financial assets.

Diagram XV-3

INDICATORS OF THE CIRCULATION VELOCITY OF THE MONEY SUPPLY, QUARTERLY, 1965–68



The reduced weight of the incremental money supply within the total monetary expansion was, as already noted, one of the factors helping to maintain economic stability during 1968. Diagram XV–2 shows that the money supply went up at about the same rate as other financial assets from the beginning of 1967 until the middle of 1968,[2] but during the second half of 1968 the growth rate slowed down noticeably, depressing the share of the money supply in the monetary expansion. The change that occurred in the second half of 1968 can be ascribed to the contractionary effect of the decrease in foreign currency assets and of the Bank of Israel's policy of monetary restraint. While these restrictive forces led to some tightening of the money market after a lag of several months, it was not particularly severe, suggesting that the propensity to hold money weakened.

Despite the decline in the share of the incremental money supply in total monetary expansion, the average annual level of the money supply was 19.0 percent higher in 1968 than in the previous year (see Table XV–2). This approximated the rise in the economy's resources (GNP plus the import surplus), as indicated by the stable circulation velocity of the money supply compared with 1967. However, compared with 1966 and even 1960–65,[3] it was much lower, as may be seen from Table XV–3.

[1] If the 1968 GNP is divided by the 1967 velocity of total financial assets, the average annual volume of these assets in 1968 would have reached some IL 6,246 million. In actual fact, it came to approximately IL 6,870 million. (A similar calculation of the velocity in relation to available resources yields figures of IL 6,511 million and IL 6,870 million respectively.) The order of magnitude of the effects of the random factors referred to above fails to explain the big discrepancy between the actual average balance of financial assets and that calculated on the assumption of a constant velocity in 1968.

[2] If we discount the currency flowing to the administered areas and East Jerusalem, the growth rate of the money supply during the period discussed lagged somewhat behind that of other financial assets.

[3] The average circulation velocity of the money supply in the years 1960–65 was 6.43 relative to the economy's available resources and 5.34 relative to the gross national product.

The stabilizing of the velocity of the money supply in 1968, at a relatively low level, is not surprising since it reflects two contrasting movements—a continuation of the downtrend in the first half of the year and a rise in the second half (see Diagram XV-3). The increase in the second half was due, as stated, to the contractionary influences operating during this period.

3. Monetary Policy and the Liquidity of Banking Institutions

The objective of the Bank of Israel's monetary policy is to regulate the expansion of the money supply and the volume and terms of credit, thereby influencing the level of aggregate demand as well. Toward this end, the Bank employs two principal instruments:

— Open-market operations (i.e. the purchase and sale of securities, mainly Short-Term Loan certificates), with a view to changing the quantity of liquid assets held by banking institutions and the quantity of money in the economy.

— Changes in the liquidity ratios which the banking institutions have to maintain against their deposits. This instrument enables the Bank of Israel to regulate the volume of credit banking institutions can give, taking into consideration the quantity of liquid assets at their disposal.

In analyzing the liquidity of banking institutions and the monetary-policy measures implemented during the year, three subperiods can be distinguished:

(a) *January-April*

The monetary policy pursued by the Bank during the months January-April 1968 represented a continuation of that adopted in 1967. At the beginning of 1968 there was still considerable unemployment in the country, and the further revival of economic activity appeared desirable. Consequently, the liquidity ratios were not altered, nor was any special effort made to mop up liquidity through sales in the open market (open-market operations during this period absorbed only IL 18 million, or less than IL 5 million a month). The banking institutions' liquid asset holdings expanded by IL 106 million (see Table XV-4). The external infusions leading to this increase were the seasonal accumulation of foreign currency assets and the rise in the Government's debt to the Bank of Israel.

The growth of liquid assets was accompanied by a rapid rise in bank credit to the public (IL 201 million); despite the substantial increase in liquid assets, this reduced the free reserves[1] of the banking institutions from IL 24

[1] The free reserves are defined as the difference between the excess liquidity of institutions with surpluses and the liquidity deficiencies of institutions with deficits.

Table XV–4

LIQUID ASSETS OF THE BANKING INSTITUTIONS,[a] BY SOURCE, 1966–68

(IL million)

End of period	Credit from the Bank of Israel[b]	Net foreign currency with the Bank of Israel	Bank of Israel open-market operations	Total factors supplying liquid assets (1+2+3)	Less: Currency held by the public	Less: Net foreign currency balances of banking institutions with the Bank of Israel	Less: Total deductions (5+6)	Balances in transit or in clearing and other deposits[c]	Total liquid assets of banking institutions (4+8–7)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1966	560.7	1,848.7	–15.1	2,394.3	751.3	1,047.2	1,798.5	14.7	610.5
1967	882.3	2,445.2	–123.3	3,204.2	966.3	1,470.3	2,436.6	15.3	782.9
1968	1,799.6	2,280.3	–253.4	3,826.5	1,091.6	1,803.4	2,895.0	–2.0	929.5
1968 January	903.8	2,476.3	–114.5	3,265.6	967.5	1,491.3	2,458.8	2.9	809.7
February	900.7	2,618.4	–128.0	3,391.1	1,002.5	1,528.5	2,531.0	2.1	862.2
March	898.6	2,646.9	–128.1	3,417.4	1,029.3	1,581.1	2,610.4	21.6	828.6
April	1,053.5	2,637.5	–141.6	3,549.4	1,055.5	1,607.9	2,663.4	3.1	889.1
May	1,239.5	2,569.7	–167.6	3,641.6	1,057.8	1,629.9	2,687.7	3.0	956.9
June	1,283.7	2,561.1	–191.8	3,653.0	1,058.0	1,647.7	2,705.7	3.9	951.2
July	1,201.4	2,697.3	–221.9	3,676.8	1,069.0	1,650.7	2,719.7	5.8	962.9
August	1,371.1	2,621.1	–243.4	3,748.8	1,078.7	1,679.9	2,758.6	–4.4	985.8
September	1,435.6	2,578.5	–252.9	3,761.2	1,101.4	1,716.1	2,817.5	4.9	948.6
October	1,538.9	2,486.3	–261.0	3,764.2	1,105.2	1,739.2	2,844.4	0.2	920.0
November	1,636.2	2,380.4	–264.5	3,752.1	1,105.9	1,770.8	2,876.7	–8.3	867.1
December	1,799.6	2,280.3	–253.4	3,826.5	1,091.6	1,803.4	2,895.0	–2.0	929.5

[a] Excluding the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.

[b] Including credit to the Government and net credit to the public (less deposits of financial institutions with the Bank of Israel).

[c] Including nonliquid deposits with the Bank of Israel and liquid assets other than deposits held at the Bank of Israel. The data for 1966 also include net demand deposit balances in transit between banking institutions (in Israeli currency). Since May 1967 such balances are no longer recognized as liquid assets.

Table XV–5

THE LIQUIDITY OF BANKING INSTITUTIONS IN ISRAELI CURRENCY, 1966–68[a]

(IL million)

End of period	Total liquid assets of banking institutions[b]	Liquid assets in Israeli currency held against deposits requiring special liquid cover[c]	Ordinary liquid assets in Israeli currency (1–2)	Deposits requiring ordinary liquid cover	Effective liquidity ratio on ordinary deposits $\frac{(3)}{(4)} \times 100$	Liquidity deficits	Liquidity surpluses	Free reserves (7–6)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1966	610.5	38.0	572.5	1,285.2	44.5	4.4	34.1	29.7
1967	782.9	62.5	720.4	1,606.3	44.8	29.4	53.6	24.2
1968	929.5	137.2	792.3	1,835.7	43.2	31.3	39.1	7.8
1968 January	809.7	65.5	744.2	1,644.3	45.3	11.7	37.5	25.8
February	862.2	69.1	793.1	1,693.4	46.8	4.5	43.9	39.4
March	828.6	67.3	761.3	1,698.1	44.8	22.7	29.3	6.6
April	889.1	70.3	818.8	1,773.2	46.2	8.2	19.4	11.2
May	956.9	82.8	874.1	1,785.4	49.0	9.7	62.1	52.4
June	951.2	95.6	855.6	1,794.3	47.7	16.8	57.3	40.5
July	962.9	104.5	858.4	1,789.2	48.0	12.9	71.4	58.5
August	985.8	116.5	869.3	1,852.7	46.9	2.7	54.3	51.6
September	948.6	129.9	818.7	1,850.5	44.2	33.5	31.8	–1.7
October	920.0	134.7	785.3	1,808.4	43.4	25.2	25.2	0.0
November	867.1	134.2	732.9	1,775.0	41.3	48.3	19.9	–28.4
December	929.5	137.2	792.3	1,835.7	43.2	31.3	39.1	7.8

[a] The data in this table are from the Examiner of Banks, and exclude the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] From column 9 in Table XV–4.
[c] Deposits requiring 10, 15, 90, or 100 percent liquid cover.

million at the end of December 1967 to IL 11 million at the end of April 1968 (see Table XV–5).[1]

(b) *May–September*

In May 1968 the Bank of Israel began to apply a policy of monetary restraint. The switch was connected with the very rapid monetary expansion of the first four months of the year, which might have undermined the stability of the economy, and also with the marked worsening in the balance of payments position. The measures adopted by the Bank of Israel were the raising of the required liquidity ratios and the stepped-up absorption of liquidity through sales in the open market.

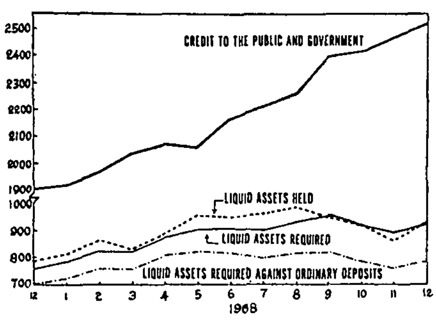
The revision of the required liquidity ratios on local-currency ordinary and time deposits in May 1968 was the first since January 1964. The ratio required to be held against an increase in ordinary deposits (beyond their volume on May 8, 1968) was raised from 65 to 70 percent, and the ratio on time deposits in Israeli currency was raised progressively from 10 to 15 percent, over a period of five months (1 percent each month).

During the months May–August the Bank of Israel's open-market operations absorbed IL 102 million, or about IL 26 million per month. This increased absorption was made possible mainly by the renewed issue at the end of March of Short-Term Loan certificates for 18 months. The return on these certificates was fixed at a comparatively high level, and banks were offered special incentives in order to stimulate sales. These steps increased the yield of the Short-Term Loan relative to alternative investments, helping to boost sales (in 1968 the 18-month series accounted for approximately 62 percent of total net Short-Term Loan sales).

Diagram XV–4

THE LIQUIDITY OF BANKING INSTITUTIONS, 1968

(IL million)



The restrictive influence of this policy was accentuated by the decline of IL 59 million in the Bank's net foreign currency assets during the months May–September.[2] This figure does not include that part of the decline covered by the

[1] During the months January–April 1968, the Government's debt to the banking institutions fell by IL 32 million, offsetting part of the decline in the institutions' liquidity.

[2] The seasonal pattern of foreign currency accumulation by the banking system throughout most of the 1960's shows a deceleration (and sometimes even a decline) in the second half of the year. The sharp fall in net foreign currency assets after April 1968 was apparently due in part to seasonal factors.

transfer of some of the Treasury's deposits from abroad. The transfer totalled IL 140 million and prevented foreign currency assets from falling by this amount, thus reducing the restrictive effect of the drain on foreign currency balances during 1968 (see Bank of Israel, *Annual Report 1967*, p. 450).

The smaller volume of foreign currency assets was a reflection of the economic forces operating at a time of rapid monetary expansion and mounting domestic demand. Under such conditions, a decline in foreign currency assets tends to counteract the monetary expansion and to check some of the inflationary pressures.[1]

The growth of the banking institutions' liquid assets totalled only IL 60 million; yet the amount of credit granted to the public and the Government expanded rapidly during this period—by IL 236 million and IL 122 million respectively. This wiped out the excess liquidity by the end of September: all told, free reserves fell by IL 13 million during this period and at the end of September were of a negative magnitude (–IL 2 million). This was after they had reached a record high of IL 59 million in July.[2]

Although the rapid expansion of banking institution credit during the months April–September 1968 was accompanied by a relatively small increase in liquid assets, their surplus liquid assets did not decline to any marked degree. The ability to expand credit to so great an extent without incurring liquidity deficiencies can be attributed to the drastic change in the factors affecting monetary expansion as from May 1968 (see Diagram XV–4).

From January to April deposits requiring ordinary liquid cover (at the rate of 65 percent) swelled by IL 167 million, while time deposits requiring liquid cover at the much lower rate of 10 percent expanded by IL 100 million. During the months May–September the picture changed: the biggest increase was in time deposits, which grew by IL 179 million, whereas deposits subject to ordinary liquidity requirements expanded by only IL 77 million.

Thus, while the total increase was similar in both periods (though the average monthly rise was smaller in May–September), the increased weight of time deposits enabled banking institutions to step up their credit business considerably during the second period, as the liquidity ratios on these deposits are comparatively low.

The disappearance of the banking institutions' free reserves in September

1 A big increase in the economy's liquidity and aggregate demand generally results in a marked expansion of imports and of the balance of payments deficit on current account. If the growth of the current deficit is not accompanied by a corresponding increase in capital imports (and this did not happen in 1968), the country's foreign currency balances will shrink. Other things being equal, this in turn will exert a contractionary monetary effect, weaken aggregate demand, and reduce the gap in the balance of payments.

2 As will be explained below, the banking institutions made serious efforts to expand their credit to the public during this period (see pp. 339 ff.).

indicated that the tight-money policy of the Bank of Israel was beginning to prove effective, in the sense that the institutions' capacity to expand credit was sharply reduced. The lag of four to five months from the inception of the policy and the first signs of a decline in foreign currency assets until the policy began to produce real results can be ascribed to three principal factors:

First, the big increase in the Government's net debt to the Bank of Israel, which resulted in an external infusion of IL 369 million during the months May–September 1968.

Secondly, the structural change in the public's incremental deposits with banking institutions, which brought up the weight of deposits requiring a relatively low rate of liquid cover.

Thirdly, the fact that the liquidity ratios for time deposits were revised progressively, so that the full effect of the increase was felt only after five months. The raising of the required liquid cover against the balance of local-currency time deposits as of May 8, 1968 was tantamount to reducing the free reserves by some IL 31 million. But this was done gradually, at the rate of approximately IL 6 million per month over a five-month period.

These three factors apparently exerted a very strong countervailing effect, so that the impact of the Bank of Israel's policy did not make itself felt until after four or five months.

(c) *October–December*

In the last quarter of 1968 the money market grew tighter, owing partly to the aforementioned restraining forces operating during the May–September period and partly to expectations engendered by the international monetary crisis.

The squeeze on money and the liquidity difficulties experienced by banking institutions during the months October–December 1968 were caused primarily by the decrease of IL 19 million in the quantity of liquid assets. This decrease stemmed from the fact that the external infusion of IL 66 million (a resultant of the IL 364 million expansion of Bank of Israel credit to the Government and a IL 298 million decline in foreign currency assets) was completely offset by the growth of foreign currency deposits of banking institutions with the Bank of Israel.

It should nevertheless be noted that during this quarter the relative importance of the contractionary factors underwent a change. The reduction of net foreign currency assets became the decisive restrictive factor, leading to an external drain of IL 298 million.[1]

[1] The drain was apparently due to some extent to the international monetary crisis and in part to the heavier foreign debt repayment in December. But it is reasonable to assume that these two factors alone do not explain the entire decline in foreign currency assets during this period.

The disinflationary measures of the Bank of Israel, which were the main factor checking monetary expansion during the May–September period, did not cause any further contraction during the last quarter of the year. The liquidity situation in the last quarter was so grave that the Bank did not wish to aggravate it further, fearing undesirable repercussions in the money market. Consequently, it did not raise the return on the Short-Term Loan at the end of 1968, despite the increased yields on close substitutes, such as local-currency time deposits and bill brokerage. The relative return on the Short-Term Loan therefore declined, and the Bank's open-market operations during the months October–December failed to mop up any liquidity. In fact, it bought up securities in December, thus injecting liquidity into the economy to the tune of IL 11 million.

The second instrument applied by the Bank of Israel—the raising of marginal liquidity ratios—likewise did not have much effect, since the banking institutions' liquid assets did not expand during the last quarter.

As already mentioned, the liquidity position of the banking institutions worsened appreciably in November, owing to the growing belief that a number of European currencies would be devalued. These expectations, the timing of which was quite fortuitous, led to a heavier withdrawal of local-currency deposits and a strong demand for credit in order to advance payments in foreign currency.

The developments in the money market during the last quarter of the year reviewed all reflect the tightness of this market. The most important of these developments were as follows:

— The continued shrinkage of the banking institutions' free reserves, which began in September. In November the level fell to –IL 28 million, but toward the end of the year the liquidity situation improved owing to the calmer mood prevailing in the international money market and to seasonal factors.

— The inability to satisfy any longer the brisk demand for bank credit, since the liquidity shortage made it impossible for banking institutions to fully accommodate their clients. The excess demand for ordinary bank credit led to a rise of IL 39 million in the outstanding balance of the bill brokerage trade, ending the downtrend that began in early 1967.

— The rise of interest rates on local-currency time deposits and in the bill brokerage market.

The tightening of the money market in the last quarter of the year suggests that the objective of the Bank of Israel's policy of monetary restraint was achieved, inasmuch as short-term credit became dearer and more difficult to obtain. However, it should be stressed that the stiffening of credit terms in the money market is not the ultimate policy target. The policy is intended to weaken aggregate demand in order to preserve the stability of the economy, and this purpose is served by a squeeze on money.

4. The Money Supply

The money supply increased by IL 360 million, or 14.2 percent, in 1968, as contrasted with IL 531 million, or 26.4 percent, the year before. While the growth rate was lower than in 1967, when expansion was particularly strong, it was higher than in the years 1964–66.

As may be seen from Table XV–6, the money supply did not increase at a uniform pace throughout the year. During the first four months it swelled by IL 267 million, representing 74 percent of the total annual increment. During the months May–December growth was very sluggish, and October and November even witnessed a decline.

The changes in the money supply during 1968 followed the seasonal pattern observed for many years. Nevertheless, the deceleration from May onward cannot be attributed solely to seasonal influences. Of the total growth of 14.2 percent in 1968, 10.5 percent was recorded during the first four months of the year and 3.3 percent during the next eight. After adjusting for seasonal variations, the rise during the months January–April still totalled 8.2 percent, much higher than the 5.6 percent rate between May and December. The reasons for the slower expansion of the money supply as from May were discussed in sections 2 and 3 of this chapter.

The IL 360 million increase in the money supply consisted of IL 125 million in currency held by the public and IL 235 million in demand deposits. The proportion of currency in the money supply was smaller than in 1967, when there was an exceptionally large expansion of holdings, but it was somewhat higher than in 1966. A comparison of average annual levels shows that currency constituted 37.6 percent of the money supply in 1968, as against 38.9 percent in 1967 and 36.4 percent in 1966.

The changes in currency and demand deposit balances displayed a more uniform pattern in 1968 than in 1967. The weight of currency within the money supply fluctuated in 1968 between a low of 37.0 percent in August and a high of 38.6 percent in November. In 1967 the range was from 38.1 percent in December to 41.7 percent in May. The factors causing the rise and spurts in currency holdings in 1967—the crisis that overtook a number of banks, the atmosphere of uncertainty, and the Six Day War—were absent in 1968. This explains the much slower and more uniform rise of currency during the year reviewed.

The expansion of the public's currency holdings had important monetary implications, as it constituted an internal drain and partly counteracted the impact of the external infusion on the growth of the banking institutions' liquid assets.[1] The increase in currency had a greater effect on liquid assets in 1968 than in 1967, even though the increase was slower in 1968. In 1967 banking

[1] See the discussion in section 3 above.

Table XV–6

THE MONEY SUPPLY, MONTHLY, 1968[a]

(IL million)

End of month	Currency: Total	Currency: Increase or decrease (–) from end of previous month, IL m.	Currency: Increase or decrease (–) from end of previous month, %	Currency: Percent of money supply	Demand deposits: Total	Demand deposits: Increase or decrease (–) from end of previous month, IL m.	Demand deposits: Increase or decrease (–) from end of previous month, %	Money supply: Total	Money supply: Increase or decrease (–) from end of previous month, IL m.	Money supply: Increase or decrease (–) from end of previous month, %	Money supply seasonally adjusted[b]: Total	Money supply seasonally adjusted[b]: Percent increase or decrease (–) from end of previous month
1967 December	965.8	–3.3	–0.3	38.1	1,572.7	49.7	3.3	2,538.5	46.4	1.9	2,595.6	2.5
1968 January	966.9	1.1	0.1	37.4	1,619.7	47.0	3.0	2,586.6	48.1	1.9	2,642.1	1.8
February	1,001.9	35.0	3.6	37.6	1,661.0	41.3	2.5	2,662.9	76.3	2.9	2,700.7	2.2
March	1,028.5	26.6	2.7	38.1	1,673.9	12.9	0.8	2,702.4	39.5	1.5	2,774.5	2.7
April	1,054.9	26.4	2.6	37.6	1,750.1	76.2	4.6	2,805.0	102.6	3.8	2,805.0	1.1
May	1,057.3	2.4	0.2	37.4	1,766.9	16.8	1.0	2,824.2	19.2	0.7	2,777.0	–1.0
June	1,057.5	0.2	0.0	37.1	1,789.8	22.9	1.3	2,847.3	23.1	0.8	2,777.9	–0.0
July	1,068.2	10.7	1.0	37.5	1,782.5	–7.3	–0.4	2,850.7	3.4	0.1	2,800.3	0.8
August	1,077.9	9.7	0.9	37.0	1,836.1	53.6	3.0	2,914.0	63.3	2.2	2,856.9	2.0
September	1,100.5	22.6	2.1	37.6	1,830.0	–6.1	–0.3	2,930.5	16.5	0.6	2,873.0	0.6
October	1,104.5	4.0	0.4	38.2	1,789.7	–40.3	–2.2	2,894.2	–36.3	–1.2	2,905.8	1.1
November	1,105.3	0.8	0.0	38.6	1,757.3	–32.4	–1.8	2,862.6	–31.6	–1.1	2,909.1	0.1
December	1,091.2	–14.1	–1.3	37.6	1,807.3	50.0	2.8	2,898.5	35.9	1.2	2,963.7	1.9

[a] The data include demand deposits in branches of Israeli banks operating in the administered areas; these deposits totalled IL 2.6 million in December 1967 and IL 7.1 million in December 1968.

[b] The adjustment for seasonal influences was made on the basis of Central Bureau of Statistics data.

institutions had large liquidity surpluses, and the internal drain caused by the expansion of currency holdings did not affect their ability to grant credit to the public and the Government, owing to the slack demand for bank credit. In 1968, and especially in the last quarter, the volume of liquid assets imposed a constraint on the institutions' capacity to grant credit, so that the internal drain had a restrictive monetary effect.

It should be noted that the incremental currency holdings in 1967 and 1968 include the amounts flowing to the administered areas and East Jerusalem in 1967 and the increase in these holdings during 1968. No data are available for these two years, but a rough estimate puts these holdings at IL 80–100 million at the end of 1967, while the rise in 1968 is estimated at IL 30–50 million.

Demand deposits in branches of Israeli banks operating in the administered areas totalled IL 2.6 million at the end of 1967 and IL 7.1 million at the end of 1968.

5. Other Financial Assets of the Public

This asset category consists of less liquid deposits of the public with banking institutions, the outstanding balance of the bill brokerage trade, and Short-Term Loan certificates held by the public. These assets have expanded at a very rapid and steady pace since 1966 (see Diagram XV-2). In the course of 1968 they went up 28.0 percent, compared with 27.7 percent in 1967 and 29.0 percent in 1966.

The monthly rate of expansion was likewise fairly uniform over the last three years, except for the period immediately before and after the Six Day War in 1967. The even rise during 1968 stands out all the more in view of the decelerated growth of the money supply from May onward.

The increase in other financial assets was accompanied by a marked structural change. The outstanding balance of bill brokerage transactions began to decline in 1967, owing to the larger supply of funds and the subsiding of demand for credit which characterized the recession, as well as to the collapse of three commercial banks, which induced a shift from bill brokerage to other assets. In 1968 the bill brokerage trade continued downward, but much more slowly, the decrease amounting to IL 96 million as contrasted with IL 279 million in 1967. This decline, of course, brought down the share of bill brokerage in total financial asset holdings of the public.

The rapid growth of approved saving schemes and of local-currency time deposits carried over through 1968. Saving scheme accounts swelled by IL 276 million, or 68.0 percent, and time deposits by IL 349 million, or 67.2 percent. This increased the relative shares of these two types of deposits.

The weight of Pazak and Tamam deposits declined in 1968, but it was still

Table XV–7

LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS, 1966–68[a]

(IL million)

End of period	Saving schemes	Time deposits in Israeli currency[b]	Deposits against liabilities	Deposits linked to the exchange rate (Pazak)	Foreign currency deposits (Tamam)	Other foreign currency deposits	Total less liquid deposits
1966	245.9	148.8	21.0	731.3	287.9	60.3	1,495.2
1967	406.2	519.6	15.1	1,018.7	399.1	78.3	2,437.0
1968	682.4	868.8	12.1	1,259.3	491.0	101.7	3,415.3
1968 January	425.3	542.2	17.0	1,035.7	404.2	58.6	2,483.0
February	443.2	589.1	17.3	1,066.5	412.1	55.1	2,583.3
March	473.5	598.6	18.5	1,092.1	424.4	69.6	2,676.7
April	490.7	622.6	17.2	1,114.8	432.3	66.2	2,743.8
May	509.1	670.6	13.8	1,136.3	440.3	57.9	2,828.0
June	537.7	700.6	14.1	1,153.3	446.5	61.0	2,913.2
July	558.1	749.5	13.3	1,156.4	448.0	64.3	2,989.6
August	577.8	780.7	12.3	1,182.8	453.7	38.3	3,065.6
September	608.0	822.2	12.6	1,205.0	462.4	65.0	3,175.2
October	624.3	839.8	14.3	1,222.7	472.6	65.0	3,238.7
November	650.4	858.9	11.7	1,241.8	480.1	83.1	3,325.9
December	682.4	868.8	12.1	1,259.3	491.0	101.7	3,415.3

[a] Excluding less liquid deposits in the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] Excluding deposits of the public earmarked for loans, most of which belong to social insurance funds and financial institutions.

larger than in 1966.[1] Outstanding Short-Term Loan holdings of the public rose by 30.5 percent in 1968, bringing up the weight of this item somewhat.

Most of the increased demand for other financial assets was reflected by the rapid expansion of local-currency time deposits and deposits in saving schemes, and thus also in the larger weight of these accounts. It should be noted in this context that the growth of Pazak and Tamam balances is largely limited by the fact that not everyone is eligible to own such accounts.[2] Moreover, the volume of Short-Term Loan sales is dictated by monetary-policy considerations. Special importance attached to these limitations in 1968, when only slight changes occurred in the relative yields of the various types of other financial assets. Consequently, the differential changes in the weights of the assets cannot be explained by reference to relative changes in their terms.

In this section we shall deal mainly with the development of the less liquid deposits of the public; the bill brokerage market and the Short-Term Loan were discussed in section 3 above.[3]

(a) *Pazak and Tamam deposits*

The outstanding balance of Pazak accounts increased in 1968 by IL 241 million, or $ 69 million, compared with $ 47 million in 1967. Tamam balances went up by IL 92 million, or $ 26 million, as contrasted with $18 million in 1967. Personal restitution receipts reached $ 149 million in 1968, as against $ 123 million in 1967. Interest paid on Pazak and Tamam amounted to $ 23 million, compared with $ 20 million in 1967. The increment to Pazak and Tamam balances in 1968 thus came to 57 percent of total restitution receipts plus the interest on the outstanding balance; in 1967 the proportion was 45 percent.

The rapid expansion of Pazak and Tamam in 1968 stands out when viewed in the light of the devaluation of November 1967, which automatically augmented the value of these deposits by IL 194 million. It is reasonable to assume that, while owners of such accounts were unlikely to shift their asset portfolio immediately after the devaluation, they should have done so in the course of 1968, and—other things being equal—this should have been reflected by a much larger conversion of Pazak and Tamam balances. In actual fact, however, the sum converted was much smaller than in previous years.[4] Consequently, the out-

[1] Pazak and Tamam accounted for 38.4 percent of "other financial assets" at the end of 1968, compared with 39.9 percent at the end of 1967 and 36.6 percent at the end of 1966. The rise in 1967 was due to the revaluation of these deposits after the devaluation in November of that year.

[2] The main source of Pazak funds is personal restitution from West Germany and the interest on these accounts. In recent years the Pazak arrangement was broadened to include other types of foreign currency receipts.

[3] Developments in the bill brokerage market are discussed further in section 6(c) below.

[4] The increase in Pazak and Tamam amounted in 1966 to 41 percent of total restitution receipts plus interest on the outstanding balance, and in 1965 to 45 percent.

standing balance of Pazak and Tamam deposits continued to rise rapidly during the year reviewed.

The smaller volume of conversions can be ascribed primarily to two factors: First was the heavier demand in 1968 for all types of financial assets, including deposits linked to the exchange rate and those in foreign currencies. The second reason was the expectation that a number of European countries would devalue their currencies. Yet another factor operating in 1968 was the larger volume of cash transfers by Israelis returning from abroad (apparently some of these transfers ultimately found their way into Pazak accounts).

The expansion of Pazak and Tamam has a special monetary effect, which differentiates them from other liquid financial assets of the public. The depositing of funds in these accounts is the principal means of preventing personal restitution receipts and other private transfers from abroad from expanding the banking institutions' liquid assets.[1] Hence, as long as personal restitution receipts are deposited in Pazak and Tamam accounts, they do not increase the institutions' capacity to grant credit and thereby add to the monetary expansion. On the other hand, it should be remembered that these are highly liquid assets, the conversion of which by the public is liable to enlarge the money supply and the liquid assets of banking institutions.

(b) *Deposits in approved saving schemes*

These deposits expanded by IL 276 million in 1968, compared with IL 160 million the year before. The accelerated growth chiefly reflected the much heavier demand for interest-bearing financial assets. Moreover, the variety of schemes savers could choose from was broadened in 1968, and though their yield remained unchanged, their relative profitability improved somewhat compared with local-currency time deposits and bill brokerage. The new schemes were of three main types. The "conversion schemes", involving the deposit of Absorption Loan certificates, were introduced in 1966, but their attraction was enhanced appreciably at the end of 1967, when depositors were offered the possibility of withdrawing their funds after one year. This change considerably increased the effective rate of return on this type of scheme,[2] but the effect of this improvement was felt only in 1968, the outstanding balance of such deposits rising from IL 1 million at the end of 1967 to IL 9 million at the end of the year reviewed. Another new scheme does not accumulate in-

[1] Other ways are the purchase of Short-Term Loan certificates with the proceeds of conversions, the purchase of foreign securities, or imports of goods and services financed from Tamam funds.

[2] It should be noted that only certificates bearing the name of the depositor or members of his family could be deposited in this type of scheme.

terest but pays it in four installments over the year. Schemes featuring the insurance of savers were another innovation in 1968.

The growth of saving scheme deposits was fairly even over the year, the average monthly increment amounting to some IL 23 million.

As in 1967, most of the increase was in the option-type schemes,[1] which were up approximately IL 263 million. Schemes involving the deposit of Absorption Loan certificates (which are also of the option type) expanded, as already mentioned, by some IL 8 million; those for secondary and higher education rose by about IL 4 million, and children's schemes by IL 9 million. On the other hand, the outstanding balance of unlinked schemes declined by approximately IL 9 million, while deposits in linked non-option-type schemes decreased by some IL 2 million. The balance of schemes for motor vehicle purchases remained unchanged in 1968.

The growth of saving schemes was accompanied by an increase of IL 228 million in the investment of such funds. This figure includes IL 113 million in Defense Loan certificates, most of which were purchased under an agreement with the Treasury.

The proportion of bonds in the total investment of saving scheme funds edged up from 74.4 percent in 1967 to 77.6 percent. At the same time, the composition of the bond holdings underwent a change: the share of Government bonds (including the Defense Loan) went up, while that of other bonds (mainly of financial institutions) declined. It should be pointed out that the share of securities in the investment portfolio far exceeds the 60 percent minimum ratio required for such deposits. The banks evidently prefer to buy bonds yielding a return similar to the interest they have to pay depositors, rather than grant directed credit from saving scheme funds.[2] In this context it should be recalled that the demand for credit of this type depends on the volume of approvals granted by the Bank of Israel, and this is a further factor explaining why directed credit does not amount to even 25 percent of the accumulation in saving schemes.

(c) *Local-currency time deposits*

Time deposits in Israeli currency expanded in 1968 by IL 349 million, or 67.2 percent; this contrasts with an increase of IL 371 million, or some 250 percent, the year before.

[1] These schemes permit the saver to choose, upon termination of the period of the deposit, between a high interest rate (up to 9 percent net per annum) without linkage of the principal, and a lower rate (up to 4 percent net per annum) with the principal linked to the consumer price index.

[2] In 1968 banks were permitted to purchase Defense Loan certificates with funds earmarked for directed credit. Such purchases were applied toward the quota which the banking institutions undertook to acquire.

The rapid growth in 1968 was one of the manifestations of the much heavier demand for financial assets in general, especially on the part of business firms and various institutional depositors. On the other hand, in 1967 two exogenous factors were also responsible for the steep rise in these deposits, rendering them an important money-market instrument. The most important factor was the lowering of the liquidity ratios on these deposits in September 1966, which enabled them to compete against other financial assets. The second factor was the collapse of three commercial banks at the beginning of 1967, which resulted in a certain reluctance on the part of the public to invest in bill brokerage and led to the shifting of funds to time deposits, which from the viewpoint of the saver constitute a fairly close substitute for bill brokerage.

In other words, besides the big increase in the total volume of other financial assets during 1967, the reduction of liquidity ratios on time deposits and the reluctance to invest in bill brokerage induced a particularly rapid expansion of time deposits.

In 1968 demand for other financial assets remained high, but the two exogenous factors referred to above were no longer operating, their impact apparently diminishing gradually in the course of 1967. Consequently, time deposits had to compete more strongly with other financial assets in order to maintain their rapid growth rate.

Most of the increase in 1968 can be ascribed to the general expansion of demand for interest-bearing financial assets and to the change in income distribution, which engendered a brisk demand for deposits of this type on the part of business firms. As already mentioned in section 2, the growth of big deposits (which for the most part belong to business and institutional investors) totalled IL 183 million, or about 52.4 percent of the total increase in time deposits. In 1967 deposits of this kind expanded by IL 104 million, or 28.0 percent of the entire increment. Another factor explaining the growth of time deposits was their active promotion by a number of small commercial banks, which had reached or neared the permitted guarantee ceiling and were therefore unable to expand their bill brokerage business.

6. Sources of Monetary Expansion

The money supply and less liquid deposits of the public increased by IL 1,338 million, or 26.9 percent, in 1968, compared with IL 1,473 million, or 42.0 percent, in the previous year.

The causes of monetary expansion in 1968 were similar to those in 1967, though their impact, as reflected in the system of accounts presented in this chapter, differed. The main source of growth in both years was the much larger Government expenditure, especially on security, which was not accompanied by a corresponding increase in receipts from taxes and domestic loans.

In 1967 the Government and the National Institutions raised nearly IL 1,000 million more capital abroad than in 1966, and this enabled them to cover their additional outlays and to substantially enlarge their deposits with the Bank of Israel. These developments were reflected by a IL 669 million rise in foreign currency balances with the banking system, while the net amount of credit received by the Government and the National Institutions from the banking system was comparatively small, totalling only IL 341 million, since the much larger deposit volume offset much of the growth of the Government's liabilities to the banking system.[1]

In 1968 the mobilization of foreign capital was on a much smaller scale than in 1967, and therefore the Government and the National Institutions had to turn to the banking system for financing a large percentage of their expenditure. They received IL 367 million in credit from the Bank of Israel, while foreign currency deposits with the Bank contracted by IL 534 million. This made a total of IL 901 million from the Bank of Israel,[2] with another IL 66 million being obtained from banking institutions. Aggregate credit from the banking system thus came to IL 967 million, making this the major cause of the monetary expansion in 1968. The decline of IL 173 million in the banking system's foreign currency assets counteracted part of the inflationary influences emanating from the public sector, slowing down the pace of monetary expansion.

The larger amount of credit granted to the public by the banking system was another factor contributing greatly to the monetary expansion of 1967 and 1968. In 1968 credit to the public was stepped up by IL 589 million (of which IL 548 million was supplied by the banking institutions), as compared with IL 518 million in 1967 (IL 371 million from the banking institutions). The rapid expansion of bank credit in 1968 reflects the much stronger demand for credit of this type. Moreover, incremental credit in 1968 was greater than indicated by the above data. In 1967 there was a substantial shifting of funds from bill brokerage to local-currency time deposits, so that the banking institutions expanded their credit to the public at the expense of a sizable contraction of bill brokerage credit. In 1968 the impact of this factor was much weaker, since the decline in the outstanding balance of bill brokerage slowed down.[3]

[1] For a further discussion of this subject, see Chapter XVI, "Flow of Funds".

[2] The withdrawal of deposits from the Bank of Israel has the same expansionary effect as the receipt of credit from it. In this chapter the entire amount received in 1968 from the Bank of Israel (IL 901 million) is treated as net credit from the Bank to the Government and the National Institutions, even though only part of this amount represents credit in the formal sense of the term.

[3] Bank credit to the public plus bill brokerage added up to IL 493 million in 1968, representing a rise of 17.8 percent; this compares with IL 239 million and 9.4 percent in 1967.

The Bank of Israel's open-market operations had a restraining effect on the rate of monetary expansion in 1967 and 1968. In 1968 the Bank absorbed IL 130 million through its sales, compared with IL 108 million in 1967.[1]

(a) *Foreign currency assets*

Net foreign currency assets with the banking system shrank in 1968 by IL 173 million, or $ 49.5 million, resulting in an external drain (see Table XV–8). Government deposits abroad also fell off, so that the depletion of the economy's foreign exchange reserves was even greater.[2]

The decline in the banking system's net foreign currency assets breaks down as follows: Foreign currency assets of the Bank of Israel decreased by $ 49.7 million, and its foreign currency liabilities by $ 2.5 million. On the other hand, there was an increase of $ 42.2 million in foreign currency asset holdings of banking institutions, while their foreign currency liabilities grew by $ 44.6 million. It should be stressed that the decline of $ 7.5 million in the gross foreign currency assets of the banking system does not reflect the full decrease in foreign currency balances.

During the year reviewed the Bank of Israel's gross foreign currency assets, the principal component of the country's foreign exchange reserves, contracted sharply, whereas the gross foreign currency assets of the banking institutions rose appreciably. The foreign currency assets of the banking institutions (which consist mainly of various deposits with banks abroad) cannot be regarded as a component of the economy's primary reserves, since they were acquired with funds originating in the growth of the institutions' short-term foreign indebtedness (mainly nonresidents' deposits and liabilities to foreign banks).

The decline in Israel's net foreign currency assets in 1968 reflected the marked widening of the country's adverse balance on goods and services account and the contraction of capital imports. In 1967, on the other hand, the net foreign currency assets of the banking system expanded by $ 110.4 million. There was a huge increase in the capital inflow as a result of the emergency fund-raising campaigns conducted abroad—an increase that far exceeded the rise in the current deficit.

The changes in the foreign currency asset holdings of the banking system in 1968 followed the usual seasonal pattern—during the first quarter of the year there was a net accumulation of $ 59.2 million while during the remaining nine months the volume contracted by $ 108.7 million.

1 The effect of sales in the open market was discussed in section 3 above.

2 The decline in the Government's overseas deposits is not reflected in the system of accounts presented in this chapter, as these funds were not deposited with the banking system.

Table XV-8

FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM, 1966–68

(IL million)

End of period	Bank of Israel				Banking institutions				Banking system	
	Foreign currency assets	Foreign currency liabilities		Net assets (1–2–3)	Foreign currency assets[b]	Foreign currency liabilities		Net assets (5–6–7)	Net foreign currency assets	
		Patach deposits[a]	Other liabilities			Patach deposits[c]	Other liabilities[d]		IL m. (4+8)	$ m.
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
1966	1,941.8	76.5	16.6	1,848.7	469.9	321.3	305.4	–156.8	1,691.9	564.0
1967	2,589.3	130.9	13.2	2,445.2	659.5	485.9	258.3	–84.7	2,360.5	674.4
1968	2,415.4	121.1	14.0	2,280.3	807.2	530.0	370.4	–93.2	2,187.1	624.9
1968 January	2,665.3	176.5	12.5	2,476.3	609.5	419.2	283.8	–93.5	2,382.8	680.8
February	2,767.2	137.3	11.5	2,618.4	595.5	416.3	289.7	–110.5	2,507.9	716.5
March	2,781.5	122.3	12.3	2,646.9	630.3	415.5	294.2	–79.4	2,567.5	733.6
April	2,758.1	108.5	12.1	2,637.5	587.9	401.5	278.7	–92.3	2,545.2	727.2
May	2,690.6	108.6	12.3	2,569.7	621.9	421.0	273.8	–72.9	2,496.8	713.1
June	2,688.7	113.1	14.5	2,561.1	634.6	422.6	278.1	–66.1	2,495.0	712.9
July	2,823.7	111.3	15.1	2,697.3	668.0	440.6	313.5	–86.1	2,611.2	746.1
August	2,747.6	114.7	11.8	2,621.1	683.3	459.3	300.2	–76.2	2,544.9	727.1
September	2,701.5	111.8	11.2	2,578.5	730.7	516.0	298.5	–83.8	2,494.7	712.8
October	2,614.0	116.8	10.9	2,486.3	687.6	480.0	287.8	–80.2	2,406.1	687.5
November	2,507.4	116.4	10.6	2,380.4	761.3	507.5	342.8	–89.0	2,291.4	654.7
December	2,415.4	121.1	14.0	2,280.3	807.2	530.0	370.4	–93.2	2,187.1	624.9

[a] Nonresidents' deposits redeposited by the banking institutions with the Bank of Israel.
[b] Mainly deposits with foreign banks and loans to nonresidents.
[c] Nonresidents' deposits, less sums redeposited with the Bank of Israel.
[d] Mainly loans from foreign banks and balances held for foreign banks.

(b) *Credit to the Government*[1]

The much larger expenditure of the Government and the National Institutions in 1968 was not accompanied by the expansion of domestic revenue from taxes and domestic loans, while the amount of capital raised abroad fell off. In order to finance its operations, the Government borrowed IL 367 million from the Bank of Israel and received IL 66 million in net credit from the banking institutions (see Table XV–9). Moreover, Government and National Institution deposits with the Bank of Israel shrank by IL 534 million. The aggregate credit of IL 967 million received from the banking system was, as already pointed out, the main cause of monetary expansion in 1968.[2]

The gross credit received by the Government from the banking institutions represented the proceeds from the sale of Government bonds, in the amount of IL 95 million.

In 1967 the Government obtained IL 189 million net credit from the Bank of Israel and a further IL 152 million from banking institutions. The incremental credit to the Government accounted for only IL 341 million of the total monetary expansion that year, as there was a substantial increase in the foreign currency deposits of the Government and National Institutions, which reduced their net indebtedness.

(c) *Bank credit to the public*

1. The expansion of credit.

Bank credit to the public was up IL 589 million, or 29.0 percent, in 1968; this compares with a growth of IL 518 million, or 34.3 percent, the year before. Part of the increment of 1967 and 1968 was at the expense of a decline in outstanding bill brokerage credit. The expansion of short-term credit (bank credit and bill brokerage) in 1968 totalled IL 493 million, as against IL 239 million in 1967—i.e. it was more than twice as great (see Table XV–10).

It should be noted that in 1967 a large percentage of the IL 147.2 million incremental Bank of Israel credit to the public (after provision for doubtful debts) went to a small number of banking institutions that had become financially involved, and was intended to enable them to honor their obligations toward their clients; in other words, these loans were not channelled directly to the various sectors of the economy.

The big increase in short-term credit was due, first and foremost, to the

[1] The inflationary effect of various credit transactions between the banking system and the Government and the National Institutions is discussed in Chapter VII, "Government and Non-Government Public Sector".

[2] The method of calculating credit to the Government and the decline in Government and National Institution deposits with the Bank of Israel is shown in Table XV–2 in the appendix.

Table XV-9

CHANGES IN OUTSTANDING CREDIT TO THE GOVERNMENT AND NATIONAL INSTITUTIONS FROM THE BANKING SYSTEM, 1966–68[a]

(IL million)

End of period	From the Bank of Israel			Credit from banking institutions				Total change in credit from the banking system
	Credit granted[b]	Less: Increase or decrease (–) in Govt. and National Institution deposits[c]	Total	Credit granted	Investment in Govt. securities[d]	Less: Increase or decrease (–) in Govt. deposits	Total	
1966	83.4	–81.8	165.2	12.6	10.0	–0.9	23.5	188.7
1967	702.3	513.0	189.3	12.9	136.7	–2.0	151.6	340.9
1968	366.8	–534.1	900.9	–22.9	94.7	5.6	66.2	967.1
1968 January	34.0	16.3	17.7	–29.0	–13.0	1.3	–43.3	–25.6
February	–31.3	–22.4	–8.9	–4.4	–1.8	–1.2	–5.0	–13.9
March	–372.2	–393.6	21.4	5.0	–32.0	–2.2	–24.8	–3.4
April	137.9	–51.6	189.5	–7.6	47.8	–0.6	40.8	230.3
May	140.2	–32.5	172.7	–3.5	6.0	0.3	2.2	174.9
June	90.0	7.6	82.4	3.7	27.3	1.1	29.9	112.3
July	–112.0	–12.1	–99.9	2.5	20.2	0.4	22.3	–77.6
August	131.9	–31.5	163.4	1.7	26.3	–0.7	28.7	192.1
September	60.4	9.8	50.6	14.7	–14.7	1.7	–1.7	48.9
October	108.6	–3.2	111.8	–13.8	0.7	0.6	–13.7	98.1
November	50.8	–17.4	68.2	–6.0	–2.9	–1.3	–7.6	60.6
December	128.5	–3.5	132.0	13.8	30.8	6.2	38.4	170.4

[a] Excluding the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.

[b] Excluding Bank of Israel open-market operations in Government securities and sales of treasury bills to banking institutions; these transactions are not accompanied by a flow of funds between the Bank of Israel and the Government, but between the Bank of Israel and the public and banking institutions.

[c] In 1966 Government deposits only.

[d] Excluding changes in holdings of treasury bills and the Short-Term Loan (for reasons explained in note [b] above).

much heavier demand for credit, which could be satisfied thanks to the substantial supply of funds in the money market.

The revival of economic activity in the second half of 1967 resulted in a greater demand for short-term credit. The liquidity situation of the banking institutions enabled them, up till September 1968, to supply the demand by expanding their credit business. Moreover, a brighter economic outlook and optimistic expectations replaced the uncertainty prevailing during the recession, and the institutions gave credit more readily.[1]

An indication of the availability of bank credit was the continued decline in the outstanding balance of bill brokerage, a development explained by the possibility of obtaining relatively cheap bank credit in place of the comparatively expensive bill brokerage credit.

Table XV–10

CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1966–68[a]

(IL million)

End of period	From the Bank of Israel[b]	From banking institutions[c]	Total bank credit	From earmarked deposits of the public[d]	Against Gov. deposits	From earmarked Govt. deposits	Balance of bill brokerage trade
1966	261.4	1,249.6	1,511.0	559.9	66.2	367.0	1,021.0
1967	408.6	1,620.4	2,029.0	662.4	66.8	425.4	742.3
1968	450.1	2,168.0	2,618.1	747.4	56.6	495.9	645.9
1968 January	418.9	1,676.4	2,095.3	669.7	63.0	431.4	726.3
February	433.4	1,732.8	2,166.2	670.4	61.0	434.5	726.9
March	481.6	1,828.7	2,310.3	691.4	66.3	431.9	702.3
April	445.6	1,821.7	2,267.3	670.6	63.5	437.7	694.2
May	446.2	1,808.0	2,254.2	674.2	59.0	442.4	685.6
June	438.9	1,878.2	2,317.1	675.4	56.6	442.9	648.5
July	454.3	1,896.6	2,350.9	682.6	53.9	446.2	634.4
August	459.0	1,924.8	2,383.8	695.8	54.3	450.4	623.6
September	484.5	2,057.9	2,542.4	708.3	50.0	451.7	605.9
October	478.8	2,092.6	2,571.4	732.5	46.9	460.8	618.6
November	518.5	2,154.7	2,673.2	741.9	53.4	463.2	633.6
December	450.1	2,168.0	2,618.1	747.4	56.6	495.9	645.9

[a] Excluding credit granted by the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] After provision of IL 31.0 million for doubtful debts at the end of 1967 and a further IL 42.3 million at the end of 1968.
[c] Excluding loans to foreign borrowers.
[d] Mainly credit from deposits of social insurance funds and financial institutions.

[1] In the middle of 1968 the banking institutions energetically promoted their credit business among households and business, *inter alia* conducting an advertising campaign through the press and radio.

The weight of bill brokerage in total short-term credit fell from 40.3 percent at the end of 1966[1] to 26.8 percent at the end of 1967 and 19.2 percent at the end of September 1968, when the downtrend came to an end. The diminished importance of bill brokerage was accompanied by a fall in interest rates paid by borrowers in this market. These two developments brought down the cost of short-term financing, and presumably this was an additional factor explaining the greater demand for credit in 1968. As already mentioned in section 3 above, the squeeze on money in the last quarter of 1968 drove up financing costs toward the end of the year, as reflected by the rise of interest rates in the bill brokerage market and the increased weight of such credit in total short-term financing.

The IL 589 million incremental bank credit in 1968 consisted of IL 419 million in ordinary and IL 128 million in directed and foreign currency credits granted by the banking institutions, and IL 42 million granted by the Bank of Israel.[2] In 1967, on the other hand, the Bank of Israel accounted for a considerable proportion of the increment. This was due, as already mentioned, to the loans extended to a number of banks that ran into difficulties, and should not be regarded as an increase in the share of directed and Bank of Israel credit in the total amount of bank credit granted to the rest of the economy (see Table XV–11).

The bill brokerage market, which contracted sharply in 1967, continued to sag in the year reviewed, but much more slowly. The decrease in the outstanding balance of bank-negotiated bill credits totalled IL 96 million in 1968, compared with a drop of IL 279 million in 1967. As already indicated, the downtrend was not uniform throughout the year. Developments in this market clearly illustrate their close interrelationship with the degree of tightness in the money market as a whole. Until September 1968 there was a surplus supply of bank credit. Banking institutions had large free reserves on hand, and tried to step up their credit business so as to increase profits. Under the prevailing conditions of rapid monetary expansion, they were able to mobilize a large volume of local-currency time deposits, even after reducing creditory interest rates somewhat.

In this situation, market forces operated to dampen the outstanding balance of bill brokerage, since a growing number of firms and other borrowers were able to obtain bank credit, thus reducing their resort to bill brokerage.[3]

1 The outstanding balance of bill brokerage credit reached its peak in December 1966.

2 The amount received is after provision of IL 42 million for doubtful debts; the gross sum thus amounted to IL 84 million.

3 The shifting of funds from bill brokerage to time deposits may have been slowed down to some extent by the banking institutions themselves, which prefer the more profitable bill brokerage trade to time deposits in Israeli currency (see Bank of Israel, *Annual Report 1967,* p. 404).

Table XV-11

INCREASE IN BANK CREDIT TO THE PUBLIC, BY COMPONENT, 1966–68[a]

(IL million)

	1966	1967	1968
Bank credit[b]			
In local currency			
Directed	59.2	82.5	105.6
Within the framework of liquidity exemptions	*32.2*	*50.5*	*59.3*
Participation in export and working capital funds and credit from saving scheme funds	*27.0*	*32.0*	*46.3*
Ordinary	153.0	290.9	419.4
In foreign currency	–37.5	–2.6	22.6
Total bank credit	**174.7**	**370.8**	**547.6**
Bank of Israel credit			
Local currency rediscounts	89.8	7.8	31.3
Foreign currency rediscounts	32.4	139.4	10.2
Total[c]	**122.2**	**147.2**	**41.5**
Total incremental credit from the banking system	**296.9**	**518.0**	**589.1**
Credit from and against Government deposits	34.5	59.0	60.3
Credit from earmarked deposits of the public	111.3	102.5	85.0
Bill brokerage	247.4	–278.7	–96.4

[a] Data for 1960–65 are given in Table XV-6 in the appendix.
[b] Excluding credit granted by the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[c] After provision of IL 31.0 million for doubtful debts at the end of 1967 and a further IL 42.3 million at the end of 1968.

In the last quarter of 1968 the contractionary influences at work in the money market began to make themselves felt, and the banking institutions were again unable to satisfy all of the demand for bank credit. The raising of interest rates on local-currency time deposits in order to attract funds and thereby permit the further expansion of credit is limited by the legal interest ceiling on bank credit, which prevents the raising of creditory rates. The raising of debitory rates with no possibility of raising creditory rates dampens the profitability of bank credit and prompts banking institutions to expand their bill brokerage business, insofar as they have not reached their permitted guarantee ceiling.

2. *The destination of credit*

The sectoral classification of credit relates to the finance granted through the banking system; in addition to bank credit to the public, it includes the sums granted from earmarked deposits of the public and those against Government

Table XV-12

OUTSTANDING BANK AND BILL BROKERAGE CREDIT TO THE PUBLIC, BY DESTINATION, 1966–68[a]

(End of period)

Destination	Credit through the banking system[b]			Bill brokerage	
	1966	1967	1968	June 1967	June 1968
			IL million		
Local authorities	177.8	293.7	347.7	13.6	8.7
Credit and financial institutions[c]	90.6	121.0	227.8	70.5	36.7
National Institutions	34.8	57.2	109.2	2.9	1.6
Agriculture	243.6	303.4	335.3	78.8	41.3
Industry	845.7	997.7	1,219.6	226.9	188.5
Construction	143.9	216.8	279.4	202.9	167.5
Commerce	132.1	181.5	223.9	97.9	90.5
Business services	148.6	184.2	241.6	48.9	33.2
Public services	64.3	86.0	83.1	15.2	8.2
Individuals	186.1	217.8	250.3	39.2	32.0
Miscellaneous[d]	69.6	109.2	139.5	53.4	39.4
Total	**2,137.1**	**2,768.6**	**3,457.4**	**850.2**	**647.6**
			Percentages		
Local authorities	8.3	10.6	10.1	1.6	1.3
Credit and financial institutions	4.2	4.4	6.6	8.3	5.7
National Institutions	1.6	2.0	3.2	0.3	0.2
Agriculture	11.4	11.0	9.7	9.3	6.4
Industry	39.6	36.0	35.2	26.7	29.1
Construction	6.7	7.8	8.1	23.9	25.9
Commerce	6.2	6.6	6.5	11.5	14.0
Business services	7.0	6.7	7.0	5.7	5.1
Public services	3.0	3.1	2.4	1.8	1.3
Individuals	8.7	7.9	7.2	4.6	4.9
Miscellaneous	3.3	3.9	4.0	6.3	6.1
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

[a] Excluding credit granted by the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] Ordinary bank credit against Government deposits and credit from earmarked deposits of the public.
[c] Excluding interbank loans, loans between cooperative credit societies, and credit from the Bank of Israel to banking institutions.
[d] Other sectors, including credit to artisans.

deposits (chiefly to tax debtors). Bill brokerage is excluded, as the data thereon are for years ending in June.[1]

A glance at Table XV–12 shows that of the IL 688 million credit increment in 1968, IL 213 million went to local authorities, credit and financial institutions, and the National Institutions; this compares with IL 168 million in 1967. Other economic sectors received IL 475 million in 1968, as against IL 464 million the year before.

In other words, credit granted through banking institutions to the private nonfinancial sectors increased to about the same extent in 1968 as in 1967. However, it should be recalled that bill brokerage shrank by IL 279 million in 1967 but by only IL 96 million in 1968. As may be seen from the table, most of the bill brokerage credit goes to these sectors; discounting the contraction of bill brokerage, we find that short-term credit to the private nonfinancial sectors rose by IL 379 million in 1968, compared with IL 185 million in 1967. The doubling of the increment reflects the much heavier demand for credit following the intensification of activity in all sectors of the economy.

The most rapid increases were in bank credit to commerce, industry, and construction, which went up by more than 20 percent.

The incremental institutional credit in 1968 includes sums granted to local authorities to cover their deficits. Most of the credit received by the National Institutions in 1968 was used for the advance payment of foreign debts.

The much larger sum going to credit and financial institutions in 1968 was for the most part connected with the receipt of a foreign loan by one of the banks on behalf of a financial institution and with the growth of earmarked deposits, from which credit is provided to various financial institutions.[2]

7. The Development of Banking Institutions

The combined balance sheet of the banking institutions rose by 20.2 percent in 1968, compared with 24.6 percent the year before. As in 1967, growth was faster if contingent accounts are excluded—25.4 percent in 1968 as against 37.2 percent in 1967. The particularly rapid expansion in 1967 was due to some extent to the devaluation and the resulting revaluation increments.

It should be noted that, unlike previous balance sheets, those for 1967 and 1968 do not include the Yaad Agricultural Development Bank. It was shifted from the banking institutions to the financial institutions sector for purposes

[1] The decline in the bill brokerage trade between June 1967 and June 1968 totalled IL 203 million, but between December 1967 and December 1968 it was only IL 96 million.

[2] See Table XV–5 in the appendix for a sectoral classification of bank credit and of credit from earmarked deposits, with a breakdown into controlled and ordinary credit.

Table XV-13

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS,[a] 1967–68

	IL million		Percent		Increase or decrease (–)	
	1967	1968	1967	1968	IL m.	%
Assets						
Cash, balances with the Bank of Israel, and treasury bills	2,373.7	2,861.3	33.4	32.1	487.6	20.5
Loans to the public[b]	1,793.2	2,351.9	25.3	26.4	558.7	31.2
Loans to the Government	55.8	32.9	0.8	0.4	–22.9	–41.0
Loans from earmarked deposits						
From Government deposits	492.4	552.1	6.9	6.2	59.7	12.1
From deposits of the public[c]	733.9	899.3	10.3	10.0	165.4	22.5
Foreign currency assets	659.7	807.2	9.3	9.1	147.5	22.4
Securities	590.0	823.2	8.3	9.3	233.2	39.5
Real estate	89.1	113.7	1.3	1.3	24.6	27.6
Net balances with other banking institutions	–20.0	–19.6	–0.3	–0.2	0.4	2.0
Other accounts	333.9	482.0	4.7	5.4	148.1	44.4
Total	**7,101.7**	**8,904.0**	**100.0**	**100.0**	**1,802.3**	**25.4**
Liabilities						
Demand deposits in Israeli currency	1,564.6	1,800.1	22.1	20.2	235.5	15.1
Less liquid deposits[d]	2,619.7	3,601.4	36.9	40.4	981.7	37.5
Foreign liabilities[e]	875.1	1,021.5	12.3	11.5	146.4	16.7
Government deposits	501.7	567.2	7.1	6.4	65.5	13.1
Earmarked deposits	748.6	917.6	10.5	10.3	169.0	22.6
Equity capital	315.2	333.4	4.4	3.7	18.2	5.8
Capital notes	31.5	45.4	0.4	0.6	13.9	44.1
Other accounts	445.3	617.4	6.3	6.9	172.1	38.6
Total	**7,101.7**	**8,904.0**	**100.0**	**100.0**	**1,802.3**	**25.4**
Contingent accounts						
Balances held by and for banking institutions	85.0	87.5			2.5	2.9
Clients' liabilities and guarantees for clients	1,453.8	1,394.4			–59.4	–4.1
Total	**1,538.8**	**1,481.9**			**–56.9**	**–3.7**
Grand total	**8,640.5**	**10,385.9**			**1,745.4**	**20.2**

[a] Excluding the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] The figures for 1967 and 1968 are respectively IL 172.8 million and IL 183.9 million larger than those cited in Table XV–10, since they include Bank of Israel loans to banking institutions in these amounts.
[c] The figures for 1967 and 1968 are respectively IL 71.5 million and IL 151.9 million larger than those cited in Table XV–10, since they include loans to the Government.
[d] Including IL 172.8 million in Bank of Israel loans to banking institutions in 1967 and IL 183.9 million in 1968.
[e] The figures for 1967 and 1968 are respectively IL 130.9 million and IL 121.1 million larger than those cited in Table XV–8, since they include nonresidents' deposits redeposited with the Bank of Israel.

of analyzing flows of funds and the macroeconomic influence of the banking system. This sectoral reclassification was connected with the gradual change that took place in the last few years in the structure, objectives, and operation of the institution, so that in 1967 there was justification for including it among the financial institutions, similarly to the Israel Bank of Agriculture.

In line with the trend observed in 1967, loans to the public again rose appreciably—by approximately IL 559 million, or 31 percent. This can be attributed to the much heavier demand for credit which accompanied the acceleration of economic activity, and to the further shifting of funds from bill brokerage to ordinary deposit-credit business.

On the assets side, the continued growth of the securities item stood out—these expanded by IL 233 million (39.5 percent) in 1968, compared with IL 272 million (85.4 percent) in 1967. This strong increase in the last two years was connected with the rapid growth of approved saving schemes and with purchases of the Defense and Development Loans under an agreement with the Treasury. Loans to the Government was the only item to decline in 1968—by about IL 23 million, or 41 percent.

The much greater liquidity of the banking institutions in the year reviewed is reflected by the increase of IL 487.6 million (20.5 percent) in the item "cash, balances with the Bank of Israel, and treasury bills".

On the liabilities side, the most striking feature was again the expansion of less liquid deposits—by some IL 982 million, or 37.5 percent. Local-currency time deposits, saving scheme accounts, and Pazak and Tamam all contributed to the growth. Demand deposits rose by only 15.1 percent in 1968, compared with 24.8 percent the year before.[1]

The growth of equity capital continued downward—IL 18.2 million, or 5.8 percent, compared with IL 19.5 million, or 6.4 percent, in 1967. Capital notes increased in 1968 by about IL 13.9 million, or 44.1 percent; this was due to a new issue by one of the banks, which was denominated in Israeli currency, in contrast to previous issues which were in foreign currency.

The contingent items continued downward in 1968, though more slowly than in the previous year. The decrease was approximately IL 57 million, or 3.7 percent, and it can be ascribed to the further contraction of bill brokerage transactions.

The number of commercial banks operating at the end of 1968 was one less than at the end of the previous year, totalling 25. The decrease resulted from the sale of the entire branch network of a foreign commercial bank operating in Israel to another commercial bank. The number of credit co-

[1] The growth of demand deposits cited here is not identical with that shown in the other tables in this chapter, since the sums deposited with the Israel Bank of Agriculture and the Yaad Bank, which are excluded here, are included in the definition of the money supply.

operatives likewise fell by one, following the merger of one of the cooperatives with a commercial bank. The total number of head offices of banking institutions at the end of 1968 was 41, and the number of branch offices came to 721.

In the course of the year, 21 new branch offices were opened, while six old branches closed down; the number of branches (apart from the two abovementioned head offices which became branch offices) thus increased by 15.

The liquidation of the branch network of the three banks that became

Table XV-14

SELECTED INDICATORS OF THE CONCENTRATION OF BANKING BUSINESS, 1966–68[a]

(percentages)

End of period	The Big Three	Other banks	Credit cooperatives	Total
Cash and balances with the Bank of Israel				
1966	70.4	27.1	2.5	100.0
1967	75.4	21.4	3.2	100.0
1968	77.2	19.5	3.3	100.0
Loans to the public[b]				
1966	69.1	27.1	3.8	100.0
1967	65.2	29.5	5.3	100.0
1968	65.9	29.0	5.1	100.0
Local-currency demand deposits				
1966	66.2	24.5	9.3	100.0
1967	70.2	21.4	8.4	100.0
1968	69.7	22.1	8.2	100.0
Other deposits[c]				
1966	76.2	21.8	2.0	100.0
1967	77.9	19.5	2.6	100.0
1968	78.7	18.5	2.7	100.0
Bill brokerage				
1966	49.7	39.5	10.8	100.0
1967	56.1	32.1	11.8	100.0
1968	59.0	30.6	10.4	100.0
Number of head offices and branches				
1966	54.4	32.0	13.6	100.0
1967	55.5	31.1	13.4	100.0
1968	55.8	30.4	13.8	100.0

[a] The indicators do not include data for the Yaad Agricultural Development Bank and the Israel Bank of Agriculture.
[b] Including credit to nonresidents.
[c] Including deposits of nonresidents (Patach).
[d] Revised figures.

financially involved at the beginning of 1967 was completed in 1968, when the last seven branches of Ellern's Bank were sold. Consequently, the total increase in the branch network of existing banks came to 24, of which 10 belonged to the Big Three and 14 to other commercial banks.

The number of offices of Israeli banks operating in the administered areas went up by four in 1968, reaching 15. One more bank opened its doors in the areas, bringing the total number of Israeli banks operating there up to five. Of the 15 branches, 10 are in Judea and Samaria, four in the Gaza Strip and Sinai, and one on the Golan Heights. These 15 branches had aggregate assets of IL 14.4 million at the end of 1968. They engage primarily in the receiving of deposits from the public and the Government, the granting of loans from such deposits, the financing of import-export business, and the execution of various payments and receipts.[1]

The weight of the three big banks in total banking business continued upward in 1968. It was larger in five out of the six items serving as indicators of the concentration of banking business, and only in local-currency demand deposits did their weight decrease (by 0.5 percent). The biggest increase was registered in bill brokerage, where the share commanded by the Big Three grew from 56.1 to 59.0 percent, continuing the rapid upward trend in this item.

It should be pointed out that the increased importance of the Big Three was due in part to the merging of one commercial bank and one credit cooperative with two of the large banks.

8. Income and Expenses of Banking Institutions[2]

The marked growth of banking business in 1968 resulted in a substantially larger income and a somewhat smaller increase in expenditure; profits were therefore much higher than in the previous year.

Operating profit reached IL 55.6 million, compared with IL 36.8 million the year before. The growth rate in 1968 was 51.1 percent, as against 16.1 percent in 1967.

Total profits (operating profit plus capital gains) advanced more slowly than in 1967—28.8 as against 33.7 percent—owing to the steep fall in net capital gains. The decline in the latter from IL 7.6 million in 1967 to IL 1.6 million was mainly due to the much larger sum provided in 1968 for the revaluation of the banking institutions' securities portfolio.

[1] More information on the combined balance sheet of the branches operating in the administered areas will be found in the *Monthly Bulletin of Banking Statistics,* issued (in Hebrew only) by the Examiner of Banks, Bank of Israel.

[2] The data on income and expenses do not include the three banks that became financially involved at the beginning of 1967 and since then are in the process of liquidation.

Operating income reached IL 658.4 million in 1968—up IL 158 million, or 31.6 percent, over the previous year. Interest on deposits with the Bank of Israel and other banks rose by IL 40.4 million, or 37.4 percent; this can be ascribed primarily to the much larger volume of deposits held with the Bank of Israel, as required by the liquidity regulations.

Other income—mainly from securities and from foreign currency, trustee, and insurance transactions—advanced by IL 46.2 million, or 84.6 percent.

Table XV-15

INCOME AND EXPENSES OF BANKING INSTITUTIONS,[a] 1967-68

	IL million		Percent		Percent increase or decrease (-)	
	1967	1968	1967	1968	1966 to 1967	1967 to 1968
Operating income						
Interest on loans	225.0	291.1	45.0	44.2	21.6	29.4
Service charges	112.7	118.0	22.5	17.9	0.3	4.7
Interest on deposits with the Bank of Israel and other banks	108.1	148.5	21.6	22.6	17.6	37.4
Other income[b]	54.6	100.8	10.9	15.3	35.8	84.6
Total	**500.4**	**658.4**	**100.0**	**100.0**	**16.5**	**31.6**
Operating expenses						
Salaries and fringe benefits	149.2	170.6	32.2	28.3	3.6	14.3
Interest on deposits[c]	244.8	352.2	52.8	58.4	31.0	43.9
Other expenses[d]	69.6	80.0	15.0	13.3	3.7	14.9
Total	**463.6**	**602.8**	**100.0**	**100.0**	**16.5**	**30.0**
Profits						
Operating profit	36.8	55.6	82.9	97.2	16.1	51.1
Capital gains (net)	7.6	1.6	17.1	2.8	406.6	-79.0
Total	**44.4**	**57.2**	**100.0**	**100.0**	**33.7**	**28.8**

	1962	1963	1964	1965	1966	1967	1968
Operating profit as a percentage of operating income	8.2	11.8	9.2	9.6	5.7	7.4	8.4
Operating profit as a percentage of equity capital[e]	20.7	21.3	13.0	13.3	8.6	11.7	17.3
Total profits as a percentage of equity capital	29.8	32.4	19.7	16.2	8.5	14.3	17.8

[a] Excluding the three banks that became financially involved at the beginning of 1967 and since then are in the process of liquidation, as well as the Yaad Agricultural Development Bank.

[b] Including income from securities (other than capital gains) and from foreign currency, trustee, and insurance transactions.

[c] Including interest and commission on loans received and rediscounts, as well as fines for liquidity deficiencies.

[d] Including administrative expenses, depreciation, donations, and bad debts.

[e] The calculation excludes foreign banks, as they have no local equity capital.

Operating expenses were, at IL 602.8 million, 30.0 percent higher than in 1967.

Interest paid on deposits went up by IL 107.4 million, or 43.9 percent, and employee compensation (salaries and fringe benefits) by 21.4 million, or 14.3 percent (compared with 3.6 percent in 1967). The growth of the latter item stemmed from a rise of about 8.5 percent in salaries and fringe benefits and of 5.4 percent in personnel.

Administrative and other expenses, including the bad debts item, rose by IL 10.4 million, or 14.9 percent.

The expansion of banking business in 1968 resulted in an improvement in profitability, as measured by three ratios: operating profit/operating income (the "profit margin") went up from 7.4 percent in 1967 to 8.4 percent; operating profit/equity capital from 11.7 to 17.3 percent; and total profit/equity capital from 14.3 to 17.8 percent.