

CHAPTER IX

ACTIVITIES OF THE BANK OF ISRAEL

1. SUMMARY OF THE BALANCE SHEET AT THE END OF 1985¹

The Bank of Israel's balance sheet totaled NIS14,580 million at the end of 1985, compared with NIS5,449 million the year before—an increase of 168 percent. This fell short of the rise in consumer prices (185 percent), but matched the depreciation of the sheqel in relation to the foreign currency basket.² The increase reflected the predominant weight in the balance sheet of assets and liabilities denominated in or linked to foreign currency. The sheqel depreciated 170 percent against the foreign currency basket, but by only 135 percent against the U.S. dollar.

Foreign reserves held at the Bank of Israel rose by \$589 million in 1985 (23 percent), after a \$272 million decrease the year before, and totaled \$3,190 million. Most of the growth took place in September and November, when U.S. government aid was received.

2. MONETARY POLICY MEASURES IN 1985

The Bank of Israel conducted a very stringent monetary policy in 1985, which found expression in the money market interest rates. This policy, which aimed to curb demand for credit and thus help to stabilize prices, was especially tight in the third quarter of the year, when the economic stabilization program was introduced. The monetary instruments developed by the Bank of Israel in recent years were applied intensively in 1985, for fear that an excessive growth of credit would seriously disrupt the economy. Even though this danger was present the entire year, the underlying circumstances in which monetary policy operated differed greatly in the two halves of the year.

¹ This section appeared in full in the Bank of Israel's Financial Statements for the Year 1985.

² The basket is composed of the following currencies:

	Total	U.S. dollar	Pound sterling	German mark	French franc	Dutch guilder
Weight in units		0.35	0.1295	0.515	0.6832	0.2187
Percent. 31.12.85	100	38	20	23	10	9
Percent. 31.12.84	100	44	19	20	9	8

The first six months saw a continuation of the package deals introduced in November 1984. This period was characterized by a large fiscal deficit, which generated an enormous public sector injection. Part of this injection was offset by the sale of foreign currency to the private sector,³ which drew down the foreign reserves at the Bank of Israel, while another part fueled the growth of the public's liquid financial asset holdings.

As in previous years, it was not possible to influence the growth of liquid assets and total financial assets of the public in the first half of 1985 by curtailing bank credit to the private sector or through any of the Bank of Israel's other monetary policy instruments. The fiscal deficit and ensuing public sector injection swelled the public's financial portfolio in real terms to such an extent that it could not be blunted by a tight credit policy. Because of the highly expansionary fiscal policy, any attempt to stabilize prices in the economy by setting a quantitative target for bank credit (and/or other monetary aggregates) would have squeezed credit very severely, thereby harming business sector activity. Even though during most of this period the public sector injection dictated a sharp reduction of interest, the Bank of Israel decided to maintain an appropriate real level of interest on nondirected (free) bank credit, as the lowering of interest would have sparked an enormous growth of such credit and heightened inflationary pressures. The Bank continued to narrow the differential between the lending and deposit interest rates, since this was the most effective way of discouraging disintermediation outside the banking system, which typically expands when bank credit is severely restricted.

Also hampering the conduct of monetary policy in the first half of 1985 was the frequent periodical adjustment of prices under the second and third package deals according to a prescribed formula. The second deal called for a controlled monthly rate of change of nonsubsidized product prices, and the third deal for a stepwise adjustment every two months. Since this made it possible to foresee the rate of change of prices, the result was, predictably, a wave of speculative demand in the commodity and foreign exchange markets, which inhibited the conduct of monetary policy. To sharply hike interest rates in anticipation of every administrative price adjustment would have seriously disrupted economic activity.

In the last two months of 1984 the Bank of Israel took steps which brought down the base interest rate and the marginal rate (the rate on overdrafts in excess of agreed limits) from 21 and 26 percent a month respectively to 10 and 17 percent. But in the first quarter of 1985 it discontinued the monetary relaxation (even though the other parties to the package deals pressed for a further reduction of interest). This was motivated by the brisk demand for credit following the rebounding of domestic demand during this period; in these circumstances any further monetary relaxation would have intensified the inflationary pressures. In April and May the Bank of Israel had to raise interest

³ The reference is to the sale of foreign currency in exchange for sheqalim, and not to the transfer of foreign currency abroad, as defined in Chapter VIII.

rates in order to head off an excessive expansion of the short-term bank credit which serves as the credit target.⁴

The very tight credit policy implemented in the first half of 1985 was reflected in the nominal and real interest rates. The cost of nondirected bank credit for domestic activities reached 15.7 percent a month in nominal and 3.4 percent in real terms, while for total short-term bank credit to the public (the monetary policy target) it came to 14 and 2 percent respectively.

Despite the high interest, total nondirected bank credit expanded 10 percent in real terms in the first half of 1985, and total short-term bank credit to the public by 8 percent. Most of the growth took place immediately before the administrative price adjustments under the second and third package deals and in anticipation of the price and exchange rate adjustments at the outset of the new economic policy introduced in July. But to some extent it was probably also connected with the reversal of the process of disintermediation outside the banking system, i.e. the flow of money back from the grey credit market to the banking system.

The economic stabilization program provided for the slashing of the government deficit and a substantial erosion of wages in the initial stage. But it was clear to the architects of the new strategy that these measures would find expression in the real sphere only gradually and over a considerable time-span. To speedily stabilize prices, the imposition of controls and the administrative freezing of prices in the economy by themselves would not fill the bill; they had to be coordinated with very tough monetary measures that would immediately dampen domestic demand. The monetary target decided upon was a 10 percent real decrease in total short-term bank credit to the public in July, to be followed by a nominal freeze from August to October. Since there was no intention of significantly reducing the real level of directed export credit (which accounts for about half of total bank credit to the public), the real balance of nondirected bank credit would have had to be slashed by 30 percent in the first four months of the plan. This was an unprecedented degree of restraint, with all that it implied regarding the interest on nondirected credit and the contraction of economic activity for the domestic market.

The Bank of Israel decided to initially keep nominal interest at its high level on the eve of the plan until credit should be tightly squeezed, as envisaged for July, and then to gradually scale down interest rates. But it took care that the reduction of interest should not cause any deviation from the credit target, as this would have jeopardized the price stability.

It was also careful that the monetary relaxation proceeded cautiously and progressively as the dampening effect of the tax and wage measures on domestic demand ran its course. It had to take into account that the decline in the public's inflationary expectations was a gradual process, especially when the objective was to stabilize prices after a 15–20 percent monthly inflation rate.

⁴ The financing of fuel imports, diamonds, and shipping and aviation is excluded from the credit target as it does not directly influence the level of domestic activity and demand.

In the second half of July, after it became clear that credit was developing as targeted, the Bank of Israel began to lower interest rates, and by the end of the year it had made seven downward adjustments, which depressed the base rate from 14 percent at the end of June to 3 percent, and the rate on overdrafts in excess of agreed limits from 22 to 5.5 percent.

In July total short-term bank credit to the public (the monetary policy target) shrank 8 percent in real terms. Part of this squeeze was offset by a real expansion over the next three months, so that in the first four months of the economic plan the real decrease came to only 2.5 percent. But the real reduction of credit to the private sector for financing economic activity was apparently greater than this, for several reasons:

(a) Beginning in the second half of August the shadow price of tax arrears far exceeded the marginal lending rate. Thus part of the business sector's demand for credit was not connected with the level of economic activity or the private sector's domestic demand, but arose from the desire to pay tax debts (tantamount to the repayment of credit to the public sector). This increased the balance of bank credit on the one hand and artificially reduced the government's measured demand surplus on the other.

(b) Part of the incremental credit in 1985, in particular the second half of the year, was connected with the heavier borrowing by nonprofit institutions and local authorities after their budgets had been cut. They stepped up their borrowing despite the high price of credit in order to avoid reducing their activity. Since the nonprofit institutions and local authorities are part of the public sector, here too the reference is to an increase in credit to the public sector which statistically is treated as credit to the private sector. This credit likewise artificially reduced the public sector's measured deficit broadly defined.

In December 1985 and the first quarter of 1986 outstanding real bank credit to the public shot up. The Bank of Israel thereupon slowed the reduction of interest in order to avert an accelerated expansion of credit.

In the second half of 1985 the rapid nominal swelling and substantial real growth of most of the monetary aggregates—both liquid financial assets and less liquid assets—ground to a halt, for the following main reasons:

(a) The much smaller public sector injection after the deep budget deficit cut.

(b) The Bank of Israel's tight credit policy, which apparently severely squeezed the real balance of credit for financing the private sector's domestic activity and domestic demand.

(c) The shrinkage of the real value of that part of the public's financial portfolio that was denominated in or linked to the dollar following the real appreciation of the dollar against the sheqel since July 1985.

In the second half of 1985, and in particular the third quarter, the spread between the lending and deposit interest rates widened noticeably. But this apparently did not stimulate disintermediation outside the banking system because of the climate of uncertainty created by the weakening of domestic demand, which greatly increased the risk involved in grey credit market transactions.

In the second half of the year, and especially the first few weeks of the new economic plan, the monetary authorities had to contend with extremely difficult conditions: the plan called for a marked asymmetry between the expected yields on foreign currency assets and the expected cost of foreign currency liabilities on the one hand and domestic money market interest rates on the other. The large devaluation implemented upon the initiation of the plan and the declared policy of stabilizing the exchange rate, at least in the first few months, sharply depressed the expected yields on foreign currency assets and the expected cost of foreign currency liabilities. On the other hand, nominal sheqel interest rates were kept high in order to support the price stability until the contractionary effect of the fiscal measures on domestic demand should fully work itself out. This asymmetry spurred the import of short-term capital from abroad, boosting demand for foreign currency credit. It also stimulated the conversion of foreign currency-linked deposits (Patam) into sheqalim. In the first few weeks such conversions totaled NIS1.25 billion, which was 2.5 times larger than the total money base on the eve of the plan. To neutralize this enormous liquidity potential and forestall an excessive growth of credit, the Bank of Israel employed in a very intensive and concerted manner the monetary instruments at its disposal—the liquidity ratios, discount-window loan, interest rate structure, and treasury bills. A brief survey of the operation of these instruments follows.

Liquidity Ratios

In the first half of 1985 the Bank of Israel did not revise the liquidity ratios on sheqel deposits at all (see Table IX-1). But after the new economic plan went into force it raised them four times, from approximately 10 percent to 40 percent. In the first two adjustments, made in the first half of July, the Bank increased the interest-bearing required liquidity, while in the last two adjustments it also increased the noninterest-bearing requirements after the banks had widened considerably the differential between the lending and deposit interest rates, thereby increasing their financial margin.

In the last quarter of 1985, along with its successful effort to narrow the spread between the lending and deposit interest rates, the Bank of Israel transferred part of the required liquidity from the noninterest-bearing to the interest-bearing category. This brought the required liquidity in the noninterest-bearing category almost back to its level on the eve of the stabilization plan. At the beginning of 1986 the Bank reduced the liquidity ratios on time deposits for one month or more from 30-38 percent to 10-25 percent, so as to enable the banks to pay a much higher interest on relatively long-term deposits than what they paid on CDs and one- and two-week deposits. So far this has not produced any noticeable results, for the overwhelming share of the public's sheqel deposits are demand deposits or deposits with very short maturities, such as CDs and one-week deposits.

Interest Rates

One of the ways in which the Bank of Israel influences the level of interest

in the money market is the setting of the rates on the liquid assets which banks deposit with it (the required and excess liquid asset cover), as well as the interest rate steps of the discount-window loan it makes available to the commercial banking system.

In 1985 the Bank revised the interest rates on liquid assets and the discount-window facility nine times (see Table IX-1): twice—at the end of the first quarter and in the middle of the second quarter—it raised the rates by 2 percentage points, while from the last week of July 1985 until the end of the year it lowered them seven times. The monthly rate on liquid assets was reduced from 14 to 3 percent, and on the marginal discount-window loan from 20 to 5 percent. It is noteworthy that since the stabilization plan has gone into force recourse to the discount-window loan has diminished greatly. In the last quarter of 1985 the Bank of Israel tried to narrow the gap between the base interest rate and the rate for drawings in excess of approved overdraft limits by narrowing the interest rate differential between the various categories of the discount-window loan.

Discount-Window Loan and Liquidity Deficiencies

In July 1985 the Bank of Israel raised the quotas for the various categories of the discount-window loan from NIS30 million to NIS40 million each (along with the steep hiking of the liquidity ratios): In mid-November it reduced the liquidity deficiency which need not be covered by the discount-window loan from 5 percent of the required liquidity to 2 percent.

Upon the introduction of the first package deal in November 1984, the Bank of Israel made the banks' eligibility for the discount-window facility conditional on payment of the minimum interest rate on short-term deposits of NIS100 or more and collection of the maximum rate on overdrafts. With the launching of the stabilization program the Bank canceled these conditions, but in November 1985 it reinstated them with respect to the maximum permitted charge on overdrafts, both the base rate and the rate for drawings in excess of agreed limits.

Open-Market Operations

Treasury Bills

In the first half of 1985 treasury bills proved to be a very effective instrument for influencing the interest rate paid by the commercial banking system on customers' deposits and for reducing the spread between it and the lending rate. Narrowing this gap is important for discouraging financial intermediation outside the banking system, but the public's treasury bill holdings were quite small during this period, shrinking from NIS48 million at the end of 1984 to a mere NIS2 million by the end of June (at December 1985 prices).

The Bank of Israel employed treasury bills on a much larger scale for its open-market operations in the second half of the year, in particular the first few months of the new economic plan. During this period the public's foreign currency conversions generated considerable excess liquidity in the banking

Table IX-1
CHANGES IN MONETARY POLICY INSTRUMENTS, 1984-861

A. Liquidity Ratios (%)										
1. On sheqel deposits, by interest rate step (%)										
Date of change	1984				1985				1986	
	6.12	4.7	11.7	25.7	1.8	8.8	24.10	28.11	16.1	13.3
Demand deposits ^a	35	35	35	45	50	50	50	50	50	45
First step	13	3	13	23	28	28	28	14	14	9
Second step	22	22	22	22	22	22	22	36	36	36
Time deposits										
One-week deposits	11	15	30	40	45	45	45	45	45	45
First step	6	6	6	11	16	12	8	6	6	6
Second step	5	9	24	29	29	33	37	39	39	39
Two-week deposits	9	13	28	38	43	43	43	43	43	43
First step	4	4	4	9	14	11	6	4	4	4
Second step	5	9	24	29	29	32	37	39	39	39
One-month deposits	8	12	23	33	38	38	38	38	25	25
First step	3	3	3	8	13	10	3	2	2	2
Second step	5	9	20	25	25	28	35	36	23	23
Two-month deposits	7	11	20	30	35	35	35	35	15	15
First step	2	2	2	7	12	9	2	2	2	2
Second step	5	9	18	23	23	26	33	33	13	13
Six-month deposits	7	7	15	25	30	30	30	30	10	10
First step	2	2	2	7	12	9	2	2	2	2
Second step	5	5	13	18	18	21	28	28	8	8
CDs	9	13	28	38	43	43	43	43	43	43
First step	4	4	6	13	18	13	9	7	7	7
Second step	5	9	22	25	25	30	34	36	36	36

2. On nondirected (free) sheqel credit

Until March 13, 1986 the liquidity ratio was 9 percent, and thereafter 1 percent.

3. On foreign currency deposits

The liquidity ratio on these deposits is 100 percent: on Patam demand deposits from November 7, 1983, on Patam time deposits from December 8, 1983, and on Patam restitution from December 22, 1983.

B. Bank of Israel interest rates (%)

Date of change	1984					1985					1986			
	27.12	28.3	23.5	25.7	15.8	5.9	26.9	24.10	14.11	28.11	9.1	20.2	13.3	
1. Deposits with Bank of Israel	10.0	12.0	14.0	11.0	8.0	7.0	5.0	3.5	3.5	3.0	2.5	1.75	1.25	
2. Discount-window loan														
Ordinary loan	10.5	12.5	14.5	12.0	9.0	8.0	6.0	4.0	4.0	3.5	3.0	2.0	1.5	
Special loan	11.5	13.5	15.5	13.0	10.0	9.0	7.0	5.0	5.0	4.0	3.5	2.5	1.75	
Third tranche	13.5	15.5	17.5	14.5	11.0	10.0	8.0	6.0	-	-	-	-	-	
Marginal loan	16.0	18.0	20.0	17.0	13.0	12.0	10.0	8.0	6.0	5.0	4.0	3.0	2.0	

C. Foreign Currency Credit Ceilings

1. On April 10, 1985, \$64 million in exemptions were granted; excluding this sum, the ceiling amounted to \$446 million.
2. On August 2, 1985 the ceiling was reduced by 3.36 percent (\$15 million).
3. On September 2, 1985 the ceiling was reduced by 13.91 percent (\$60 million).
4. On March 27, 1986 the exemptions were canceled and the ceiling was set at \$478 million.

^a Effective liquidity ratio.

system, creating a large potential source of credit growth. Outstanding treasury bills soared from NIS2 million at the end of June to NIS410 million at the beginning of November, but declined to NIS125 million by the end of the year.

Besides the four-week series issued weekly since June 1984, the Bank of Israel began to market an eight-week series in July 1985 and a twelve-week series in December. But since the yields on the longer series were about the same as for the four-week series, there was no significant shift to the new issues.

Stock exchange transactions in treasury bills rose from an average of about NIS1 million a day in 1984 and the first half of 1985 to around NIS12 million a day in the second half of 1985 (at December 1985 prices).

The maximum quantity of treasury bills in circulation is prescribed by law. The law authorizes the Minister of Finance to increase the ceiling with the approval of the Knesset Finance Committee. Because of the buoyant demand for this paper, the ceiling was raised several times during the year reviewed:

(a) On January 1 it was raised from NIS20 million to NIS75 million, and the Finance Minister was authorized to increase it up to NIS150 million.

(b) On July 9 he increased the ceiling to NIS150 million.

(c) On July 23 it was raised from NIS150 million to NIS500 million, and the Finance Minister was authorized to increase it to NIS1 billion.

(d) On October 29 he increased it to NIS1 billion.

Bonds

In 1985 the Bank of Israel continued to reduce its intervention in the secondary government bond market, a trend begun in late 1982. On the other hand, it actively engaged in the sale of tradable bonds to the general public and institutional investors by tender. In determining the quantity to be issued and offered to the public, account is taken of the budget financing requirement and the rollover of the government's domestic debt.

The progressive diminution of the Bank's intervention in secondary market trade was accompanied in 1983-84 by an increased volatility of bond prices. This, however, did not unsettle the capital market, thanks primarily to the efforts made in the past three years to increase the involvement of institutional investors (social insurance funds, approved savings schemes, etc.), which made for a more efficient bond market and enabled the Bank of Israel to reduce its intervention in 1985 without causing sharp technical swings in bond prices. The greater involvement of institutional investors, together with the net redemption of tradable bonds in 1983-84, enabled that segment of the public (businesses and households) which held bonds as a liquid component in their financial portfolio to gradually pull out of the market without causing a crisis. Even though the Bank of Israel hardly intervened in the market in 1985, bonds were much less volatile, owing, as stated, to the energetic involvement of institutional investors.

The Bank of Israel's weight in stock exchange bond trade (excluding internal setoffs of buy and sell orders) fell from 34 percent in 1983 to 13 percent in

1984 and to less than 1 percent in 1985.⁵

In 1985 the Bank of Israel purchased NIS2.2 million of bonds, compared with a net sale of NIS6.6 million in 1984 and NIS900,000 in 1983 (at current prices). Most of the Bank's transactions took place in the first half of the year, when net purchases totaled NIS2.1 million; NIS1.1 million of this sum was recorded in January, when bond prices tumbled by an average of 10.4 percent in real terms. In March the Bank purchased NIS600,000 of bonds at a 4.8 percent average real price decline. In the second half of the year, after the economic stabilization plan went into force, net purchases amounted to only NIS100,000.

"Arrangement" Bank Shares

The Bank of Israel's transactions in bank shares covered in the October 1983 arrangement, which are conducted on behalf of the government, have declined appreciably, from 39 percent of total stock exchange trade in the final quarter of 1983 to 6 percent in 1984 and virtually zero in 1985. The Bank's nonintervention in such trade in the year reviewed was reflected by sharp real price fluctuations.

At the end of October 1985, NIS984 million of "arrangement" bank shares that had been converted into locked savings schemes were redeemed by senior citizens (see note 11 in Chapter VIII). Of this sum, 42 percent was reinvested in special (nontradable) bonds issued for this purpose, while other amounts were reinvested in bank savings schemes, social insurance funds, and secondary market bonds.

3. FUNDING THE GOVERNMENT BUDGET

The Bank of Israel, in its capacity as banker to the government, raises funds for financing the government budget, both through the issue of bonds (State Loans) and the receipt of deposits from banks and financial institutions for the Finance Ministry. These deposits originate in the public's accumulated savings in the various approved instruments.

The total amount mobilized in 1985 was NIS3,611 million (at current prices). Of this sum, 54 percent originated in bank-administered savings schemes, including NIS413 million in nontradable government bonds issued specially for the reinvestment of "arrangement" bank share redemption proceeds.

Another 25 percent (5 percent in 1984) was raised through tradable government bonds sold by tender, a method introduced in December 1984 and which was used exclusively in 1985 for issuing such securities to the public. The weight of tradable government bonds issued to the general public and sav-

⁵ Beginning in January 1986 the Tel Aviv Stock Exchange required that members report daily on internal setoffs and transactions conducted off the floor, as is customary in the share market. Inclusion of data on setoffs would understate the Bank of Israel's weight in stock exchange bond trade.

ings institutions in the total amount raised for the Treasury rose in the year reviewed. This can be attributed to the policy of significantly reducing the issue of special bonds to social insurance funds and savings schemes, the improvement of tradable bond terms, and the offering of a broader array of such securities by tender.

The weight of special bonds issued to provident and pension funds and insurance companies declined sharply this year, from 38 percent in 1984 to 21 percent. The drop was especially steep in the case of provident funds, apparently because they invested more of their accumulation this year in secondary market bonds.

Redemptions, at NIS3,792 million, were much larger than in previous years. This includes NIS984 million in "arrangement" bank shares redeemed at the end of October, of which only NIS413 million was reinvested in the bonds specially issued for this purpose. On balance, there was a negative net capital mobilization (the excess of issues over redemptions) of NIS181 million.

The Bank of Israel also handles the National Insurance Institute's deposits. The amount raised from this source and transferred to the Finance Ministry totaled NIS560 million in 1985.

4. DIRECTED BANK OF ISRAEL CREDIT

The balance of export credit granted in Israeli and foreign currency in accordance with Bank of Israel guidelines averaged NIS2,090 million in 1985, compared with NIS470 million the year before—an increase of 345 percent in nominal and 10 percent in real terms. This increase, which occurred despite a further drop in the amount provided by the Diamond Fund, resulted from an 8 percent growth of exports financed through the funds and a greater utilization of foreign currency credit because of the exchange rate freeze in the second half of 1985.

The transfer of export production financing from Israeli to foreign currency was completed at the beginning of August 1985 with the termination of the sheqel fund and the provision of supplementary financing through the foreign currency fund. At the end of 1985 the rate of foreign currency financing in this fund came to 54 percent, as against 40 percent the year before.

Directed credit for domestic activities totaled approximately NIS2 million in 1985, compared with NIS1 million the year before. The credit is granted from earmarked government deposits, through funds assisting industrial enterprises and agricultural settlements.

5. FOREIGN EXCHANGE CONTROL

The activities which Israeli residents may undertake in foreign currency and with foreign residents are defined by the General Permit, issued in accordance with the Exchange Control Law, 5738-1978. From time to time the Permit is

amended in the light of general economic and monetary developments and in accordance with the policy of the government and Bank of Israel. Following are the principal amendments introduced in 1985:

(a) February

- (1) The suspension in October 1984 of the use of international credit cards abroad by Israeli residents was terminated. An Israeli resident going abroad may now arrange with an authorized dealer to have his foreign travel allowance withdrawable, in whole or in part, by his credit card.

(b) April

- (1) In October 1984 the general requirement to obtain supplier or other credit for the purpose of effecting payment for the import of goods had been canceled except in the case of motor cars. This exception was now canceled.
- (2) The requirement to use existing lines of credit in the form of overdraft accounts and not to reduce their use was canceled.
- (3) The right to take out of Israel any currency that is legal tender abroad but is not included in the list of foreign currencies set out in the Exchange Control Law was rescinded. This amendment closed a loophole whereby certain foreign currencies not defined as such in the law were taken out of Israel although fully convertible in world markets.

(c) May

- (1) The amount of foreign currency an Israeli resident aged 12 or more may take out of the country with him was reduced from \$1,000 to \$800.

(d) June

- (1) The general permit for an Israeli employer to pay wages in foreign currency to an Israeli resident working abroad was canceled. Henceforth a specific permit from the Controller of Foreign Exchange is required for this purpose.
- (2) The allocation of the additional foreign travel allowance for business travel abroad was restricted as follows: The right to an additional allowance was limited to an employee making a business trip abroad on behalf of his employer and to an exporter (defined for this purpose as one who deposited with an authorized dealer at least \$50,000 of his export proceeds during the 12 months prior to his trip). The additional allowance was limited to \$120 a day, or a total of \$2,400 per journey.
- (3) The amount of foreign currency a tourist may acquire at the airport upon his departure from Israel, without documents attesting to the conversion of foreign currency into sheqalim with an authorized dealer, was reduced from \$500 to \$100.
- (4) An Israeli resident may take out of the country with him as part of his travel allowance foreign currency that is legal tender abroad but is not

included in the list of foreign currencies set out in the Exchange Control Law. This supersedes an earlier amendment whereby an Israeli resident traveling to Turkey or Greece was not allowed to take out with him the currency of these countries.

- (5) The prohibition against early repayment of a foreign currency loan received from an authorized dealer was restricted to loans that are not included in the credit ceilings.

(e) July

- (1) The acquisition of foreign currency in exchange for sheqalim for deposit in a resident demand deposit was prohibited.
- (2) A special resident deposit was introduced in which an Israeli resident may deposit export proceeds, transfer payments from abroad, and cash or checks payable to the depositor. The interest received on this deposit is exempt from tax.
- (3) All authorizations for the transfer of currency from one Patam account (resident deposit denominated in foreign currency) to another, except in the case of heirs and trustees, and the transfer of currency from a Patach account (foreign resident deposit) to a Patam account were canceled, with effect from the end of the year.
- (4) The right of a foreign resident who acquired Israeli securities with the proceeds of a nonresident deposit to sell the securities and reconvert the proceeds was limited to shares other than "arrangement" bank shares. This provision was intended to prevent the flow of foreign currency into the economy during a period of exchange rate freeze in order to take advantage of high sheqel yields, and an opposite flow upon the formation of devaluation expectations. This amendment does not apply if the securities were acquired before July 23, 1985.
- (5) The right of a tourist to reconvert sheqalim into foreign currency (against documents showing the conversion of foreign currency into sheqalim) was limited to \$5,000 if he is aged 18 or more and to \$2,000 if he is under the age of 18.
- (6) The right of an exempt person to reconvert sheqalim into foreign currency was limited to the currency he converted into sheqalim through an authorized dealer, and this only after the lapse of at least six months from the date of the conversion. (Previously he could also reconvert foreign currency that was deposited in a resident deposit.) This provision too was intended to prevent the flow of foreign currency into the economy during a period of exchange rate freeze and an out-flow upon the appearance of devaluation expectations.

(f) September

- (1) A senior citizen who is a foreign resident and who acquired the special bonds issued for the reinvestment of the proceeds of the October 1985 redemption of "arrangement" bank shares will not forfeit the reconversion right which he possessed with respect to the original shares.

(g) October

- (1) The permits to transfer currency from one Patam account to another were revised to include the following categories:
- An Israeli corporation that has issued securities denominated in foreign currency and which are listed for trade on the Tel Aviv Stock Exchange.
 - A broker who is a member of the Tel Aviv Stock Exchange and deals in securities denominated in foreign currency.
 - Heirs.
 - Trustees.

6. SUPERVISION OF BANKING CORPORATIONS

At the end of 1985 the number of banking corporations operating in Israel (including the Gaza District) under the supervision of the Department of the Examiner of Banks stood at 67, the same as in the previous year. The number of offices of ordinary banking institutions⁶ operating in Israel was reduced by 10,⁷ and the number in Judea, Samaria, and the Gaza District by 2. At the end of the year there were 1,066 offices operating in Israel, including 1,038 branches and head offices of ordinary banking institutions, 19 restricted branches, and 9 exchange counters; 27 branches of ordinary banking institutions and 2 restricted branches were operating in Judea, Samaria, and the Gaza District. At the end of 1985 the ordinary banking institutions in Israel, Judea, Samaria, and the Gaza District had total assets of NIS71.2 billion (excluding contingent accounts). The number of overseas offices of Israeli banks declined from 147 at the end of 1984 to 143 at the end of the year reviewed following the closure of three offices of banking subsidiaries and one representative office. The existing offices comprised 18 banking subsidiaries (66 offices), 36 branches and agencies, and 41 representative offices. At the end of 1985 they had total assets (excluding contingent accounts) of NIS174 billion.

7. ECONOMIC RESEARCH AND PUBLICATIONS

In 1985 the Bank of Israel brought out the following publications:

(a) Research Department

- (1) Annual Report 1984 (Hebrew and English).
- (2) Main Points of the Annual Report 1984 (Hebrew and English).
- (3) Calendar of Economic Events, 1984 (Hebrew).
- (4) Governor's Report on the Increase in the Money Supply between June 1984 and November 30, 1984 (Hebrew).
- (5) Governor's Report on the Increase in the Money Supply between November 30, 1984 and March 31, 1985 (Hebrew).

⁶ Banks, merchant banks, and a foreign bank.

⁷ Includes branches, exchange counters, and restricted branches.

- (6) Recent Economic Developments, No. 37 and 38 (bilingual: Hebrew and English).
 - (7) Economic Review, No. 56 and 57 (English); No. 59 and 60 (Hebrew, English forthcoming).
 - (8) National Budget for 1985 (in cooperation with the Ministry of Finance and Economic Planning Authority; Hebrew).
 - (9) Internal surveys of monetary and macroeconomic policy developments (Hebrew).
 - (10) Main Israeli Economic Data (binder and weekly updates; bilingual: Hebrew and English).
 - (11) Industrial Capital Stock in Israel, 1969–1984 (updates; bilingual: Hebrew and English).
 - (12) Economic Development in Judea-Samaria and the Gaza District, 1981–82 (English).
 - (13) The Israeli Economy—Facts and Figures, 1985 (English).
 - (14) Changes in the Wage Structure of the Civil Service and Rising Inflation (English).
- (b) Department of the Examiner of Banks
- (1) Annual Survey of Israel's Banking System, 1984 (Hebrew).
 - (2) Main Points of the Annual Survey of Israel's Banking System, 1984 (Hebrew).
 - (3) Annual Statistics of Israel's Banking System, 1980–84 (bilingual: Hebrew and English).
 - (4) Banking Statistics (monthly; bilingual: Hebrew and English).
 - (5) Bank Credit by Economic Sector (quarterly, Hebrew).
 - (6) Directory of Israeli Bank Branches on 1.1.85 (Hebrew).
 - (7) Issues in Banking, No. 5 (Hebrew).
 - (8) Directions for the Preparation of Annual Financial Statements of a Bank (Hebrew).
 - (9) Report on the Application of the Banking (Service to Customer) Law (Hebrew).
 - (10) Banks in Israel—Selected Figures, 1984 (English).
- (c) Bank of Israel Comptroller
- (1) Financial Statements for the Year 1984 (Hebrew and English).
- (d) State Loans Administration
- (1) Explanatory Notes and Tables for Calculating Government Bond Redemptions (quarterly, Hebrew).
 - (2) State of Israel Bonds—Coupon Bonds and Savings Certificates: List of Stop Payments (monthly, Hebrew).
- (e) Currency Department
- (1) Annual Survey, 1984 (Hebrew).
- (f) General Counsel
- (1) Legislation and Directives (updates, Hebrew).
- (g) Controller of Foreign Exchange
- (1) Foreign Currency Control Directives (updates, Hebrew).
 - (2) Foreign Currency Liabilities (quarterly, Hebrew).

(h) Monetary Department

- (1) Capital Market Developments, July–September 1984 (Hebrew).
- (2) Capital Market Developments, Annual Survey 1984 (Hebrew).

(i) Foreign Department

- (1) Foreign Currency Exchange Rates in Israel, 1948–1985 (bilingual: Hebrew and English).
- (2) Interest Rates on Patam Deposits with the Bank of Israel, 1978–1984 (Hebrew).
- (3) Representative Sheqel Exchange Rates (bilingual: Hebrew and English).

(j) Governor's Office

- (1) The Economy and Society in the Test of Time: Selected Articles by David Horowitz (Hebrew).

In addition to current research, the Research Department carried out a number of basic studies of specific subjects, of which the following were published (in Hebrew unless otherwise stated):

- (1) The Inflation Tax on Real Balances, the Inflation Subsidy on Credit, and the Inflationary Process in Israel (Hebrew, English forthcoming).
- (2) Excess Demand for Labor, Inflationary Expectations, and the Natural-Rate Hypothesis: The Case of Israel, 1968–1980 (Hebrew, English forthcoming).
- (3) The Weight of Value Added in Exports.
- (4) Empirical Studies of the Demand for Money in Israel.
- (5) New Estimates of the Demand for Money in Israel.
- (6) Two Issues in the Demand for Money in Israel, 1970–1981.
- (7) The Stability of the Demand for Money in Israel, 1965–83.
- (8) Nonreversibility of the Interactions between Inflation and Real Money Balances.
- (9) Road Investment in Israel.
- (10) The Undermining of Package Deal II.
- (11) The Effect of Unemployment in Israel on Socio-Economic Distress and the Labor Supply.
- (12) The Effect of Inflation on Tax Collection.

The Research Department also publishes a Discussion Paper Series, which presents to Israeli economists the drafts of studies before their final publication. In 1985 the following papers appeared:

- (1) Wage Indexation Sensitivity and the Nature of Labor Contracts in Israel (English).
- (2) Rates of Return in Israeli Industry: Government Intervention, Risk, and Branch Structure Effects (Hebrew).
- (3) Relative Price Variability under Israel's Inflationary Conditions and Implications for the Interest Rate (Hebrew).
- (4) An Empirical Test for Competing Theories on the Determinants of a Country's Creditworthiness (English).
- (5) The Quality of Israel's National Budget Forecasts, 1959–1983 (Hebrew).
- (6) Inflation as the Equilibrator of Real Wages (and Other Factor Incomes) in the Israeli Economy (English).

(7) The Educational Structure of the Jewish Population and Labor Force in Israel, 1950-80 (Hebrew).

A large number of studies are currently in preparation. Following is a list of the principal subjects (in Hebrew unless otherwise stated):

- (1) Estimating Inflationary Expectations Using Data on Bond Market Yields.
- (2) The Variability of Relative Prices in Different Exchange Rate Regimes.
- (3) Inflation, Wages, and Import Prices in Israel.
- (4) The Contribution of Inflation to the Growth of Israel's Banking Industry.
- (5) Uncertainty and Price Dynamics: A Microeconomic Approach.
- (6) Time-Series Characteristics of Inflation in Israel.
- (7) The Slow Devaluation Policy and Speculative Bubbles in the Assets Market.
- (8) Econometric Model of the Israeli Economy.
- (9) Effect of the Internal and External Debt on Private Consumption.
- (10) The Relationship between Private and Government Saving.
- (11) The Influence of Demographic Factors on Private Saving.
- (12) Demand for Financial Assets.
- (13) The Interest Rate Structure in Israel.
- (14) Inflation, Reserve Requirements, and the Tax on Money (English).
- (15) The Subsidization of Basic Commodities.
- (16) Wage Differentials between Males of Different Country-of-Origin Groups.
- (17) The Structure of Unemployment in Israel.
- (18) Demand for Foreign Exchange Reserves in Israel.
- (19) Choosing the Optimal Currency Basket Peg for Exchange Rate Policy.
- (20) Effective Rates of Protection and Their Effect.
- (21) Export Profitability Indexes.
- (22) The Black Foreign Currency Market in Israel.
- (23) The Effect of Subsidized Mortgages on the Demand for Housing.
- (24) Israel's Tourist Industry.
- (25) Technological Progress, R&D, and Productivity of Israeli Industry.