CHAPTER XV

MONEY SUPPLY, CREDIT, AND THE BANKING INSTITUTIONS

1. Main Monetary Developments

Monetary expansion was very rapid in 1967. Means of payment swelled by some IL 531 million, or 26.4 percent, in the course of the year, compared with 5.7 percent during 1966. The rise in the average level was 20.3 and 7.3 percent respectively.[1] Less liquid deposits with the banking system grew even faster than the money supply, and both together rose by 42 percent during 1967 and by 30 percent on an annual average, compared with 13.2 and 12.4 percent respectively in the previous year. If bank-negotiated bill credits—the outstanding balance of which decreased—and the Government Short-Term Loan are included with financial assets, then the increase in the average annual level came to 23.9 percent, compared with 14.3 percent during 1966.[2]

Economic developments during the year exhibited diverse movements. In the first half, the recession continued and economic activity reached a low point on the eve of the Six Day War. Subsequently it began to pick up, with a consequent rise in real national product toward year's end. Developments in the monetary sphere likewise were not uniform during the year.

The policy pursued by the Government and the Bank of Israel with a view to stimulating economic activity and reducing unemployment led to rapid monetary expansion, especially in the first half of 1967 and primarily in means of payment. The war in June gave added impetus to this development. In the second half of the year the economy showed a marked change of trend, and the expansionary policy was moderated. During this period financial assets grew chiefly because credit from the banking system and foreign currency conversion were stepped up. Monetary developments were also affected by the crises in the Feuchtwanger, Ellern's, and Israel Credit Banks at the beginning of the year, and by the devaluation in November.

The economic slowdown and the accompanying unemployment of 1966 were responsible for changes in the behavior of the public. Uncertainty about future incomes and the expectations of stable or falling prices were reflected by a heavy

[1] Part of the additional money supply in 1967 was absorbed by the inhabitants of Judea, Samaria, and the Gaza Strip (see the discussion below).

[2] Financial assets, so defined, rose by IL 1,312.8 million, or 27.4 percent, from the end of 1966 to the end of 1967; this compares with a growth of 18.2 percent during the previous year.

Table

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC,

(IL

	1964	1965	1966	1967[a]
Sources				
Foreign currency assets	54.3	219.0	–70.0	342.8
Credit from the Bank of Israel	114.8	39.0	272.3	345.1
Credit from banking institutions	127.5	153.4	195.2[c]	550.9
Other factors, net	–42.6	–17.9	10.1[c]	6.8
Total	254.0	393.5	407.6	1,245.6
Components				
Money supply	98.1	191.5	108.9	530.7
Less liquid deposits	155.9	202.0	298.7	714.9
Total	254.0	393.5	407.6	1,245.6
Bill brokerage	179.0	160.6	247.4	–278.7
Short-Term Loan	—	–74.8	82.1	118.9

[a] Excluding devaluation differentials.
[b] Including devaluation differentials on assets and liabilities appearing in the balance sheets

demand for financial assets and smaller purchases of real estate, motor cars, and other consumer durables. These tendencies grew even more pronounced in the first half of 1967, when the war and the preceding period of tension were added to the recession and mounting unemployment.

The public's increased liquidity preference in turn further depressed aggregate demand, and would have pushed down prices were it not for their downward rigidity. As it turned out, prices held steady, while GNP and the trade deficit declined. There is an interaction between these developments: a deceleration of economic activity increases uncertainty about future incomes, thereby further stimulating liquid savings. Price stability likewise increases the propensity to save, since it engenders expectations that prices will continue to hold steady, thereby raising the real yield on financial assets. The increase in liquidity preference apparently led to a change in the composition of the public's asset holdings in favor of those with a higher liquidity.

In this situation, the Government and the Bank of Israel injected large sums into the economy—mainly in the second quarter—in order to renew economic growth and reduce unemployment. The monetary expansion did not raise demand immediately, but only after a certain interval. A lagged reaction is not unusual, especially in the light of the liquidity preference of the public, which resulted in the absorption of a considerable proportion of the incremental means

XV-1

BY SOURCE AND COMPONENT, 1964-67

million)

1967[b]	Percent increase or decrease (–) as against previous year				
	1964	1965	1966	1967[a]	1967[b]
668.6	3.6	14.2	-4.0	20.3	39.5
228.3	139.8	19.8	115.4	67.9	44.9
573.1	13.5	14.3	15.9	38.7	40.3
2.6	—	—	—	—	—
1,472.6	10.4	14.6	13.2	35.5	42.0
530.7	6.1	11.2	5.7	26.4	26.4
941.9	18.6	20.3	25.0	47.8	63.0
1,472.6	10.4	14.6	13.2	35.5	42.0
-278.7	41.2	26.2	32.0	-27.3	-27.3
118.9	—	-26.1	43.4	43.8	43.8

of the Bank of Israel and the banking institutions.
[c] Revised figures.

of payment and thereby held up for a time the rise in aggregate demand aimed at by the expansionary fiscal and monetary policies. It was not until the second half of 1967 that product and demand began to grow in response to the monetary expansion of the first half of the year—an expansion reflecting both the reflationary-policy measures and the effects of the war.

Changes in the relative liquidity of the economy are shown in Diagram XV-3, which presents quarterly data on the circulation velocity of the money supply. While the average velocity for the year was considerably below that of 1966 (see Table XV-6), this reflects two conflicting movements: in the first three quarters of 1967 a decline in the circulation velocity of the money supply (or a rise in liquidity), which was reversed in the last quarter. That is to say, despite the comparative stability of the money supply, GNP at current prices increased and relative liquidity declined.

The rapid monetary expansion of 1967 in some ways resembled that of 1963. In both instances prices did not rise until the following year, and the money pumped into the economy found its way into the real estate and share markets in 1963 and into short-term financial assets in 1967. Nevertheless, there was a fundamental difference between these two years: whereas the 1963 expansion occurred at a time of vigorous economic growth, full employment, and inflation, in 1967 it came during a period of recession and unemployment.

Table XV-2

INCREASE IN FINANCIAL ASSETS OF THE PUBLIC AND DEVALUATION DIFFERENTIALS, BY SOURCE AND COMPONENT, 1964–67

(IL million)

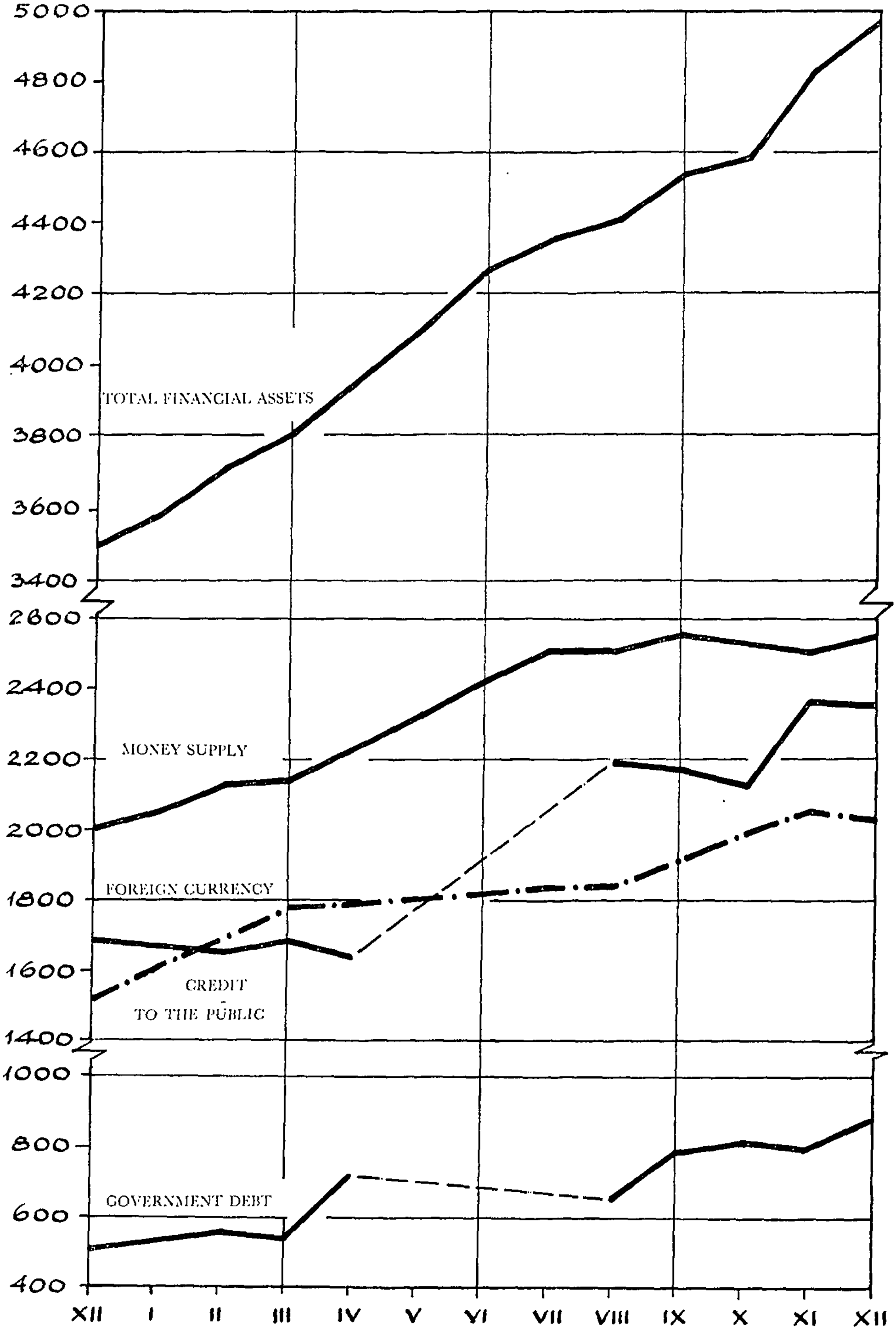
	1964	1965	1966	1967		
				Excluding devaluation differentials	Devaluation differentials	Including devaluation differentials
Sources						
Foreign currency assets						
With the Bank of Israel	85.3	281.5	–61.6	279.4	317.1	596.5
With banking institutions	–31.0	–62.5	–8.4	63.4	8.7	72.1
Total	54.3	219.0	–70.0	342.8	325.8	668.6
Credit from the Bank of Israel						
Credit and advances to the Government	250.2	139.3	246.9	765.3	–63.0	702.3
Less: Deposits of the Government and National Institutions[a]	165.3	123.9	81.7	435.5	77.5	513.0
Rediscounts and loans	29.9	23.6	122.2	123.5	23.7	147.2
Open-market operations	—	—	–15.1	–108.2	—	–108.2
Total, net	114.8	39.0	272.3	345.1	–116.8	228.3
Credit from banking institutions						
To the Government	9.3	40.6	26.0[b]	201.1	1.5	202.6
To the public	118.2	112.8	169.2[b]	349.8	20.7	370.5
Total	127.5	153.4	195.2[b]	550.9	22.2	573.1
Other factors, net	–42.6	–17.9	10.1[b]	6.8	–4.2	2.6
Total sources	254.0	393.5	407.6	1,245.6	227.0	1,472.6
Components						
Money supply	98.1	191.5	108.9	530.7	—	530.7
Less liquid deposits	155.9	202.0	298.7	714.9	227.0	941.9
Total financial assets	254.0	393.5	407.6	1,245.6	227.0	1,472.6

[a] In 1964–66 this item consisted of Government deposits only.
[b] Revised figures.

Diagram XV–1

FINANCIAL ASSETS, BY COMPONENT, 1967

(IL million)



The decline in investment and the stagnation of economic activity reduced the public's demand for credit. Total short-term credit to the public, including that provided by the Bank of Israel and banking institutions and bill brokerage credit, rose by IL 239 million, or 10 percent, compared with IL 539 million (27 percent) in 1966 and IL 297 million (17 percent) in 1965.

The striking increase in the money supply and the ebbing of demand for credit exerted downward pressure on the interest rate. This was partly reflected by a reduction of the nominal interest rate on bank-negotiated bill credits and a number of other short-term financial assets. The average interest rate also declined because the weight of bill brokerage, a relatively expensive form of credit, dropped from 40 percent of total short-term credit at the end of 1966 to 27 percent at the end of 1967.

In the prevailing circumstances, nominal interest rates could have been expected to fall more than they did. That they did not do so is because Government demand for credit remained high. The Government did not cut the interest rate on its own bond issues, and it borrowed large sums at the prevailing rate; this applies chiefly to the option-type loans,[1] sales of which soared as a result.[2] The strong Government demand for credit in order to finance the war requirements counteracted the decline in demand for credit by other sectors, and this kept the average rate of interest from dropping as much as it otherwise would have.[3]

The fall in yield did not affect all financial assets equally, and this was one reason for the changes in the asset portfolio. The most notable declines were that of 3–4 percent in the interest rate in the bill brokerage market and that of 2 percent on the Short-Term Loan. The interest on Pazak and other local-currency time deposits was also reduced somewhat. The financial entanglement of Feuchtwanger Bank at the beginning of 1967 and the losses suffered by investors in bills traded through this concern on a nonguaranteed basis made the public shy away from the bill brokerage market and induced it to switch to other financial assets. In consequence, the outstanding balance of bank-negotiated bill credits plunged by IL 279 million during the year. Some of these funds were invested in such assets as fixed-term deposits (which grew by IL 371 million) and saving schemes (up IL 160 million). In addition, the outstanding balance of the Short-Term Loan soared by IL 119 million in the second half of the year.

The sources of monetary expansion show a striking increase in Bank of Israel credit and advances to the Government, especially in the first half of 1967, and

[1] Value-linked loans permit the investor to choose, upon maturity, between a high rate of interest without linkage of the principal, and a lower rate with the principal linked to the consumer price index.

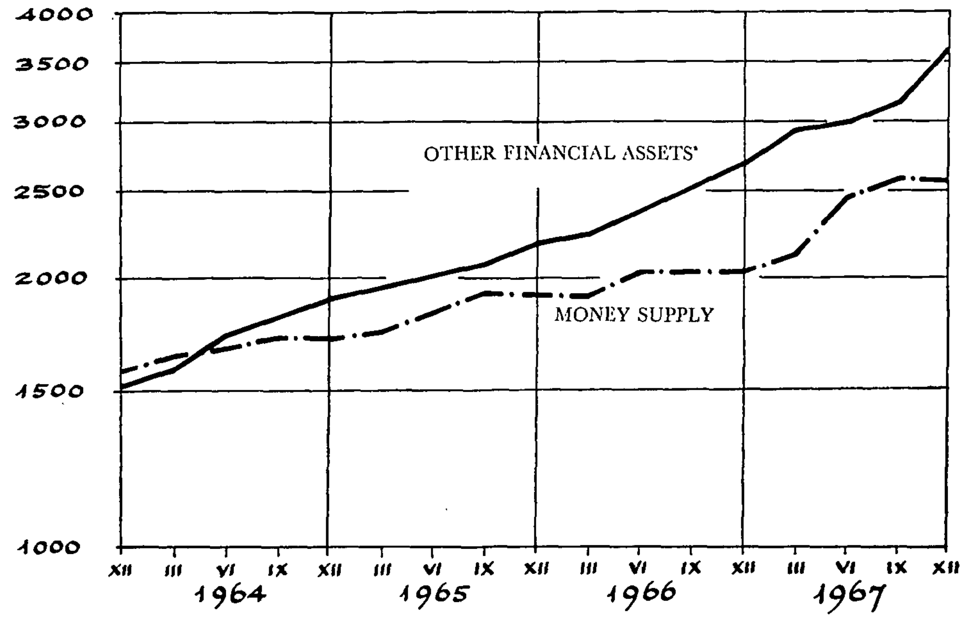
[2] Only the right to premature redemption after two years was abolished.

[3] However, the Government eased mortgage and industrial loan terms by abolishing linkage in lieu of a fixed premium of 3–4 percent. When prices are rising, or are expected to rise, this is tantamount to a reduction of the interest rate.

Diagram XV-2

FINANCIAL ASSETS HELD BY THE PUBLIC, 1964–67

(IL million)



Semi-logarithmic scale.

[a] Nonliquid deposits of the public, Short-Term Loan, and bills purchased through banks (bill brokerage).

in commercial bank credit to the public and the Government, mainly in the last six months. The much larger volume of credit provided by the Bank of Israel considerably increased the liquid asset holdings of the banking institutions, enabling them to expand credit on a sizable scale while further improving their liquidity position. But not all the incremental credit granted by the Bank of Israel was reflected by a growth of bank reserves, for the internal drain (i.e. the large-scale withdrawal of cash by the public, including Israeli currency circulating in the administered areas) in the second half of 1967 partly offset the external infusion.

Foreign currency assets of the banking system were augmented by $ 110 million in 1967, compared with a decline of $ 23 million in 1966 (devaluation increments on the holdings came to IL 326 million). This increase was primarily due to the response of World Jewry to the emergency campaigns conducted after the Six Day War. A large percentage of the receipts were deposited with the Bank of Israel in a special Jewish Agency account, so that the large foreign capital inflow had little effect on the money supply; the latter grew for other reasons, chiefly the larger volume of credit provided the Government and the public. The increase in the deposit with the Bank of Israel largely offset the huge growth in the amount of credit granted by the Bank, thereby concealing the real causes of the monetary expansion.

In 1967 the Bank of Israel continued to pursue the expansionary monetary policy initiated, in coordination with the Government, in the second half of 1966: it reduced the liquidity ratios appreciably and granted the Government IL 765 million in credit for implementing projects designed to stimulate economic activity and provide more jobs. The financing of the war increased the budget deficit and injected more money into the economy. Rediscounting operations and loans by the Bank of Israel were up by a substantial IL 147 million during the year.[1]

A good part of the increase was connected with the loans granted, in accordance with a Government decision, to several banking institutions that had become financially involved, in order to enable them to meet their obligations toward their clients. All these operations considerably augmented the banking institutions' liquid asset holdings in the first half of the year. In the second half, as economic activity began to pick up, and in view of the substantial monetary expansion of the first half and the huge increase in foreign currency balances after the war, the Bank of Israel stepped up sales of the Short-Term Loan in the open market. In this manner, IL 108 million was absorbed and frozen, thereby moderating the growth of the money supply. In the latter part of the year means of payment virtually levelled off and the banks' liquid asset holdings shrank, although over the year as a whole they expanded by IL 162 million, or 29 percent.

The large supply of funds during the year enabled the Bank of Israel to cut the rate of interest on the Short-Term Loan by about 2 percent. Moreover, the interest paid on Pazak deposits was trimmed from 7 to 6 percent. In the wake of these decreases, the interest rates on other short-term assets, particularly bills traded through the banks, were also lowered.

The enormous growth of the banking institutions' liquid assets during the year enabled them, as already mentioned, not only to expand credit to the Government and the public, but also to improve their liquidity situation. Bank credit to the public (excluding bill brokerage and Bank of Israel credit) soared by nearly IL 371 million, and that to the Government by IL 203 million. This growth in the amount supplied to the public can be attributed partly to the aforementioned shift from the bill brokerage market. The incremental credit to the Government reflects the purchase of IL 100 million worth of Defense Bonds, the deposit with the Treasury of IL 50 million in proceeds from a bond issue by Yaad Agricultural Development Bank, and the investment of saving scheme funds in other Government bonds.

[1] After provision of IL 31 million for doubtful debts to cover possible losses in realizing the collateral pledged against the loans granted to banks that had become financially involved.

The alteration of the exchange rate on November 19, 1967, in line with the dollar parity of sterling, had virtually no effect on economic developments in 1967. The devaluation was a relatively modest one and occurred near the end of the year. Nevertheless, the IL value of foreign currency deposits of the public rose by some IL 200 million, and such deposits can be readily converted into cash. The devaluation differentials on the Government's net foreign currency deposits and the net foreign currency assets of the Bank of Israel—together about IL 140 million—offset part of the Government's debt to the Bank. It was agreed that IL 120 million of the differentials would be used to pay off long-term liabilities to the Bank of Israel, instead of financing current operations or repaying current advances, which are tantamount to increasing the budget deficit.

The swelling of the money supply during the year reviewed was accompanied by a growth in the relative share of currency (see Table XV–5). The steep rise in currency in circulation was connected with the Six Day War. In May and the early part of June (the period of prewar tension), cash withdrawals were stepped up and the amount in the hands of the public expanded appreciably. After the war most of these sums were probably redeposited; however, this was virtually offset by the currency put into circulation in the administered areas, so that during the second half of the year the net amount of currency in circulation hardly changed.

2. The Money Supply

The money supply increased by IL 530.7 million, or 26.4 percent, in the course of 1967, compared with IL 108.9 million, or 5.7 percent, during the previous year. The rise in the average annual level was 20.3 and 7.3 percent respectively. The 1967 growth rate was much higher than in any of the three preceding years, and almost as high as in 1963, a year of peak monetary expansion.

The 1967 figures include, as stated, the money used in the administered areas; this consisted mostly of currency, IL demand deposits being virtually nil.

Most of the year's growth occurred in the first seven months, during which the figure shot up by IL 484 million. Over the rest of the year the money supply was fairly stable, rising by only IL 47 million.

The precipitate rise in 1967 was connected partly with the increased liquidity preference of the public, for in periods of uncertainty the latter tends to hold more ready cash. Moreover, the cost of holding cash decreased, both because prices were stable and because the interest on various short-term assets fell. The decline in interest narrowed the yield differential between means of payment and short-term assets, i.e. it resulted in a change in relative prices in favor of means of payment.

Of the IL 530.7 million incremental means of payment, IL 316.0 million

Table XV-3

ANNUAL INCREASE IN THE MONEY SUPPLY, 1964–67

(IL million)

	Balance at end of year	Change in end-year balance		Average annual balance	Change in average annual balance	
		IL m.	%		IL m.	%
			Currency			
1964	590.3	65.3	12.4	584.5	88.5	17.8
1965	657.4	67.1	11.4	647.1	62.6	10.7
1966	751.1	93.7	14.3	716.7	69.6	10.8
1967	965.8	214.7	28.6	920.9	204.2	28.5
			Demand deposits			
1964	1,117.1	32.8	3.0	1,098.2	105.3	10.6
1965	1,241.5	124.4	11.1	1,186.3	88.1	8.0
1966	1,256.7	15.2	1.2	1,250.7	64.4	5.4
1967	1,572.7	316.0	25.1	1,445.5	194.8	15.6
			Money supply			
1964	1,707.4	98.1	6.1	1,682.7	193.8	13.0
1965	1,898.9	191.5	11.2	1,833.4	150.7	9.0
1966	2,007.8	108.9	5.7	1,967.4	134.0	7.3
1967	2,538.5	530.7	26.4	2,366.4	399.0	20.3

consisted of demand deposits and IL 214.7 million of currency. The share of currency in the money supply rose from 37.4 percent at the end of 1966 to 38.1 percent at the end of 1967. However, as already mentioned, this can be partly attributed to the new areas coming under Israel's control. On an annual average, the weight of currency went up from 36.4 percent in 1966 to 38.9 percent in 1967.[1]

Most of the growth in demand deposits occurred in April, June, and July. The total increase of IL 316 million consisted of IL 234 million in checking-account deposits and IL 82 million in deposits not withdrawable by check.

The changes in the pattern of cash holdings should be viewed against the background of the Feuchtwanger Bank affair at the beginning of the year and the war in June. The troubles of Feuchtwanger Bank, which came to the public's

[1] Even if we assume that the amount of Israeli currency held by the inhabitants of the administered areas came to about IL 100 million at the end of 1967, the growth of the money supply still totalled some IL 430 million, or about 21 percent. Under this assumption, the weight of currency in the money supply declined from 36.4 percent at the end of 1966 to 34.0 percent at the end of 1967, the rise in the average level of the money supply was 18.8 percent, and the circulation velocity of the money supply relative to national income dropped by 13.2 percent.

Table XV–4

THE MONEY SUPPLY, BY MONTHS, 1967

(IL million)

End of month	Currency			Demand deposits			Money supply		
	Total	Increase or decrease (–) from end of previous month		Total	Increase or decrease (–) from end of previous month		Total	Increase or decrease (–) from end of previous month	
		IL m.	%		IL m.	%		IL m.	%
1966 December	751.1	–0.3	–0.0	1,256.7	10.4	0.8	2,007.8	10.1	0.5
1967 January	782.8	31.7	4.2	1,264.9	8.2	0.7	2,047.7	39.9	2.0
February	813.9	31.1	4.0	1,307.3	42.4	3.4	2,121.2	73.5	3.6
March	834.0	20.1	2.5	1,302.1	–5.2	–0.4	2,136.1	14.9	0.7
April	854.9	20.9	2.5	1,384.6	82.5	6.3	2,239.5	103.4	4.8
May	970.4	115.5	13.5	1,358.2	–26.4	–1.9	2,328.6	89.1	4.0
June	977.4	7.0	0.7	1,452.9	94.7	7.0	2,430.3	101.7	4.4
July	970.8	–6.6	–0.7	1,521.1	68.2	4.7	2,491.9	61.6	2.5
August[a]	963.8	–7.0	–0.7	1,537.4	16.3	1.1	2,501.2	9.3	0.4
September	970.5	6.7	0.7	1,577.2	39.8	2.6	2,547.7	46.5	1.9
October	977.1	6.6	0.7	1,544.0	–33.2	–2.1	2,521.1	–26.6	–1.0
November	969.1	–8.0	–0.8	1,523.0	–21.0	–1.4	2,492.1	–29.0	–1.2
December	965.8	–3.3	–0.3	1,572.7	49.7	3.3	2,538.5	46.4	1.9

[a] As from August, the data include demand deposits in branches of Israeli banks operating in the administered territories. These deposits came to IL 2.6 million at the end of December.

Table XV-5

CURRENCY AS A PERCENTAGE OF MONEY SUPPLY, 1964–67

Annual averages	
1964	34.7
1965	35.3
1966	36.4
1967	38.9
End of month—1967	
January	38.2
February	38.4
March	39.0
April	38.2
May	41.7
June	40.2
July	39.0
August	38.6
September	38.2
October	38.8
November	38.9
December	38.1

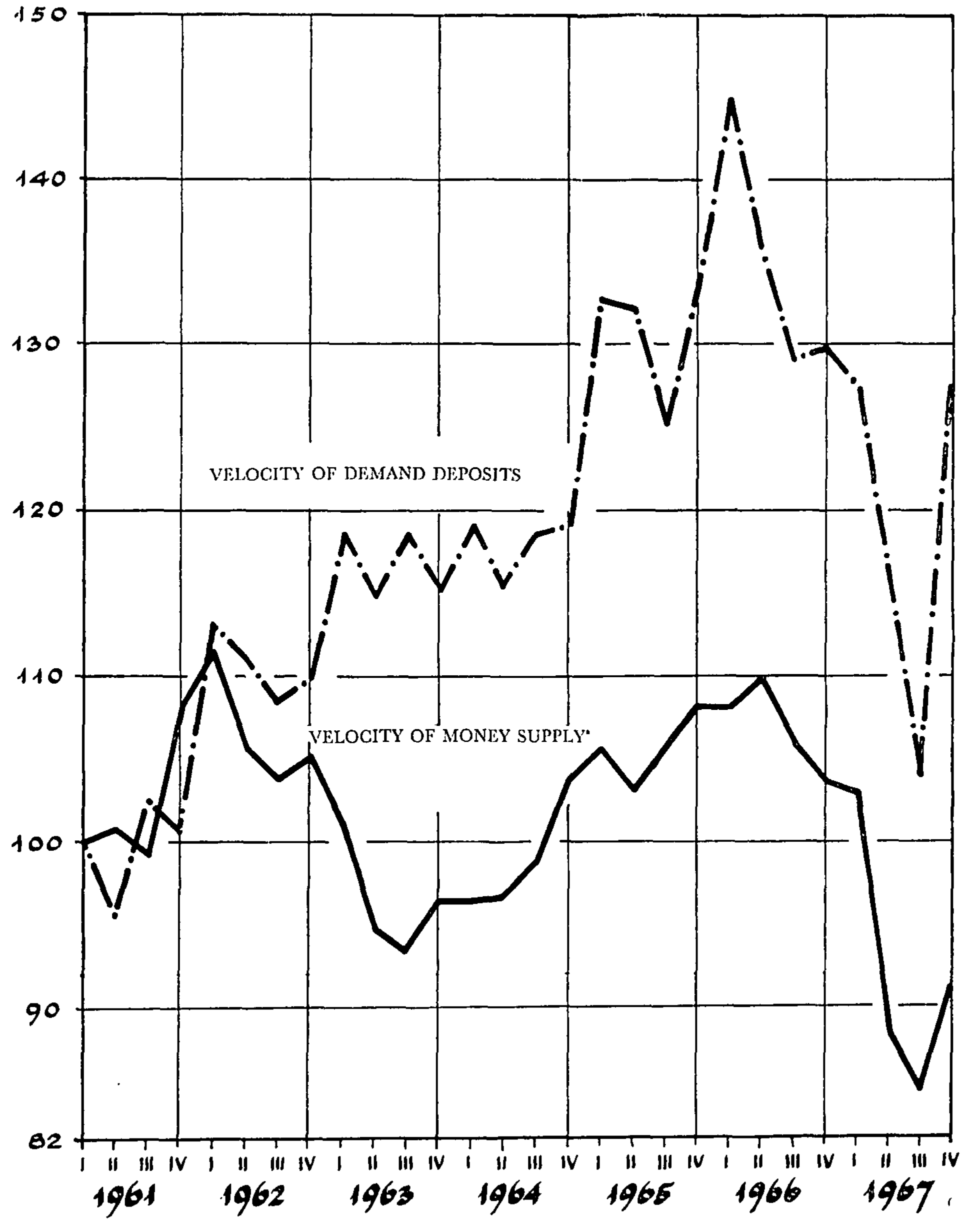
notice in January, resulted in an increased withdrawal of cash, the rise totalling IL 104 million during the first four months of the year. This was accentuated by the prewar period of call-up and tension, the volume of currency jumping by IL 115.5 million in May alone. Thus, during the first five months of 1967 currency in circulation went up by a huge IL 220 million. Presumably, the influence of both factors was temporary, and a large percentage of the funds were eventually redeposited. However, because of the currency put into circulation in the administered areas, the total fell by only some IL 5 million from the end of May to the end of December 1967. No detailed monetary data are available on the administered areas for the immediate prewar period; the estimates on hand are for the end of 1966. The picture that emerges is one of a backward economy with a small number of banks. Considerable use is made of cash, not only for conducting transactions but also for the hoarding of wealth, as is indicated by the high proportion of currency in the money supply: 62 percent in Judea and Samaria,[1] compared with 37 percent in Israel at the end of 1966.

After the war the use of cash in these areas grew even more pronounced, as a result of the closing of banks and the prevailing state of uncertainty and ap-

[1] There are no data on means of payment in the Gaza Strip and Sinai.

Diagram XV-3

INDICATORS OF THE AVERAGE ANNUAL VELOCITY OF THE MONEY SUPPLY, QUARTERLY, 1961–67



[a] The circulation velocity of the money supply has been calculated as the ratio between the net national product at current prices and the average balance of the money supply. Quarterly data on the real product for 1965–67 are based on Central Bureau of Statistics figures. In calculating the quarterly index of change in NNP for preceding years, we have arbitrarily assumed an equal rate of growth over the year. Product data at current prices were obtained by inflating the real product by the consumer price index for the corresponding period.

Table XV–6

CIRCULATION VELOCITY OF THE MONEY SUPPLY, 1964–67

Year	Average annual circulation velocity of the money supply in relation to:		Average annual velocity of demand deposits[c]
	National income[a]	Total available resources[b]	
	(1)	(2)	(3)
1964	4.25	6.45	19.2
1965	4.67	6.78	21.2
1966	4.71	6.66	21.9
1967	4.05	5.67	18.6

[a] Nominal national income divided by the average annual money supply.
[b] Gross national product at current prices plus the import surplus, divided by the average annual money supply.
[c] 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.

prehension. This helps to explain the large-scale withdrawal of Israeli currency for the use of the population in these territories. A rough estimate puts the figure for the administered areas and East Jerusalem at IL 80–100 million.[1]

The huge increase in the money supply in 1967 did not lead to a corresponding growth in aggregate demand, but found expression in a steep drop in the circulation velocity of the money supply. In relation to national income, the velocity declined by about 15 percent, and relative to total available resources, by 12 percent. The velocity of demand deposits was also down 15 percent (see Table XV–6). Analysis of the public's cash holdings likewise suggests that the circulation velocity of the incremental currency in 1967 was relatively low. In the first four months of the year at least part of the increase was at the expense of bill brokerage, and apparently it can be largely explained by security considerations. The big increment in May also had a very low velocity, since the public kept the money in their homes during this period of tension.

The enormous rise in the public's cash holdings had considerable monetary significance, in that it reduced bank reserves. The large-scale external infusion in 1967, which swelled the banks' liquid assets, was to some extent offset by the public's cash withdrawals. The latter thus prevented a large increase in the banks' surplus reserves, which could have constituted a potential source for the further expansion of credit.

[1] About IL 4.4 million worth of Jordanian dinars and IL 45.6 worth of Egyptian pounds were converted by the Bank of Israel.

3. Less Liquid Deposits of the Public

Less liquid deposits of the public also showed an exceptionally large growth in 1967—IL 942 million, or 63 percent, compared with IL 299 million, or 25 percent, in 1966. The 1967 increment includes IL 227 million in devaluation differentials on foreign currency deposits.

The weight of local-currency time deposits and of saving scheme accounts rose in 1967; this contrasts with the trend which had persisted for many years of a relatively faster rise in Pazak and Tamam balances. Local-currency time deposits grew by IL 371 million and saving deposits by IL 160 million. Pazak and Tamam accounts were up by about IL 287 million and IL 111 million respectively (including devaluation differentials).

Not all of the growth in the public's deposits constituted a net addition to its financial assets, since some of it (this applies particularly to local-currency time deposits) represented a shift from the bill brokerage trade, which contracted in 1967. If the changes in the outstanding balance of bill-brokerage credits and the Short-Term Loan are included in the calculation, the rise in less liquid deposits comes to about IL 782 million, or 28 percent, as against IL 628 million, or 29 percent, in 1966.

The marked increase in short-term financial assets can be ascribed in part to expectations that the recession would continue; as in 1966, such expectations generated a preference for liquid saving over investment in real assets. The rise in the real return to the saver as compared with preceding years undoubtedly contributed to this development; although the nominal yield on short-term financial assets fell during 1967 by up to 3 percent, the price level held steady, so that real interest was actually higher than in the past.

(a) *Pazak and Tamam deposits*

Pazak holdings went up by $ 47 million in 1967, compared with $ 40 million the year before, while Tamam deposits expanded by $ 18 million, as against $ 12 million in 1966. The devaluation increased the IL value of these two types of accounts.

All told, Pazak and Tamam grew by IL 287.4 million and IL 111.2 million respectively, including devaluation increments of IL 139.2 million and IL 55.3 million.

Pazak and Tamam originate primarily in restitution payments from Germany. These came to $ 123 million in 1967, rather more than the $ 110 million received in 1966. Interest paid to owners of Pazak and Tamam accounts totalled $ 20 million in 1967, compared with $ 18 million in the preceding year. In dollar terms, the year's addition to Pazak and Tamam balances amounted to 46 percent of total restitution receipts plus the interest on the outstanding balance; this compares with 41 percent in 1966. In IL terms, the growth (including

Table XV-7

LESS LIQUID DEPOSITS OF THE PUBLIC WITH BANKING INSTITUTIONS, 1964–67

(IL million)

End of period		Saving schemes	Time deposits	Deposits against liabilities	Total less-liquid deposits in local currency[a]	Deposits linked to the exchange rate (Pazak)	Tamam foreign currency deposits	Other foreign currency deposits	Total deposits
1964		155.5	43.7	32.8	232.0	476.9	214.9	71.2	995.0
1965		201.1	31.3	26.7	259.1	611.6	250.6	75.7	1,197.0
1966		245.9	149.2	21.1	416.2	731.3	287.9	60.3	1,495.7
1967		406.2	520.1	15.1	941.4	1,018.7	399.1	78.4	2,437.6
1967	January	249.3	184.8	22.4	456.5	743.0	292.1	52.4	1,544.0
	February	255.9	214.6	20.3	490.8	746.6	294.6	61.9	1,593.9
	March	266.6	259.3	18.6	544.5	759.5	300.2	58.7	1,662.9
	April	274.8	289.9	18.0	582.7	773.2	304.9	63.4	1,724.2
	May	282.4	309.1	19.6	611.1	785.3	309.1	62.3	1,767.8
	June	291.9	328.1	18.7	638.7	796.8	310.0	103.0	1,848.5
	July	302.3	354.7	21.9	678.9	808.7	312.9	55.9	1,856.4
	August	315.2	387.5	20.2	722.9	816.5	314.2	57.0	1,910.6
	September	335.9	429.9	18.4	784.2	826.4	320.7	57.8	1,989.1
	October	350.7	460.7	17.3	828.7	848.7	327.5	52.8	2,057.7
	November	370.6	492.4	16.1	879.1	1,007.6[b]	389.6[c]	60.8	2,337.1[d]
	December	406.2	520.1	15.1	941.4	1,018.7	399.1	78.4	2,437.6

[a] Excluding deposits of the public earmarked for loans, most of which belong to social insurance funds and financial institutions.
[b] Includes IL 139.2 million devaluation increment.
[c] Includes IL 55.3 million devaluation increment.
[d] Includes IL 227.0 million devaluation increment.

devaluation increments) amounted to 64 percent.[1] However, not all of the remaining 54 percent of the dollar increment was converted into means of payment, part of it being used by owners of Tamam for financing the purchase of foreign securities, travel abroad, and other foreign outlays.

In March the maximum interest paid on one-year Pazak deposits was lowered from 7 to 6 percent. At the same time, the nominal yield was cut on several other short-term financial assets which constitute a possible substitute for Pazak; as a consequence, Pazak balances were apparently unaffected by the revision of the interest rate, and in fact they grew more in 1967 than in the previous year. Interest on Tamam deposits for a one-year period remained at 4.5 percent.

(b) *Deposits in approved saving schemes*

These deposits expanded by IL 160.3 million in 1967, compared with IL 44.8 million in 1966. The growth can be largely attributed to the relatively higher yield earned on such deposits in 1967, as compared with other short-term financial assets, after the aforementioned reduction of nominal yield rates. Moreover, part of the substantial sum that was withdrawn from the bill brokerage market in 1967 may have found its way into saving deposits. In the first half of the year the average monthly rise in such deposits was IL 8 million (compared with IL 3.5 million per month in 1966); in the second half the growth accelerated, the average monthly increment going up to IL 19 million.

Nearly all of the year's increase was in the option-type schemes,[2] which expanded by IL 157.6 million. Changes in the other schemes more or less offset one another. Deposits in linked schemes rose by about IL 5 million, as did saving for secondary and higher education. Nonlinked schemes shrank by IL 13 million. Children's saving schemes expanded by IL 4 million, while those for the purchase of motor vehicles fell slightly. The only new scheme introduced in 1967 was that for higher education.

Banking institution investment of saving scheme funds also rose, and amounted to 75 percent of the balance of such deposits at the end of 1967—about the same proportion as in the previous year. There was a striking increase in option-type loans issued by subsidiaries of the banking institutions and a further rise in purchases of option-type Government loans, both of which offer similar terms as the option-type saving schemes.

1 This means that owners of Pazak and Tamam accounts did not step up their conversions into local currency following the rise in the IL value of their deposits due to the devaluation (at least not up to the end of the year).

2 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.

The IL 406 million balance in saving scheme accounts at the end of 1967 breaks down as follows: option-type schemes—IL 279 million; children's saving—IL 44 million; nonlinked—IL 27 million; linked—IL 30 million; for secondary and higher education—IL 21 million; and for motor vehicles—IL 5 million.

The share of the three largest banks in such deposits held steady at about 92 percent; this is much higher than their weight in other banking business.

(c) *Local-currency time deposits*

The rapid expansion of time deposits, which began in September 1966 after the liquidity ratio for deposits for six months or longer was reduced to 10 percent, was sustained in 1967. Growth amounted to IL 370.9 million, or an average of IL 31 million per month, compared with a IL 29 million average in the last four months of 1966. The upward movement was fairly steady over the year.

The increase in such deposits was connected with the decline in bill brokerage transactions. The growing reluctance to invest in bill brokerage after the Feuchtwanger Bank affair and the decline of interest rates in this market induced a transfer of funds from this market to time deposits and the conversion of bill brokerage credits into ordinary bank credit. Banks stand to lose by a shift from bill brokerage to time deposits, because they no longer collect the brokerage and guarantee commissions, and because they must hold liquid assets at the rate of 10 percent against the new deposits. Although the bank pays a lower rate of interest on time deposits than on brokerage transactions, the interest gained on the former is less than the commission lost on the latter.

The large offer of funds, which accompanied a moderate expansion of credit to the public, enabled the banks to reduce interest on time deposits by up to 1 percent, less than the reduction of interest on bill brokerage and the Short-Term Loan. In 1967 the big banks paid 7.5 to 8 percent interest on deposits for terms of 6-12 months, while some of the smaller banks paid higher rates.

4. Sources of Monetary Expansion

The financial assets of the public, consisting of the money supply and less liquid deposits with the banking system, swelled by IL 1,472.6 million, or 42 percent, in 1967, compared with IL 407.6 million, or 13.2 percent, in 1966.

During the first five months of the year the main source of monetary expansion was the large volume of credit provided the Government by the banking system. The emergency campaigns conducted abroad after the war increased the capital inflow and foreign-currency asset holdings. A large proportion of these assets were not converted but deposited in the Bank of Israel, as reflected by the contraction of net credit granted by the Bank to the Government. From the aspect

Table XV-8

FOREIGN CURRENCY ASSETS AND LIABILITIES OF THE BANKING SYSTEM, 1964-67

(IL million)

End of period	Total assets	Less:		Net assets (1)-(2)-(3)
		Nonresidents' deposits	Other foreign liabilities[a]	
	(1)	(2)	(3)	(4)
1964	2,101.2	366.6	191.7	1,542.9
1965	2,415.3	401.7	251.7	1,761.9
1966	2,411.7	397.9	321.9	1,691.9
1967	3,248.8	616.8	271.5	2,360.5
1967 Janury	2,377.4	392.6	306.3	1,678.5
February	2,356.0	385.6	307.6	1,662.8
March	2,393.5	402.2	297.8	1,693.5
April	2,361.2	410.9	295.0	1,655.3
August[b]	2,954.2	506.8	256.6	2,190.8
September	2,938.0	507.9	260.1	2,170.0
October	2,886.0	519.9	243.0	2,123.1
November	3,245.2[c]	609.0[d]	267.0[e]	2,369.2[f]
December	3,248.8	616.8	271.5	2,360.5

[a] Mainly loans from foreign banks and balances held for foreign banks.
[b] No data were published for the months May-July, in accordance with the emergency regulations of 1967.
[c] Includes IL 384.3 million devaluation increment.
[d] Includes IL 51.7 million devaluation increment.
[e] Includes IL 22.9 million devaluation increment.
[f] Includes IL 325.8 million devaluation increment.

of their inflationary effect, there is no difference between Bank of Israel credit and foreign currency conversion, as both increase the banks' liquid assets.

Credit to the public from the banking system also rose considerably during the year, mostly in the first quarter and the last four months, with only a slight increase between April and August. As already indicated, part of the growth represents a switch from bill brokerage to ordinary bank credit.

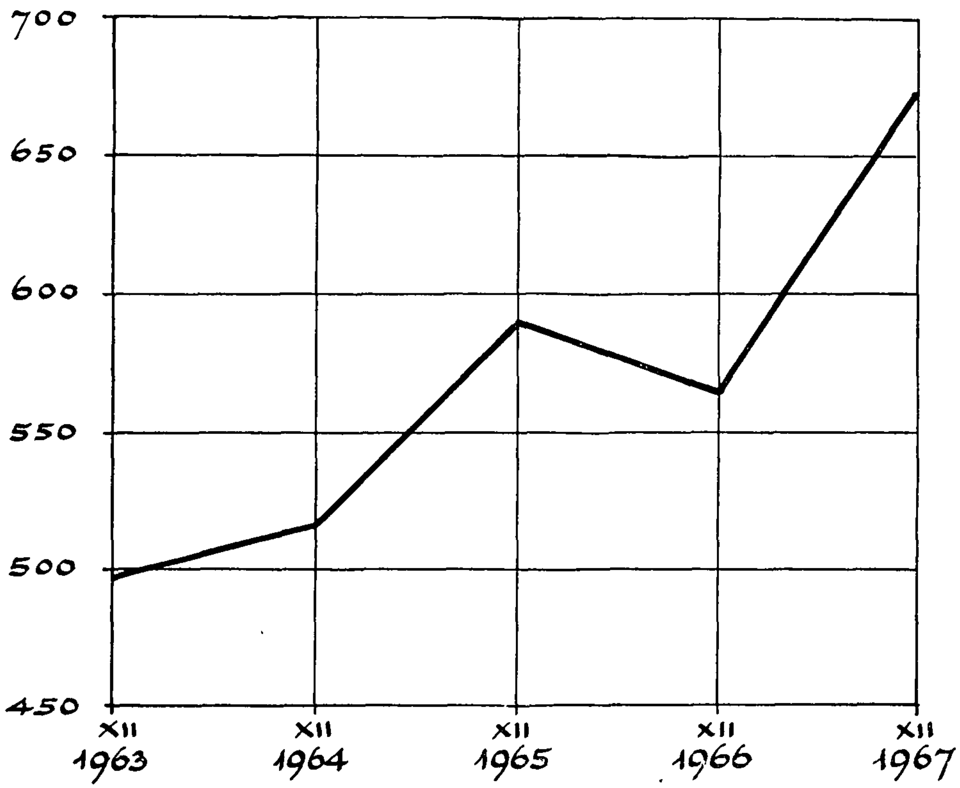
(a) *Foreign currency assets*

Capital inflow was considerably higher than in 1966, a result of the overseas emergency campaigns and the stepped-up sale of State of Israel Bonds. Since the adverse balance in the country's goods and services account declined slightly in 1967 and came well short of the volume of capital imports, the huge

Diagram XV-4

FOREIGN CURRENCY ASSETS WITH THE BANKING SYSTEM, 1963-67

($ million)



increase in the latter found expression in a rise in foreign currency assets with the banking system. During the year net holdings were augmented by $ 110 million to reach $ 674 million; this compares with a drop of $ 23 million in 1966. The gross balance of such assets rose by $ 124 million to stand at $ 928 million at year's end. Foreign liabilities of the banking system reached $ 254 million; this represents a rise of $ 14 million, the resultant of a $ 43 million increase in non-residents' deposits (Patach) and a decline of $ 29 million in other liabilities abroad (due to several fortuitous factors).

Following the change on November 19, 1967 of the dollar parity of the Israeli pound (from IL 3 to IL 3.50 per dollar) to bring it in line with the new rate for sterling, the IL value of foreign currency assets went up.[1] The devaluation

[1] Assets held in sterling and other devalued currencies (on which no devaluation increment accrued) constituted a negligible proportion of the total, so that a devaluation gain was earned on most of the balances.

Table XV-9

CHANGES IN OUTSTANDING CREDIT TO THE GOVERNMENT FROM THE BANKING SYSTEM, 1964–67

(IL million)

End of period		From the Bank of Israel			From banking institutions				Total change in outstanding credit
		Current credit and advances	Less: Deposits of the Government and National Institutions	Total	Credit and advances	Investment in Government securities[a]	Less: Government deposits	Total	
1964		250.2	165.3	84.9	–14.3	18.9	–4.7	9.3	94.2
1965		139.3	123.9	15.4	15.4	22.6	–2.6	40.6	56.0
1966		246.9	81.7	165.2	31.5	2.6	–0.9	35.0	200.2
1967		702.3	513.0	189.3	63.3	137.0	–2.3	202.6	391.9
1967	January	17.2	1.3	15.9	–0.5	1.5	0.2	0.8	16.7
	February	41.2	–2.2	43.4	5.6	–1.0	0.1	4.5	47.9
	March	11.5	58.2	–46.7	11.3	1.8	–2.9	16.0	–30.7
	April	107.2	–65.4	172.6	4.8	7.0	2.1	9.7	182.3
	May-August[b]	546.4	653.1	–106.7	–3.1	61.8	–0.8	59.5	–47.2
	September	15.0	–86.9	101.9	–1.2	28.7	0.2	27.3	129.2
	October	3.7	–1.3	5.0	9.2	11.9	0.1	21.0	26.0
	November	47.8	61.1	–13.3	1.1[c]	1.6	0.3	2.4	–10.9
	December	–87.7	–104.9	17.2	36.1	23.7	–1.6	61.4	78.6

[a] Excluding changes in Short-Term Loan holdings of the banks.
[b] No data were published for the months May–July, in accordance with the emergency regulations of 1967.
[c] Includes IL 1.5 million devaluation increment.

increment on foreign currency assets held with the Bank of Israel came to IL 317 million.[1]

The changes in foreign currency asset holdings over the year did not follow the usual seasonal pattern in 1967, but declined slightly in the first five months and rose rapidly once the emergency campaign funds began to flow in.

(b) *Credit to the Government*

In order to stimulate economic activity and increase employment, the Government followed an expansionary fiscal policy in 1967, resorting to deficit financing. Initially, the deficit was financed chiefly by Bank of Israel credit. The Six Day War also increased the Government's expenditure, and for this purpose too it borrowed from the banking system.

Part of the incremental Bank of Israel credit was supplied through the purchase of IL 115 million worth of treasury bills in March 1967. In addition, the Knesset approved two laws enabling the Government to receive advances from the Bank totalling together IL 262 million. The Government also received a much larger sum in ordinary advances during the year. Altogether, gross Bank of Israel credit to the Government in 1967 came to IL 765 million, and this was the chief cause of the year's monetary expansion. The Government also received IL 203 million from banking institutions, but not all of this amount increased the money supply. The aggregate amount of gross credit provided the Government by the banking system was IL 968 million.

Foreign currency deposits of the Government and the National Institutions with the Bank of Israel, which consisted mostly of the emergency campaign proceeds, were up IL 513 million in 1967. This, together with the net devaluation increment of IL 63 million on foreign currency assets with the Bank of Israel, largely offset, from the accounting aspect, the huge growth in Bank of Israel credit to the public sector. The net debt to the banking system therefore increased by about IL 392 million, compared with IL 200 million in 1966.

The IL 203 million additional bank credit includes IL 100 million worth of Defense Loan certificates purchased by banking institutions, while approximately IL 50 million derived from the deposit with the Treasury of the bond issue proceeds of Yaad Agricultural Development Bank.[2] The remainder represents banking institution purchases of Government securities with saving scheme deposit funds.

1 At the same time, the Bank of Israel also revalued its foreign currency liabilities, chiefly Pazak and Tamam balances and Government foreign currency deposits; the revaluation increment amounted to IL 254 million, so that the net gain was IL 63 million.

2 This sum does not represent ordinary bank credit to the Government, nor did it have an expansionary effect on means of payment. The bank merely served as an agent for raising funds from the public in order to help finance the budget.

(c) *Open-market operations of the Bank of Israel*

The monetary policy of the Bank of Israel is intended to influence the quantity of money held by the public, and thereby aggregate domestic demand. Various instruments are used to implement the policy: regulation of credit to the Government and the public, changing of interest rates, and the revision of liquidity ratios. The Bank of Israel can also influence the volume of bank reserves through its open-market operations—in the main the purchase and sale of the Government Short-Term Loan, which was transferred to the Bank of Israel in 1966.

These instruments are not used independently, and we are here concerned with their overall influence. In 1967, especially the first half, the Bank pursued an expansionary monetary policy. Thus it granted the Government much more credit in order to enable the latter to finance a budget deficit, it expanded credit to the public, reduced the interest rate on the Short-Term Loan, and set weekly quotas for new series of the Loan at a level falling short of demand. In view of the large-scale infusion of money into the economy and the huge growth of the banks' liquid reserves, the Bank of Israel did not deem it necessary in the first half of 1967 to increase liquidity further by purchasing securities in the open market. As a result, the net balance of Short-Term Loan certificates traded in the market did not change during this period. In the second half of the year, following the accelerated monetary expansion of April-June and after the additional liquidity began to be reflected by an upswing in economic activity, and in view of the further rise in bank credit to the public and Government, the Bank of Israel began to absorb funds by means of the Short-Term Loan. The total amount raised from the public in this manner in 1967 was IL 108 million, all of it in the second half of the year. As a consequence, the expansion of the money supply was slowed down toward the end of the year.

The Bank of Israel also used the Short-Term Loan to encourage the reduction of other interest rates in the economy. Interest on the loan was first pared somewhat at the end of 1966, and during 1967 another 2 percent all told was shaved off the rate. This undoubtedly helped to bring down interest rates on other financial assets, especially that in the bill brokerage market. The Government, however, did not alter the rate on its own option-type loans. These reductions changed the relative prices of financial assets in favor of Government securities and approved saving schemes in banks, which expanded at a very vigorous rate in 1967. One reason why the Government did not reduce interest rates on its bonds is that in order to finance its larger postwar outlays it chose to mobilize funds in the money market, in addition to increasing taxes.

(d) *Bank credit to the public*

1. *The expansion of credit*

Bank credit to the public went up by IL 517.7 million, or 34.0 percent, in 1966, compared with IL 291.4, or 23.7 percent, the year before. Not all of the

Table XV-10

CREDIT GRANTED TO THE PUBLIC BY THE BANKING SYSTEM, 1964–67[a]

(IL million)

End of period		From the Bank of Israel	From banking institutions	Total bank credit	From earmarked deposits of the public[b]	Against Govt. deposits	From earmarked Govt. deposits	Balance of bill brokerage trade
		(1)	(2)	(3)	(4)	(5)	(6)	(7)
1964		115.6	975.2	1,090.8	345.0	46.4	335.3	613.0
1965		139.2	1,088.0	1,227.2	450.3	60.5	357.0	773.6
1966		261.4	1,257.2	1,518.6	562.2	66.4	395.6	1,021.0
1967		408.6[a]	1,627.7	2,036.3	665.3	66.9	471.7	742.3
1967	January	293.1	1,326.8	1,619.9	572.2	66.7	395.2	1,010.8
	February	324.2	1,367.2	1,691.4	575.9	65.0	399.6	992.2
	March	346.2	1,437.5	1,783.7	583.3	82.4	398.4	964.9
	April	367.0	1,424.6	1,791.6	593.1	78.7	403.1	918.1
	May	389.3	1,415.7	1,805.0	597.9	70.7	408.7	891.6
	June	387.5	1,427.3	1,814.8	653.8	67.7	411.0	848.0
	July	385.1	1,446.6	1,831.7	659.1	71.6	413.6	823.8
	August	389.1	1,448.0	1,837.1	659.9	68.5	413.5	804.7
	September	403.2	1,509.7	1,912.9	662.4	65.9	413.6	789.1
	October	424.8	1,568.1	1,992.9	666.9	60.4	421.2	756.1
	November	448.4[d]	1,615.0[e]	2,063.4	662.3	62.4	436.2	748.6
	December	408.6	1,627.7	2,036.3	665.3	66.9	471.7	742.3

[a] Excluding loans to foreign borrowers.
[b] Mainly credit from deposits of social insurance funds and financial institutions.
[c] After provision of IL 31 million to cover doubtful debts.
[d] Includes IL 23.7 million devaluation increment.
[e] Includes IL 20.7 million devaluation increment.

1967 increment represents a net addition to total outstanding credit; part of it stemmed from the aforementioned shift from bill brokerage to ordinary bank credit. Short-term bank credit and bank-negotiated bill credit together increased in 1967 by IL 239.0 million, or 9.3 percent only, after having expanded by IL 538.8 million, or 27 percent, in 1966.

The main factor dampening demand for short-term credit was the sluggish rate of economic activity, particularly in the first half of the year, and the belief that it would continue. The greater credit risk inherent in the recession also discouraged banks from expanding credit.

The growth of outstanding short-term credit over the year shows a strong rise in the first quarter, a decline from April through August, followed by a resumption of the upward movement. The first-quarter growth can be ascribed to the reduction by the Bank of Israel of the formal liquidity ratios at the end of 1966. The decline in the months April to August, which occurred despite the enormous expansion of the banks' liquid asset holdings, was due chiefly to the much slower rate of economic activity during this period, which also covered the Six Day War. The upturn in September reflects the more vigorous tone that began to mark the economy in the second half of the year. That the banks were able to expand credit during this period even after purchasing IL 100 million worth of Defense Loan certificates testifies to the existence of large liquid reserves.

Table XV–11

INCREASE IN BANK CREDIT TO THE PUBLIC, 1963–67[a]

(IL million)

	1963	1964	1965	1966	1967
Bank of Israel rediscounts	12.3	30.5	8.1	122.2	147.2[b]
Bank credit					
In local currency	104.4	69.3	88.4	177.8	367.4
Within the framework of liquidity exemptions	*8.5*	*32.9*	*37.3*	*34.6*	*41.7*
Other credit	*95.9*	*36.4*	*51.1*	*143.2*	*325.7*
In foreign currency	38.6	48.4	39.9	–8.6	3.1[c]
Total bank credit	143.0	117.7	128.3	169.2	370.5
Total incremental credit from the banking system	155.3	148.2	136.4	291.4	517.7
Credit from and against Government deposits	16.4	22.2	35.8	44.5	76.6
Credit from deposits of the public earmarked for loans	37.2	72.3	105.3	111.9	103.1
Total increase in credit to the public	208.9	242.7	277.5[b]	447.8	697.4

[a] The effect of bills sold by the Bank of Israel to banking institutions during the years 1963 to 1965 has been deducted in this table.
[b] Excluding IL 31 million provided for doubtful debts; including IL 23.7 million devaluation increment.
[c] Including IL 20.7 million devaluation increment.

The increase of IL 517.7 million in bank credit to the public consisted of IL 325.7 million in ordinary Israeli currency credit, IL 147.2 million in Bank of Israel rediscounts and loans, and IL 41.7 million in controlled credit in the framework of the liquidity exemptions. Foreign currency credit to Israeli residents declined by IL 17.6 million; the net increase of IL 3.1 million in this item stemmed from the IL 20.7 million devaluation increment. The expansion of Bank of Israel rediscounts and loans was connected mainly with the grant of loans to several banking institutions that had run into difficulties. The export finance funds, in which the Bank of Israel participates, were also enlarged. The increase in outstanding bills rediscounted and loans by the Bank of Israel is after the provision of IL 31 million for doubtful debts to cover possible losses in realizing the collateral pledged against the loans.

The pumping of larger sums into the economy by the Government and the Bank of Israel, together with the reduction of liquidity ratios at the end of 1966, considerably bolstered the liquidity position of the banking institutions. The banks, which perhaps for the first time were not faced by excess demand for credit, began to grant loans for strictly consumption purposes, contrary to previous practice. Nevertheless, they did not expand credit to the full extent possible, and this found expression by a growth of liquidity surpluses in some banks and a reduction of liquidity deficiencies in others. As a result, the average effective liquidity ratio went up from 43.6 percent in 1966 to 45.0 percent.

The bill brokerage trade contracted sharply in 1967, reversing the rapid upward trend of previous years. The outstanding balance of bank-negotiated bill credits declined by IL 278.7 million, or 27.3 percent, during the year reviewed. The interest rate in this market fell by 3–4 percent. Bill brokerage was affected by the factors which depressed the overall demand for credit, as well as by several specific to this market. These included the lowering of the liquidity ratio on time deposits in September 1966, the Feuchtwanger Bank affair, and the raising of the rate of income tax deducted at source on bill brokerage interest from 25 to 30 percent in February 1967. The Feuchtwanger Bank affair brought to light the risk inherent in unguaranteed bill brokerage transactions, and investors began to avoid the market, transferring considerable funds to other financial assets, such as time deposits and saving schemes. The outstanding balance of unguaranteed bank-negotiated bill credits plunged from IL 142.8 million at the end of 1966 to IL 17.8 million at the end of 1967, when it represented only 2 percent of the total bill brokerage balance.

2. *The destination of credit*

The data on the sectorial distribution of credit include loans from earmarked deposits of the public, as well as credit against Government deposits, most of which is granted to tax debtors. They do not include bill brokerage, and hence are of limited significance; this applies particularly to 1967 in view of the precipitate fall in bill brokerage transactions and the switch to ordinary bank credit.

The major changes in the distribution of outstanding credit in the year reviewed were the decline in the share of industry and the rise in that of the construction sector and of local authorities. The reduced weight of industry was connected with the cutting back of production during the first half of the year; nevertheless, the absolute volume of credit to this sector increased by 18 percent. The much larger amount lent the construction and housing sector in

Table XV-12

OUTSTANDING CREDIT TO THE PUBLIC, BY SOURCE AND DESTINATION, DECEMBER 31, 1967[a]

(End of year)

Destination	Controlled by the Bank of Israel[b]	Uncontrolled credit	Total (1)+(2)	Credit against Govt. deposits	Total (3)+(4)
	(1)	(2)	(3)	(4)	(5)
			IL million		
Agriculture	140.8	169.0	309.8	3.0	312.8
Industry	408.2	568.3	976.5	27.3	1,003.8
Construction	1.1	211.1	212.2	4.8	217.0
Commerce	21.5	156.3	177.8	6.4	184.2
Public services	27.1	59.4	86.5	0.5	87.0
Local authorities	0.6	291.7	292.3	1.9	294.2
Credit and financial institutions	3.2[c]	127.8	131.0	0.1	131.1
National Institutions	12.4	44.8	57.2	—	57.2
Business services	25.3	146.8	172.1	12.8	184.9
Individuals	0.2	210.0	210.2	7.9	218.1
Miscellaneous[d]	4.8	102.4	107.0	2.2	109.2
Total	645.2	2,087.6	2,732.6	66.9	2,799.5
			Percentages		
Agriculture	21.8	8.1	11.3	4.5	11.2
Industry	63.3	27.2	35.7	40.8	35.9
Construction	0.2	10.1	7.8	7.2	7.7
Commerce	3.3	7.5	6.5	9.6	6.6
Public services	4.2	2.8	3.2	0.7	3.1
Local authorities	0.1	14.0	10.7	2.8	10.5
Credit and financial institutions	0.5[c]	6.1	4.8	0.2	4.7
National Institutions	1.9	2.2	2.1	—	2.0
Business services	3.9	7.0	6.3	19.1	6.6
Individuals	0.0	10.1	7.7	11.8	7.8
Miscellaneous[d]	0.8	4.9	3.9	3.3	3.9
Total	100.0	100.0	100.0	100.0	100.0

[a] Including credit from earmarked deposits of the public, which cannot be classified by destination.
[b] Including Bank of Israel rediscounts and controlled credit granted by banking institutions.
[c] Excluding Bank of Israel loans to banks.
[d] *Including credit to artisans.*

1967 was apparently due to the shift from bill brokerage to ordinary bank credit.

The striking growth of IL 116 million in credit to local authorities stemmed partly from the transfer of old debts of the authorities to a number of banking institutions for collection. In addition, the large banks granted considerable credit in 1967, in coordination with the Ministry of the Interior, to local authorities experiencing difficulty in balancing their budgets.

The changes in credit allocation also reflect the shift from bill brokerage to ordinary bank credit. No accurate data are available on the sectorial breakdown of the funds so transferred, but an analysis of the destination of bill brokerage transactions in June 1967 shows that the share of industry in the outstanding

Table XV-13

OUTSTANDING CREDIT TO THE PUBLIC, BY DESTINATION, 1964–67[a]

(End of year)

Destination	1964	1965	1966	1967
		IL million		
Agriculture	196.7	224.6	250.4	312.8
Industry	636.4	674.8	848.4	1,003.8
Construction	84.3	94.1	144.1	217.0
Commerce	105.0	113.8	132.1	184.2
Public services	35.6	47.7	64.4	87.0
Local authorities	64.4	128.1	178.0	294.2
Credit and financial institutions	45.8	79.5	90.6	131.1
National Institutions	33.6	31.9	34.8	57.2
Business services	83.4	118.8	148.6	184.9
Miscellaneous[b]	197.0	224.7	255.8	327.3
Total	1,482.2	1,738.0	2,147.2	2,799.5
		Percentages		
Agriculture	13.3	12.9	11.7	11.2
Industry	42.9	38.8	39.5	35.2
Construction	5.7	5.4	6.7	7.7
Commerce	7.1	6.6	6.2	6.6
Public services	2.4	2.7	3.0	3.1
Local authorities	4.3	7.4	8.3	10.5
Credit and financial institutions	3.1	4.6	4.2	4.7
National Institutions	2.3	1.8	1.6	2.0
Business services	5.6	6.8	6.9	6.6
Miscellaneous[b]	13.3	13.0	11.9	11.7
Total	100.0	100.0	100.0	100.0

[a] Including credit to tax debtors against Government deposits, as well as credit from earmarked deposits of the public.
[b] Including credit to individuals.

balance was at a relatively low 27 percent, compared with 38 percent in ordinary bank credit; on the other hand, the share of construction and housing in bill brokerage credit came to 24 percent, as against 8 percent in ordinary bank credit. If the sectorial composition of this switch in type of credit was similar to that of the outstanding balance of bill brokerage credit, then the share of industry in ordinary bank credit declined and that of the construction sector rose.[1]

5. The Liquidity of Banking Institutions

Ordinary liquid assets of the banking institutions, which had declined in 1966, increased by IL 162.3 million in the year reviewed to stand at IL 728.2 million. Deposits requiring ordinary liquid cover expanded by IL 322.9 million and totalled IL 1,612.0 million at the end of 1967. The effective liquidity ratio thus rose from 43.9 percent at the end of 1966 to 45.2 percent at the end of 1967.

The Bank of Israel did not revise the required liquidity ratios during the year reviewed. In the second half of 1966 it had reduced them progressively by a total of 6 percent, and this resulted in the substantial narrowing of liquidity deficiencies in some banks and the creation of surplus reserves in others.

In 1967 the surplus reserves were further augmented as a result of the large-scale external infusion (the increase in Bank of Israel credits). This enabled the banking institutions to expand credit to the public and the Government and to reduce any remaining deficit in liquid cover. However, the liquidity surpluses were not fully utilized, as is reflected by the rise in the effective liquidity ratio (both between the beginning and the end of 1967 and on an annual average). Moreover, the average liquidity deficiency was smaller in 1967 than in the previous year (IL 20 million as against some IL 34 million), while surplus reserves went up from an average of IL 16 million in 1966 to IL 62 million in 1967. The principal cause of this development was the slackening of demand for credit due to the low level of economic activity. In 1967, as already noted, the banking institutions even began to offer credit for consumption purposes, in contrast to the general practice of previous years.

The growth of liquid assets was the net result of several countervailing influences. The main factor expanding liquid assets was the larger volume of credit provided the Government and the public by the Bank of Israel. The swelling of foreign-currency asset holdings had almost no effect, since the bulk of the foreign currency receipts were deposited with the Bank of Israel, and instead of being converted into means of payment were used to reduce the Government's debt to the Bank of Israel, thereby replacing credit from the Bank of Israel as a source of expansion. Among the factors operating to reduce the volume of liquid assets

[1] In June 1967 the balance of bill brokerage credit stood at about IL 850 million, and that of ordinary bank credit at IL 2,536 million.

Table XV–14

CHANGES IN THE LIQUID ASSETS OF BANKING INSTITUTIONS,[a] BY SOURCE, 1964–67

(IL million)

End of period	Credit from the Bank of Israel[b]	Net foreign currency with the Bank of Israel	Net balances in transit between banking institutions	Total (1)+(2)+(3)	Less: Currency held by the public[c]	Less: Net foreign currency balances of banking institutions with the Bank of Israel	Less: Liquid assets held against deposits requiring 10, 90, or 100% liquid cover[d]	Less: Total (5)+(6)+(7)	Ordinary liquid assets in Israeli currency (4)–(8)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1964	243.3	1,628.8	1.6	1,873.7	590.4	713.8	39.6	1,343.8	529.9
1965	271.0	1,910.3	–0.4	2,180.9	657.4	884.7	32.2	1,574.3	606.6
1966	547.7	1,848.7	5.9	2,402.3	751.2	1,047.2	38.0	1,836.4	565.9
1967	768.5	2,445.2	–5.5	3,208.2	966.2	1,470.3	43.5	2,480.0	728.2
1967 January	592.1	1,834.1	6.0	2,432.2	782.9	1,066.4	42.1	1,891.4	540.8
February	657.7	1,817.4	4.9	2,480.0	814.2	1,078.9	39.0	1,932.1	547.9
March	629.1	1,843.6	1.4	2,474.1	834.2	1,093.4	38.2	1,965.8	508.3
April	820.3	1,813.2	–0.1	2,633.4	855.0	1,116.4	45.2	2,016.6	616.8
August[e]	638.0	2,309.2	0.7	2,947.9	964.3	1,164.9	33.3	2,162.5	785.4
September	724.2	2,278.5	–1.6	3,001.1	970.9	1,184.2	37.4	2,192.5	808.6
October	724.5	2,226.7	0.8	2,952.0	977.7	1,212.1	39.4	2,229.2	722.8
November	671.1	2,485.5	0.5	3,157.1	969.6	1,439.2	43.1	2,451.9	705.2
December	768.5	2,445.2[f]	–5.5	3,208.2	966.2	1,470.3	43.5	2,480.0	728.2

[a] Net of liquid assets held against deposits requiring 10, 90, or 100 percent liquid cover.
[b] Includes credit to the Government, to the public (less deposits of financial institutions but including deposits of investment banks with the Bank of Israel), and Bank of Israel open-market operations.
[c] Including cash at the Israel Bank of Agriculture.
[d] Excluding demand deposits held for other banking institutions, which are listed net in column (3).
[e] No data were published for the months May–July, in accordance with the emergency regulations.
[f] Including IL 317.1 million devaluation increment.

Table XV–15

THE LIQUIDITY OF BANKING INSTITUTIONS IN LOCAL CURRENCY, 1964–67[a]

(IL million)

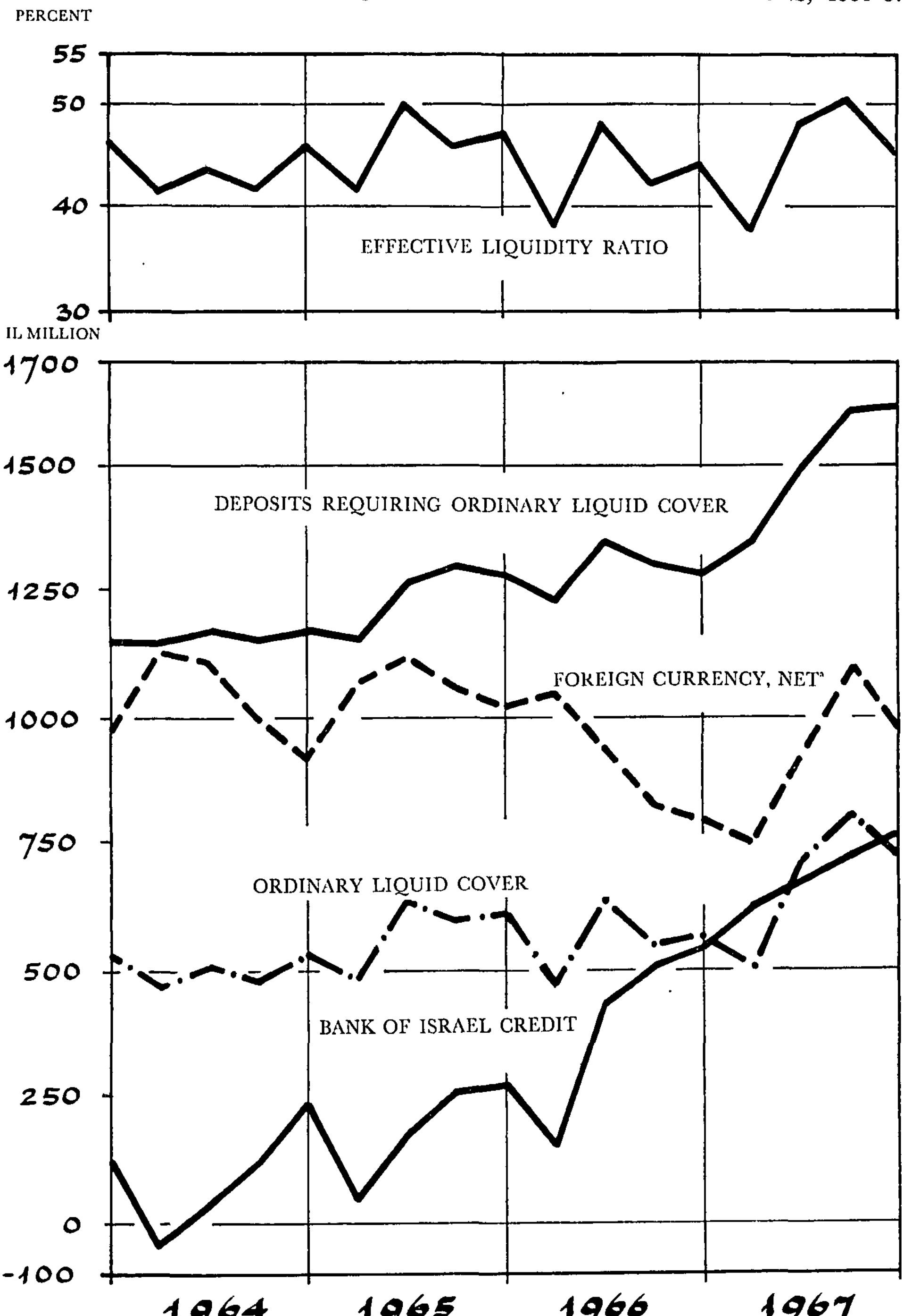
End of period	Liquid balances at Bank of Israel	Treasury bills with banking institutions	Cash held by banks	Net balances in transit between banking institutions	Less: Liquid assets held against deposits requiring 10, 90, or 100% liquid cover[b]	Total ordinary liquid assets (1)+(2)+(3)+(4)−(5)	Deposits requiring ordinary liquid cover	Liquidity ratio $\frac{(6)}{(7)} \times 100$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1964	541.6	—	26.3	1.6	39.6	529.9	1,167.0	45.4
1965	610.1	—	29.1	–0.4	32.2	606.6	1,283.4	47.3
1966	516.8	52.4	28.8	5.9	38.0	565.9	1,289.1	43.9
1967	701.2	44.3	31.7	–5.5	43.5	728.2	1,612.0	45.2
1967 January	485.8	53.2	37.9	6.0	42.1	540.8	1,302.7	41.5
February	490.6	54.2	37.2	4.9	39.0	547.9	1,331.0	41.2
March	458.6	52.0	34.5	1.4	38.2	508.3	1,348.1	37.7
April	573.9	49.8	38.4	–0.1	45.2	616.8	1,413.5	43.6
May	583.9	32.7	43.7	–1.1	25.4	633.8	1,394.7	45.4
June	659.0	51.7	37.8	–1.0	29.2	718.3	1,489.8	48.2
July	693.7	58.4	38.8	–1.0	27.3	762.6	1,554.4	49.1
August	716.3	62.6	39.1	0.7	33.3	785.4	1,573.4	49.9
September	755.8	57.5	34.3	–1.6	37.4	808.6	1,609.5	50.2
October	677.1	45.0	39.3	0.8	39.4	722.8	1,576.6	45.8
November	666.5	44.3	37.0	0.5	43.1	705.2	1,558.5	45.2
December	701.2	44.3	31.7	–5.5	43.5	728.2	1,612.0	45.2

[a] The figures in this table differ somewhat from those published by the Examiner of Banks, for two reasons: first, they do not include the Israel Bank of Agriculture; second, the liquid balances given here are taken from the balance sheet of the Bank of Israel, whereas the data of the Examiner of Banks are based on the balance sheets of banking institutions. Figures for ordinary liquid assets, deposits requiring ordinary liquid cover, and the effective liquidity ratio are net of deposits requiring 10, 90, or 100 percent liquid cover and of the liquid assets held against them.

[b] Excluding demand deposits held for other banking institutions, which are listed net in column (4).

Diagram XV-5

FACTORS AFFECTING THE LIQUIDITY OF BANKING INSTITUTIONS, 1964-67



[a] Foreign currency held with the Bank of Israel, less foreign currency deposits of the banking institutions with the Bank of Israel.

were the growth of foreign currency deposits (in particular Pazak and Tamam) with the Bank of Israel and the IL 215 million increase in currency in circulation with the public.

The changes in the effective liquidity ratio in the course of 1967 followed the pattern of previous years. In the first quarter cash withdrawals reduced liquid asset holdings, while deposits requiring liquid cover expanded; accordingly, the liquidity ratio fell from 43.9 percent at the end of 1966 to 37.7 percent at the end of March 1967. In the following months the large sums injected into the economy by the Government and the Bank of Israel greatly increased the volume of liquid assets. As bank credit expanded only slightly during this period, the effective liquidity ratio rose to a peak of 50.2 percent in September; subsequently it declined and at year's end stood at 45.2 percent. The average annual effective liquidity ratio was 45.0 percent in 1967, compared with 43.6 percent the year before.

The unauthorized deficit of liquid assets changed in line with the changes in the liquidity ratios. In the first quarter the deficiency increased from IL 4.4 million at the end of 1966 to IL 50 million at the end of March; thereafter it fell steadily and amounted to under IL 4 million in September. In the last months of the year it again went up and reached IL 29.4 million at the end of December.

Figures on surplus reserves also indicate an improvement in the liquidity situation in 1967. In the first quarter the aggregate surplus declined from IL 36 million at the end of 1966 to IL 27 million at the end of March 1967. A rapid growth then set in, and a peak of over IL 100 million was reached in August. In the final months the figure fell and came to IL 60 million at the end of December.

6. The Development of Banking Business

The combined balance sheet of Israel's banking institutions grew by 24.6 percent in 1967, compared with 15.6 percent the year before. Excluding contingent accounts, the rise was exceptionally rapid—37.2 percent as against 14.4 percent in 1966.[1] Contingent accounts contracted by 12.9 percent, compared with a rise of 19.3 percent in 1966.

On the assets side, the outstanding development was the huge growth in the item "cash, treasury bills, and balances with the Bank of Israel"—up IL 651.6 million, as contrasted with IL 117.4 million in 1966. This rapid expansion reflects the growth of liquid assets and of Pazak and Tamam deposits (which under present regulations must be redeposited in full with the Bank of Israel), as well as the increase in their IL value due to the devaluation. Credit to the

[1] This high growth rate is partly accounted for by devaluation increments, which came to about IL 340 million.

Table XV-16

ASSETS AND LIABILITIES OF BANKING INSTITUTIONS, 1966–67

	IL million		Percent		Increase or decrease (–)	
	1966	1967	1966	1967	IL m.	%
Assets						
Cash, treasury bills, and balances with Bank of Israel	1,725.5	2,377.1	32.7	32.8	651.6	37.8
Loans to the public[a]	1,296.0	1,819.9	24.5	25.1	523.9	40.4
Loans to the Government	77.8	131.7	1.5	1.8	53.9	69.3
Loans to the public						
From Govt. deposits	462.0	538.8	8.8	7.4	76.8	16.6
From earmarked deposits	598.2	736.8	11.3	10.2	138.6	23.2
Foreign currency assets	469.9	659.7	8.9	9.1	189.8	40.4
Securities	318.7	590.8	6.0	8.2	272.1	85.4
Real estate	84.5	89.7	1.6	1.2	5.2	6.2
Net balances with other banking institutions	–9.7	–30.0	–0.2	–0.4	–20.3	–209.3
Other accounts	260.7	335.4	4.9	4.6	74.7	28.7
Total	5,283.6	7,249.9	100.0	100.0	1,966.3	37.2
Liabilities						
Demand deposits in local currency	1,255.8	1,567.0	23.8	21.6	311.2	24.8
Less liquid deposits[a]	1,522.5	2,620.3	28.8	36.1	1,097.8	72.1
Foreign liabilities[b]	715.2	875.1	13.5	12.1	159.9	22.4
Government deposits	473.4	548.1	9.0	7.6	74.7	15.8
Earmarked deposits	606.4	751.5	11.5	10.4	145.1	23.9
Equity capital	303.6	323.1	5.7	4.4	19.5	6.4
Bonds	46.8	116.9	0.9	1.6	70.1	149.8
Other accounts	359.9	447.9	6.8	6.2	88.0	24.5
Total	5,283.6	7,249.9	100.0	100.0	1,966.3	37.2
Contingent accounts						
Balances held by and for banking institutions	99.3	85.0			–14.3	–14.4
Clients' liabilities and guarantees for clients	1,671.7	1,457.2			–214.5	–12.8
Total	1,771.0	1,542.2			–228.8	–12.9
Grand total	7,054.6	8,792.1			1,737.5	24.6

[a] The figures for 1966 and 1967 are respectively IL 38.8 million and IL 182.8 million larger than the corresponding figures in Tables XV–6 and XV–9, as they include Bank of Israel loans to banking institutions in these amounts.
[b] Including deposits of nonresidents (Patach).

public also rose much faster in 1967, by 40.4 percent compared with 18 percent in 1966.[1] The big increase in bank credit, as already described, was largely due to the shift from bill brokerage credit, which also reduced contingent accounts.

The increase in foreign currency assets stemmed in part from the rise in their IL value after the devaluation. The growth of the banking institutions' security portfolio reflects the purchase of IL 100 million worth of Defense Loan certificates and the larger investment of saving deposit funds following their rapid growth. The decline in net balances with other banking institutions was connected with a change in the liquidity regulations, according to which deposits with other banks are no longer defined as liquid assets.[2]

On the liabilities side, the enormous increase in less liquid deposits stands out—IL 1,097.8 million compared with IL 321.5 million in 1966. Fixed-term, saving, and Pazak and Tamam accounts (including devaluation increments thereon) all contributed to the growth. Demand deposits also expanded rapidly—by 24.8 percent compared with only 1.3 percent in 1966.

The growth of equity capital continued to slow down, the rise in 1967 being IL 19.5 million as against IL 21 million the year before. The weight of this item in the combined balance sheet (including contingent accounts) declined from 4.3 percent at the end of 1966 to 3.6 percent at the end of 1967.[3]

The increase in bonds reflects an issue by one of the banks (the proceeds were deposited with the Treasury). Another bank issued capital notes abroad.

The decline in contingent accounts resulted from the sharp contraction of the bill brokerage trade. The reduction of this item exceeded that of guaranteed bill brokerage business, since some of the transactions were guaranteed by more than one banking institution because of Bank of Israel restrictions on the volume of financial guarantees. Acceptances also diminished, apparently because of the smaller import of goods in 1967.

There was no change in the number of commercial banks operating in 1967,[4] but the number of cooperative credit societies fell by one, owing to a merger.

The banking institutions extended their branch network by a net total of 14 only, compared with 22 the year before. All told, 17 new branches were opened, but four existing ones closed down, and after the aforementioned credit cooperative merger, the head office of one became a branch of the other.

Of the 32 branches of the Feuchtwanger, Ellern's, and Israel Credit Banks, 22 were taken over by other banks and three were closed.

Of the 17 new branches opened during the year, 11 belong to the Big Three

[1] See note [a] to Table XV–1.

[2] See Bank of Israel Bulletin, No. 28, February 1967, p. 88.

[3] Excluding contingent accounts, equity capital fell from 5.7 percent at the end of 1966 to 4.4 percent.

[4] Feuchtwanger, Ellern's, and the Israel Credit Bank continued to operate formally, though most of their branches were sold or closed.

Table XV–17

BANKING INSTITUTIONS AND THEIR BRANCHES, 1964–67

End of year	1964	1965	1966	1967
The Big Three				
Head offices	3	3	3	3
Branches	372	380	397	412
Total	375	383	400	415
Other banks				
Head offices	23	24	24	24
Branches	195	204	211	209
Total	218	228	235	233
Credit cooperatives				
Head offices	23	20	18	17
Branches	79	84	82	83
Total	102	104	100	100
All banking institutions				
Head offices	49	47	45	44
Branches	646	668	690	704
Total	695	715	735	748

and six to other banks. Six of the new branches are located in East Jerusalem and 11 in other towns.

In addition to these, 11 new branches were opened in the Israel administered areas—eight in Judea and Samaria and three in the Gaza Strip and Sinai (these are not included in Table XV–17).

The weight of the Big Three in total banking business rose noticeably in the year reviewed. The fastest rises were in "other accounts", where their share went up from 76.1 to 86.9 percent, and in bill brokerage—from 49.7 to 56.0 percent. In cash, treasury bills, and balances with the Bank of Israel and in demand deposits, the share of the Big Three also went up, but not so markedly. The only item in which their share declined was loans to the public—from 68.9 to 65.0 percent.

The gain of the Big Three was mainly at the expense of other banks, since the weight of credit cooperatives rose in most items.

These structural changes were connected with the crises in the Feuchtwanger, Ellern's, and Israel Credit Banks, which prompted many depositors to transfer their business from these institutions—and to some extent from others as well—to other banks, especially the three leading ones.

The decline in the share of the Big Three in loans to the public was probably

Table XV–18

CASH AND BALANCES WITH THE BANK OF ISRAEL, CREDIT, DEPOSITS, AND BALANCE OF BILL BROKERAGE TRADE, 1964–67

(percentages)

End of period	The Big Three	Other banks	Credit cooperatives	Total
Cash and balances with Bank of Israel				
1964	66.8	27.1	6.1	100.0
1965	67.8	26.3	5.9	100.0
1966	70.4	27.2	2.4	100.0
1967	75.3	21.5	3.2	100.0
Loans to the public[a]				
1964	67.7	26.2	6.1	100.0
1965	67.9	26.8	5.3	100.0
1966	68.9	27.3	3.8	100.0
1967	65.0	29.7	5.3	100.0
Local-currency demand deposits				
1964	64.5	25.9	9.6	100.0
1965	64.3	26.1	9.6	100.0
1966	66.0	24.7	9.3	100.0
1967	70.1	21.5	8.4	100.0
Other deposits[b]				
1964	76.3	19.5	4.2	100.0
1965	75.5	20.8	3.7	100.0
1966	76.1	21.8	2.1	100.0
1967	86.9	10.3	2.8	100.0
Bill brokerage				
1964	43.0	45.9	11.1	100.0
1965	45.5	42.3	12.2	100.0
1966	49.7	39.5	10.8	100.0
1967	56.0	32.1	11.9	100.0

[a] Including credit to nonresidents.
[b] Including deposits of nonresidents (Patach).

due primarily to their greater caution this year in granting credit: they apparently preferred to invest their surplus reserves in loans to the Government or with the Bank of Israel. Another contributory factor was that the switch from bill brokerage to ordinary credit was more pronounced in the smaller banks.

7. Income and Expenses of Banking Institutions

The banking institutions showed a higher profit figure in 1967, with both operating profit and net capital gains rising. Table XV–19 does not fully reflect this improvement, since the data include the three banks which became financially entangled and were in process of liquidation during the year.

Operating income and expenses rose much more slowly than in 1966, when they went up at an exceptionally fast rate. However, the expansion of operating

Table XV–19

INCOME AND EXPENSES OF BANKING INSTITUTIONS, 1966–67

	IL million		Percent		Percent increase or decrease (–)	
	1966	1967	1966	1967	From 1965 to 1966	From 1966 to 1967
Operating income						
Interest on loans	195.5	242.4	42.6	46.0	24.7	24.0
Service charges	120.8	116.1	26.3	22.0	29.3	–3.9
Interest on deposits with Bank of Israel and other banks	100.2	112.8	21.8	21.4	30.8	12.6
Other income[a]	42.5	55.5	9.3	10.6	16.8	30.6
Total	459.0	526.8	100.0	100.0	26.4	14.8
Operating expenses						
Salaries and fringe benefits	153.6	156.9	35.5	31.8	19.0	2.1
Interest on deposits[b]	201.0	261.9	46.4	53.1	37.7	30.3
Other expenses[c]	78.2	74.2	18.1	15.1	46.7	–5.1
Total	432.8	493.9	100.0	100.0	31.8	13.9
Profits						
Operating profit	26.2	33.8	101.9	81.6	–24.7	29.0
Capital gains (net)	–0.5	7.5	–1.9	18.4	–106.3	—
Total	25.7	41.3	100.0	100.0	–39.8	61.1

	1962	1963	1964	1965	1966	1967
Operating profit as a percentage of operating income	8.2	11.8	9.2	9.6	5.7	6.4
Operating profit as a percentage of equity capital[d]	20.7	21.3	13.0	13.3	8.6	9.8
Total profits as a percentage of equity capital[d]	29.8	32.4	19.7	16.2	8.5	12.1

[a] Including income from securities (other than capital gains) and from foreign currency, trustee, and insurance transactions.
[b] Including interest and commission on loans received and rediscounts, as well as fines for liquidity deficiencies.
[c] Including administrative expenses, depreciation, donations, and bad debts.
[d] The calculation excludes foreign banks, as they have no local equity capital.

income outstripped that of expenses, so that operating profit advanced by an impressive 29.0 percent, in contrast to a 25 percent decline in 1966.

Net capital gains came to IL 7.5 million, after falling for several years running (in 1966 there was a net capital loss of about IL 0.5 million).

Total profits reached IL 41.3 million—up 61.1 percent from the IL 25.7 million figure of 1966.

The slower growth of operating income in the year reviewed was due mainly to the decline in service charges, which in turn stemmed from the sharply reduced volume of bill brokerage business. The increase in ordinary bank credit, due partly to the switch from bill brokerage, explains some of the rise in interest on loans. Interest on deposits with the Bank of Israel and other banks also increased more slowly than in 1966. This can be ascribed to the reduction of deposits with other banks after the Bank of Israel ceased recognizing them as liquid assets. In contrast to these items, "other income" moved up strongly. Interest on Government and other securities was responsible for most of the rise, reflecting the large investment of saving scheme funds in approved securities and the purchase of IL 100 million worth of Defense Loan certificates.

Operating expenses were up 13.9 percent in 1967, compared with 31.8 percent the year before. The deceleration was mainly a result of the small percentage increase in employee compensation and a decline in "other expenses".

Employee compensation (salaries and fringe benefits) rose by only 2.1 percent in 1967, compared with 19 percent in 1966; this is the lowest increase in recent years. The number of employees dropped by 290 during the year, while average earnings per employee went up 4.3 percent. Staff was trimmed chiefly because of falling business volume in the three banks that ran into difficulties and the closure of some of their branches. "Other expenses" declined from their particularly high level in 1966, when several banks incurred bad debt losses and most institutions provided a much larger amount for doubtful debts.

Before-tax operating profit amounted to 6.4 percent of operating income, compared with 5.7 percent in 1966. In relation to equity capital, the figure went up from 8.6 percent in 1966 to 9.8 percent.

The overall profitability of banking institutions, which is measured by the ratio between total pretax profits (including capital gains) and average equity capital, increased even more—from 8.5 to 12.1 percent. Excluding the three aforementioned banks, overall profitability came to 15.2 percent in 1967, compared with 12.8 percent in 1966.